Microinsurance and Microfinance Institutions
Evidence from India

CGAP Working Group on Microinsurance
Good and Bad Practices
Case Study No. 15

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Good and Bad Practices in Microinsurance

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1. A **series of case studies** to identify good and bad practices in microinsurance
2. A **synthesis document** of good and bad practices in microinsurance for practitioners based on an analysis of the case studies. The major lessons from the case studies will also be published in a series of **two-page briefing notes** for easy access by practitioners.
3. **Donor guidelines** for funding microinsurance.

The CGAP Working Group on Microinsurance

The CGAP Microinsurance Working Group includes donors, insurers and other interested parties. The Working Group coordinates donor activities as they pertain to the development and proliferation of insurance services to low-income households in developing countries. The main activities of the working group include:

1. Developing donor guidelines for supporting microinsurance
2. Document case studies of insurance products and delivery models
3. Commission research on key issues such as the regulatory environment for microinsurance
4. Supporting innovations that will expand the availability of appropriate microinsurance products
5. Publishing a quarterly newsletter on microinsurance
6. Managing the content of the Microinsurance Focus website:
   www. microfinancegateway. org/section/resourcecenters/microinsurance

Table of Contents

Tables

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Acronyms

AIG	American International Group
ASA	Activists for Social Alternatives
BLF	Block-level federation
EPF	Employees Provident Fund
ESI	Employees State Insurance (India)
FWWB	Friends of Women World Banking
GIC	General Insurance Corporation (India)
GSS	Group Social Security
GTZ	Deutsche Gesellschaft fuer Technische Zuammenarbeit GmbH (German Technical Cooperation)
GV	Grama Vidiyal
IBNR	Incurred but not received
ILO	International Labour Organization
IRDA	Insurance Regulatory and Development Authority (India)
JBY	Janashree Bima Yojana
LIC	Life Insurance Corporation (India)
m	Millions
MFI	Microfinance Institution
MYRADA	Mysore Resettlement and Development Agent
NGO	Non-governmental Organization
NIC	National Insurance Group
NSAP	National Social Assistance Programme (India)
OGI	Ordinary Group Policy
SEWA	Self Employed Women's Association
SHEPHERD	Self Help Promotion for Health and Rural Development
SHG	Self help group (India)
UIIC	United India Insurance Corporation
UPR	Unearned premium reserve
YCO	Swayamkrushi Youth Charitable Organization

Executive Summary

This paper looks at microinsurance from the perspective of microfinance institutions (MFIs), which are important microinsurance delivery channels. By reviewing the experiences of three Indian MFIs—SPANDANA in Andra Pradesh, and SHEPHERD and ASA in Tamil Nadu—it seeks to answer questions about what products to offer, and how to design and deliver them.

Even though these organizations operate in similar environments, they have adopted very different approaches, which presumably make sense given their experiences, degree of maturity, and intentions. Insights into the choices they made, and the reasons for making those choices, may benefit others.

SPANDANA is a large, professional MFI that runs an in-house life insurance scheme with simple benefits. At the other extreme, SHEPHERD is a relatively small NGO offering a wide-range of insurance products (life, health, asset) in partnership with different insurers with the intention of providing its customers with comprehensive social protection. The third MFI, ASA, falls somewhere in between. It has a long experience with different insurance products using both in-house and partner-agent models, and now—with the advent of Indian regulations that require insurers to serve the low-income market—it appears to have both feet firmly in the partner-agent camp.

All three MFIs have offered microinsurance long enough—in some cases more than 10 years—to provide valuable lessons for other microfinance institutions. The main lessons, organized around three themes—1) mission, vision and outcomes; 2) delivery mechanisms; and 3) product design—are as follows:

Lessons: Mission, Vision and Outcomes

- MFIs cannot provide all services; and clients cannot afford to buy numerous insurance products. The challenge for the MFI and its clients is to figure out the most cost-effective solutions to their clients' primary problems.
- These cases demonstrate that the MFIs' mission and vision significantly influenced which products were selected and how they chose to sell and service them.
- There appears to be a trade-off between reaching many people with a simple (mandatory) product and reaching fewer people with more complex, varied, and voluntary insurance.
- MFIs should examine who is likely to receive a life insurance benefit. By ensuring that children, especially girls, can receive the benefit, the product could be more attractive to women.
- For women to really benefit from life insurance, the coverage should be on the lives of their husbands. As the cases will show, however, this is easier said than done because of adverse selection problems that can emerge when coverage was extended to husbands without screening or age restrictions.

- While an MFI might undertake prevention strategies to fulfil its social mission, these interventions could have the additional advantage of reducing claims.
- It makes sense for MFIs to start with a simple life policy to learn about insurance. However, once MFIs know how to manage insurance risks, then it makes sense for them to move on and provide coverage that better meets clients' needs.

Lessons: Delivery Mechanisms

- There are many problems with the partner-agent model, but they can be fixed.
- In India, where insurers are legally compelled to sell insurance to low-income clients, it is difficult to see the advantages of an MFI selling insurance in-house.
- MFIs do not have to be wedded to one insurance partner forever. If the insurer is not performing, the MFI can get a new partner. Yet if an MFI changes insurance partners too frequently, it can cause confusion among clients and staff.
- The alternative to changing partners is to get existing partners to improve. SHEPHERD has adopted this approach by inviting insurers to the field so they better understand the target market and begin to recognise the difference between insurance and microinsurance.
- To get good products and processes from insurers at a decent price, MFIs need to know what they want and they have to take the driver's seat in the negotiations. The larger they are, the more demanding they can be.
- An efficient claims processing system is one of the most important points for negotiation. MFIs should insist that they pay the claims, and then be reimbursed from the insurer, based on documentation that is appropriate for their clients.
- A review committee, with representatives from the MFI, insurer and clients, could be a way of improving claims processes.
- MFIs should also persuade insurers to drop as many exclusions as possible, even if they have to pay a higher price.

Lessons: Product Design

- Efficiency depends less on the delivery model than on the simplicity of the product or product menu.
- Simple products work best because they are easier to administer and easier for clients to understand. Adding riders is fraught with difficulties. Even small riders may can have large consequences.
- The link between insurance and a loan can improve efficiencies, but it also has significant limitations. Of the three, only SHEPHERD has concluded that insurance should not be linked to microcredit since risks can happen when people do not have a loan.
- To get the product right, MFIs have to know what clients need and are willing to pay for.

- The target market is heterogeneous, so it is wise to offer a couple of different product options as long as they do not overly complicate the marketing message.
- MFIs should only include benefits that clients can claim without difficulty.
- If MFIs sell microinsurance to non-members, the organizations (or their insurance partners) are vulnerable to adverse selection risks. To control this risk, insurance should only be offered to persons who have joined a group for purposes other than accessing insurance.
- Without actuarial calculations, premiums are likely to be set too high—which means that clients are getting poor value for money—or too low, which can place the entire scheme in jeopardy.
- MFIs need to conduct a costing analysis to determine how much they need to earn in commission to cover their administrative expenses.
- MFIs cannot afford to lose money on an in-house insurance scheme, so they have to price conservatively and hence overcharge their customers.

1. Introduction

Microfinance institutions (MFIs) typically offer a variety of loan products and, increasingly, savings services as well. Today these organizations are grappling with a challenging question: should we offer insurance, and if so, what types of products, and how? Using the experiences of three microfinance institutions in India, this case study seeks preliminary evidence to answer these questions. While the questions seem straightforward, the answers are considerably less so. Microfinance institutions are quite heterogeneous. This study therefore requires an exploration of sub-level questions since different approaches make sense for different organizations, in different environments, serving different markets for different reasons.

Even within similar environments (in this case South India), there remain a range of approaches, none of which are necessarily right or wrong, but presumably they make sense for the organizations today, given their experiences, degree of maturity, and intentions. Indeed, it is not coincidental that this paper looks at MFIs in India.[1] As described in the next section, this environment is conducive to a range of possible products and delivery mechanisms. In particular, the insurance authority, Insurance Regulatory and Developmental Authority (IRDA), is a strong proponent of the formal insurance industry serving the low-income market, which creates a broader range of insurance opportunities for the microfinance industry than found in many countries.

Before introducing the environment and the MFIs, and distilling lessons from their experiences, it is necessary to clarify the questions that this paper hopes to answer. These are organized into three categories: 1) mission, vision and outcomes, 2) delivery mechanisms, and 3) products design.

1.1 Mission, Vision and Outcomes

Microfinance institutions get involved in insurance for a variety of reasons, and their motivations could have a significant bearing on what products they offer and how they offer them. Some organizations are primarily concerned about the well-being of their clients. Their primary motivation for offering insurance is to protect the poor, to ensure that workers in the informal economy and their family members have access to an appropriate menu of affordable social protection, risk prevention and coping mechanisms. Other MFIs primarily want to protect themselves. They want to offer insurance to reduce credit risks stemming from the death or illness of borrowers.

Of course, many MFIs are motivated by both objectives, but their primary motivation will likely influence their insurance services. Consequently, this case study considers three questions: 1) how do their motivations affect how they offer insurance; 2) how do their motivations affect what type of insurance that they offer; and 3) what are the implications of offering insurance to their target market, particularly low-income women?

[1] The term microfinance institution used in this paper refers to any organization that provides financial services to low-income households, including microcredit NGOs as well as regulated microfinance institutions.

1.2 Delivery Mechanisms

If a microfinance institution wants to offer insurance to its clients, there are two main ways to do so: a) self insurance, also termed full-service provider; or b) in partnership with an insurance company. Under what circumstances is one option preferable to the other? Certainly, if no partner is available or willing to offer insurance through the MFI, then it might have to go on its own. But increasingly insurers are interested in partnering with MFIs, especially those that have significant volumes, and especially in India where insurers are required to have a portion of their portfolios in the “rural and social sectors.” So under these favourable conditions for MFIs, might there still be circumstances in which they would want to self-insure? What are the advantages and disadvantages of the two options, and how might regulatory conditions affect the MFIs’ decisions?

Linkages with Insurers

Linkages with insurance companies make sense for many MFIs since their core activities are savings and credit; and most do not have the expertise to offer insurance on their own. The MFI acts as a distribution channel making it possible for the insurer to reach a market that it could not cost-effectively serve on its own. From the clients’ perspective, they have access to insurance coverage that is priced and managed by professionals.

Another lesson emerging from experience elsewhere is that when they link with insurers, MFIs often do not get particularly good deals, for themselves and by extension for their clients. With partners, how does an MFI get the best deal possible? How should one structure the arrangement to create a genuine win-win-win scenario that benefits insurers, MFIs and their clients, especially with regard to price and product coverage? How do MFIs get past insurers’ marketing mirage to find real value?

Starting the partnership is only half the battle. More challenges tend to emerge as the MFI and the insurer manage their relationship. From the MFIs’ perspective, what are the major relationship challenges, and how do they overcome them? The three biggest challenges tend to be: 1) burdensome claims documentation, 2) delays in paying claims, and 3) occasional claims rejections—all of which are particularly troubling since the poor tend to be lukewarm about insurance at best. If claims are difficult to make, if they are delayed or rejected, the MFIs—not the insurers—will face significant public relations problems. How have the MFIs been able to ensure that the documentation requirements are appropriate for the low-income market, including ensuring that documents are easy and inexpensive to access (while being difficult to forge)? How have the MFIs expedited claims payment procedures and reduced or eliminated the likelihood that claims are rejected?

Going Solo

If a microfinance institution cannot find an insurance partner or cannot persuade an insurer to meet the needs of its customers, then the MFI might consider offering insurance on its own. In fact, some MFIs argue that they do not want to partner with an insurer because they (or their customers) will have to pay extra for the insurer’s overhead. They want to earn a profit, not just a commission.

One of the major challenges MFIs face in offering their own insurance is how to structure the product and price it appropriately, as they typically lack the in-house expertise to do this. The two most common approaches are either: a) to pick a nice round number that the MFI thinks the clients can afford; or b) the MFI copies the pricing offered by insurers. The lesson from self-insurance elsewhere is that product design and pricing needs to be done by professionals. What has been the experience of the Indian MFIs? How will the MFI cope if it experiences covariant or catastrophic losses?

The other main argument against going solo is that in many jurisdictions it could be considered illegal. Insurance regulators may be willing to look the other way, or may not even realise that the scheme exists if the MFI is relatively small. But once it achieves significant scale, it is bound to attract attention. For MFIs that are self-insuring, how have they dealt with the potential regulatory risks?

Marketing

Regardless of the institutional arrangements, one of the biggest challenges in delivering microinsurance has been the complications of educating staff and clients about the products, getting them to appreciate the benefits and embrace insurance as an appropriate risk management tool. What do field staff need to know about insurance? How does the MFI make sure that they do know? How do they market the products to the clients and educate the low-income market about insurance?

1.3 Product Design

The next set of questions pertains to the types of insurance products that MFIs offer and their key design features. The starting point is: how do MFIs decide what products to offer? Besides the important question of what risks to cover, organizations also have to decide whether they want to bundle many different benefits into one basket policy, or whether it is more appropriate to keep the product simple. For marketing purposes, insurers sometimes prefer the basket cover, since it can make the policies sound comprehensive, but is that the right approach for the low-income market?

After picking products, one must also understand how they are priced. What assumptions do the organizations make with regard to operating costs, risk premiums, and reinsurance, and how did they come to those conclusions? Would their clients be willing to pay more for greater benefits?

From price, the logical next set of questions involves efficiency. Indeed, given the relative high costs of delivering large volumes of small policies, maximising efficiency is a critical strategy to ensuring that the products are affordable to the low-income market. One way is to make the products mandatory, which increases volumes, reduces transaction costs and minimises adverse selection. What does an organization lose by offering mandatory insurance, and how does it overcome the disadvantages? If it offers voluntary insurance, how does it streamline the transactions to make the products affordable? Is there a way of combining a mandatory product with some voluntary features to make the service more customer-oriented while retaining the benefits of compulsory cover? Another efficiency strategy is to use technology to reduce paperwork, manual processing and errors. Have these MFIs experienced any breakthroughs that enhance their efficiency?

The next set of questions focus on strategies for controlling risks. Again, mandatory insurance might be the organization's primary strategy, but how else are they controlling for adverse selection? What role do exclusions play in controlling moral hazard and covariant risks; do these exclusions cause comprehension complications for the low-income market and public relations problems when claims are rejected? How are the organizations controlling for the risks of client and staff fraud?

* * *

Based on the experience of the three MFIs, this paper answers or provides insights into many of these questions. Before doing so, however, the next section describes the Indian microinsurance environment, with an emphasis on the social and rural sector requirements for insurers. Section 3 introduces the three MFIs and provides a brief background on their organizational development. Section 4 examines in some detail the evolution of their microinsurance products and explains why they decided on the particular products they have chosen. Section 5 looks at how the premiums were calculated for their products and examines the financial results of the microinsurance programmes. Finally, Section 6 contains the core lessons of the three MFIs, loosely along the lines of the questions outlined above.

2. The Indian Context

To understand the MFIs, their insurance products and results, one must first be familiar with the context in which they work. In the 1990s, the Indian government set about liberalizing its previously nationalised insurance industry. The creation of the Insurance Regulatory and Development Authority (IRDA) in 1999 laid the framework for the entry of private (including foreign) insurance companies. After years of being dominated by the state-owned insurers, Life Insurance Corporation (LIC) and General Insurance Corporation (GIC) and its subsidiaries[2], in 2000-2001, IRDA licensed 16 new insurance companies, 10 life and 6 non-life. At the beginning of 2005, there were 14 life and 14 non-life insurers operating in India.[3]

It is useful to note that IRDA is unique among insurance regulatory bodies in that it explicitly has a development agenda—development is even in its name. The primary focus for most insurance authorities is on consumer protection, and their efforts to protect consumers may have the unintentional side effect of excluding the low-income market from appropriate insurance services. In India, the IRDA tries to strike a balance between its consumer protection responsibilities and its development agenda.

2.1 Microinsurance Legislation

India has many informal insurance schemes. These schemes are often small, run by cooperatives, churches and non-governmental organizations (NGOs), which pool their members' contributions to create an insurance fund for a specific purpose, for example to cover funeral costs. In some countries, there is specific legislation to regulate these schemes, however in India, no such law exists; any organization conducting insurance has to comply with the stipulations of, among other regulations, the 1938 Indian Insurance Act as amended.

Compliance with this Act requires, among other conditions, over $22 million of capital. All insurance schemes that do not comply with the Act operate in a legal vacuum. At present, the IRDA has not taken action against informal schemes; however, regulated insurers have expressed their unhappiness about competing with informal insurers that do not bear any regulatory expenses.

Two central regulations have shaped microinsurance in India. The first is a set of regulations published in 2002 entitled the **Obligations of Insurers to Rural Social Sectors** (see Box 1). This is essentially a quota system, imposed on private insurers that entered the Indian insurance market after it was liberalised, which compels them to sell a percentage of their policies to disadvantaged persons. The old public insurance monopolies have no specified quotas, but they have to ensure that the amount of business done with the specified sectors was "not be less than what has been recorded by them for the accounting year ended 31st March, 2002"—a figure that will be revised from time-to-time by the regulator.

[2] The GIC had four regional subsidiaries: the National Insurance Company, the New India Assurance Company, the Oriental Insurance Company, and the United India Insurance Company.
[3] A complete list can be obtained from the website of the IRDA – www. irdaindia. org.

Box 1. Obligations of Insurers to Rural Social Sectors

Rural areas: density of population < 400/km² or 25% of men work in agricultural pursuits

- **Life insurance**: 5% of total policies in Year 1, up to 16% in Year 5
- **General insurance**: 2% of gross premium income in Year 1, 3% in Year 3, and 5% thereafter

Social sector: unorganized workers, economic vulnerable or backward classes in urban and rural areas

- 5000 policies in Year 1; up to 20,000 in Year 5 for both life and general insurance

These quotas rise each year, reaching a maximum after 5 years. This requirement has generated massive pressure on insurers to sell microinsurance. If they do not, they cannot sell their more profitable products—the IRDA has fined some insurers for failing to meet their targets. Consequently, this regulation has stimulated some significant innovations. In their drive to meet their microinsurance sales targets, a few insurers are developing new products and delivery channels.[4]

The impact of the quota is of course not all positive. There have been unverified reports that some insurers are dumping poorly serviced microinsurance products on clients solely to meet their targets. Some insurers stop selling microinsurance once they have met their targets. These practices are difficult to regulate, as it is harder to police the quality of insurance sold and serviced to the poor than its quantity.

The second central regulatory document is a paper published by the IRDA in August 2004 entitled **Concept Paper on Need for Regulations on Micro-Insurance in India**. While not regulation, the paper nonetheless reflects the intentions of the regulator. There is much that is commendable in the Concept Paper, but there are some concerns:

1) The implicit restriction of microinsurance to the partner-agent model limits the potential scope;
2) The paper is overly prescriptive regarding product design; and
3) It only allows intermediaries to collaborate with one life insurance company and one general insurer—at present many Indian MFIs have met the needs of their clients by partnering with a variety of insurers.

In addition, the concept paper recommends reducing the training for NGO agents from 100 hours (or 50 hours for life insurance) to 25 hours. Quality control with regard to NGO skills in this area can hence no longer be ensured since the number of hours is unlikely to be sufficient for most organisations.

2.2 Profile of Microinsurance in India

Prior to the passage of the Obligations of Insurers to the Rural Social Sectors, microinsurance schemes were often some variant of a community-based model or in-house insurance managed by MFIs.

[4] For example, see Roth and Athreye (2005), "Tata-AIG, India," Good and Bad Practices in Microinsurance, Case Study No. 14. Geneva: International Labour Organization.

In the **community-based model**, a group of people get together and essentially develop their own insurance scheme in which they pool their own funds and develop their own rules. The Swayamkrushi Youth Charitable Organization (YCO) in the Andra Pradesh is an example of a community-based model that still operates. It is primarily a savings and credit association with added insurance features. The cooperative's 8,100 members pay a yearly premium of Rs 100 ($2.22) into a pool managed by the cooperative and receive cover for death and property loss. The life insurance benefit is Rs 15,000 ($333) for a natural death, and double that in the event of an accidental death.

In the in-house or **full-service model**, an MFI or NGO runs its own insurance scheme for its clients and any profit or loss is absorbed by the MFI. While this approach was more common before the quota system, it still exists in some organizations, including SPANDANA, which is discussed below.

The passage of the Rural Social Sectors' Obligations changed the Indian microinsurance landscape dramatically. This requirement has motivated insurers to seek partnerships with MFIs and NGOs to act as agents, selling and servicing the insurers' policies. This model of collaboration, the **partner-agent model**, has become the dominate approach to microinsurance in India and has encouraged many MFIs to switch from a full-service to a partner-agent approach. For example, SEWA, a microinsurance pioneer, after years of switching back and forth between the partner-agent and self-insurance, is now offering its life, health and asset coverage in partnership with various insurers.[5]

2.3 The Role of the State in Social Protection

The primary social protection schemes available in India are listed in Appendix 1. Through empowerment programmes and facilitation services, many NGOs actively assist their members to access this wide range of social protection schemes. Despite these efforts, the social protection coverage of the Indian population is not yet satisfactory. The risk of illness, for example, one of the most significant risks faced by poor and rich alike, is in theory covered by the government's free universal health care. In practice, the health care offered by the state is so limited and of such poor quality that more than 75 percent of health care expenditures are paid by private sources.

Overall, it would be fair to say that the social security network is patchy, with minimal coverage for most low-income Indians. The bulk of social security benefits accrue to those that have or have had formal employment. The persons who need the benefits the most often do not have the information or the social connections to access them. In the absence of the state providing a hedge against risks, the poor must provide for themselves. One means of doing so is through microinsurance. Ideally, microinsurance would complement social protection schemes, but too often that is not the case.

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[5] See Garand (2005), "VimoSEWA, India," Good and Bad Practices in Microinsurance, Case Study No. 16, Geneva: International Labour Organization.

3. The Institutions

To answer the questions introduced in Section 1, this study draws on evidence from three Indian MFIs (or more technically, 2 MFIs and 1 NGO, since in India a microfinance institution is a specific regulatory category): ASA, SHEPHERD and SPANDANA. They were chosen in part because they were all involved in a German Technical Cooperation (GTZ) project on microinsurance, through which they received some funding and technical assistance from a project managed by Friends of Women's World Banking (FWWB).

These organizations were also chosen because they have three distinct approaches to microinsurance. In a nutshell: SPANDANA, a large, professional MFI, runs an in-house life insurance scheme; SHEPHERD, a small NGO, offers a wide-range of insurance products in partnership with different insurers with the intention of providing its customers with comprehensive social protection; whereas ASA is somewhere in between, having experience with both the in-house and partner-agent models. All three MFIs have offered microinsurance long enough—in some cases more than 10 years—to provide valuable lessons for other microfinance institutions. This section introduces the MFIs, describes their target market, and explains how their insurance services fit into the broader category of risk management.

Table 1. Outreach Overview of the MFIs (Dec. 31, 2004)

	ASA	SHEPHERD	SPANDANA
Number of Members	66,126	15,000	386,035
Number of Loans Disbursed (past year)	54,868	4,800	271,182
Amount Disbursed (past year)	Rs 252.7 m ($5.6 m)	Rs 53 m ($1.8 m)	Rs 2,063 m ($45.84m)
Loan Outstanding	Rs 170.3 m ($ 3.8 m)	Rs 20 m ($0.44 m)	Rs 2,389 m ($53.08m)
Savings	Rs 71.4 m ($1.6 m)	Rs 15 m ($0.33 m)	Rs 138 m ($3.06m)
Percent Women Members	100	100	100
Number of Employees (whole organization)	300	20	181 (3/04)
Lending Methodology	Grameen	SHG	Modified Grameen

3.1 History of the Institutions

ASA

The Activists for Social Alternatives (ASA) is an NGO working for the development of the poor in a drought prone area of central Tamil Nadu. Founded in 1986 by Sathianathan Deveraj, ASA was designed to address the rights of the downtrodden and exploited, most of whom belong to the *Dalit* community.[6] ASA's vision is: "A value-based, poverty-free, productive, prosperous, humane and sustainable community." To achieve that vision, ASA strives to be a community-owned, professionally-managed organization. The mission of ASA is "to empower women of the poorest families socially, economically and politically through networking them into community institutions and efficient poverty alleviation and microfinance programmes." To combat gender inequality, child marriage and the caste system, ASA formed women's groups (sanghas) and built institutions out of such groups through education, sensitization and capacity building.

In 1993, after a study tour to Bangladesh to visit the Grameen Bank, ASA launched a microfinance programme called Grama Vidiyal (GV), meaning the "Dawn of Rural Poor." In 1997, ASA created a separate entity for microfinance, the Grama Vidiyal Trust, since it required a separate organization structure. ASA follows a hybrid approach to poverty alleviation, taking microfinance as an entry point and utilizing the borrower groups to promote the empowerment of women, thereby trying to address poverty and other social issues holistically.

Grama Vidiyal offers collateral free loans to poor women mainly for income-generating purposes using a Grameen methodology. Consumption and housing loans are also provided with the group guarantee, taking into consideration the need and circumstances. GV offers to its members a saving facility as well. Saving and credit are offered during the centre meetings, which are usually conducted by the Field Managers every week.

Besides savings and credit, ASA provides several other services to the members and their communities, including schools, enterprise development training, Internet kiosks, watershed development, and capacity building and federating for community-based organizations.

ASA moved into microinsurance to save the families of the clients who suffer losses due to the unforeseen risks like death. Since ASA was already active in microfinance, it seemed a natural step to offer insurance as well.

ASA now has 350 employees. Seven employees at the head office are involved with insurance activities full-time, while 160 field staff members work on it part-time, enrolling members and collecting the premiums. At the head office, the insurance manager is assisted by an underwriting officer, a claim-processing officer, and five divisional coordinators. At the branch level, branch managers give roughly 20 percent of their time to insurance. ASA's staff receive an incentive depending upon the work load associated with insurance.

SHEPHERD

Self-Help Promotion for Health and Rural Development (SHEPHERD) was formed and registered under the Society Act in 1995. SHEPHERD is located in Triuchirapalli (Trichy) in Tamil Nadu. SHEPHERD's founder and Secretary-General, Peter Palanisamy, started the organization to empower poor rural women, particularly *dalits*. Though agriculture is the main source of income for its target market, the availability of employment is limited. People

[6] The word *Dalit* is a catch-all phrase that includes untouchables (*Harijans*), outcastes of various kinds, scheduled castes (socially/economically marginalized Hindu castes, given special privileges by the government), and others living in a reduced social state and poverty.

only work for 5 to 6 months in a year, depending on the rainfall. SHEPHERD operates in three districts selected because they had high incidences of drought, bonded labour, underemployment and migration. SHEPHERD's main objectives are: a) to inculcate the habit of savings; b) to help women to lead sustainable livelihoods; and c) to protect them from calamities or risk. In sum, to reduce their vulnerability.

SHEPHERD began working in these communities by promoting a community banking approach, organizing women into self-help groups and then connecting them to banks. SHEPHERD also links the SHGs together into a block-level federation (BLF), which provides some oversight of the SHGs' performance. The BLFs are then grouped into a third-tier organization called Nanana Surabi, a registered non-profit company that serves as an apex body for fund distribution.

There are two main distinctions between SHEPHERD's approach and that of the other two MFIs. First, rather than building itself into a financial institution, SHEPHERD is more of a facilitator, trying to build the federation into a sustainable intermediary between the SHGs and the banks and other funding sources. The second difference, a natural follow-on to the first, is that SHEPHERD actively uses a participatory methodology to involve its members in making decisions about the services provided to them or by them.

The tricky part about SHEPHERD's approach is that the NGO earns very little money as a facilitator. For example, if a bank lends to SHEPHERD at 13.5 percent, it would add 2 percent for its costs, Nanana Surabi would add 2.5 percent, and the SHG would add 6 percent, so the ultimate borrower would pay 24 percent. SHEPHERD's two percent surcharge is insufficient to sustain its operations, so it is more dependent on donor and government support than ASA or SPANDANA.

SHEPHERD's interest in insurance began in 1999 when six of its clients died due to ill health and childbirth complications. Senior management wished that they could do more to assist the bereaved families besides nominal contributions for the funeral expenses, so they explored the possibility of introducing insurance. The following year, as the result of communal violence, 700 huts burned down in the districts where SHEPHERD operates, affecting a few of its members directly. From these experiences, Peter Palanisamy drew two conclusions. First, to address the diverse risk-management needs of the poor, a variety of complementary interventions are required. Second, insurance should not be linked to microcredit because risks can happen when people do not have an outstanding loan.

Of its 20 employees, SHEPHERD has two staff members who work full time on microinsurance, and another who works part time. In addition, the field staff who form the SHGs are involved in marketing insurance. The field staff receive Rs 10 ($0.22) for the enrolment of the new members. To better manage its insurance activities, SHEPHERD is in the process of forming a separate company for its microinsurance programme, which will be registered under Section 25 of the Company's Act as a non-profit agency.

SPANDANA[7]

Located in Guntur, Andhra Pradesh, SPANDANA was formed in 1992 and registered under the Society Act in 1995. It only started microfinance in 1998 after a chance encounter between one of the organization's founders, Padmaja Reddy, and a rag picker who explained the importance of small loans. The experience encouraged Padmaja Reddy to leave her job and work full-time building an organization that could provide credit in Guntur's slums.

Since then, microfinance has been the major axis around which all other SPANDANA programmes revolved. Unlike many Indian MFIs, SPANDANA started its operations in urban areas and then moved to rural areas. SPANDANA began offering microfinance using the SHG model. As the portfolio grew, delinquency started setting in. Around the same time, the organization reached the conclusion that the SHG approach was not sustainable without ongoing grant funding to cover the group formation costs.

SPANDANA then tried out the Grameen model, which created an interesting shift in the attitude of SPANDANA's promoters, who were now providing financial services to the poor rather than just facilitating access. With experience with both SHG and Grameen, SPANDANA has adapted features from both into its own hybrid model that relies on 10-member groups instead of five. The change in lending methodology also spurred significant growth. SPANDANA now has 31 branches in four districts, split evenly between urban and rural areas.

SPANDANA grew steadily for a number of years, but it exploded in 2003, growing from 34,000 to 110,000 borrowers in 12 months. This exponential increase was largely because of a tie up with ICICI Bank, which provided the loan funds and kept the loans on its books, while SPANDANA earned a commission to cover its costs and assumed most of the risk. The success of the partnership stimulated competition from other banks, which made it possible for SPANDANA to grow to 386,000 borrowers in 2004.

Unlike SHEPHERD and many other Indian NGOs, SPANDANA does not solicit the involvement of its clients in its ownership or governance structure. It believes that not all services are amenable to a participatory methodology, and only professionals and experts should provide financial services. Indeed, SPANDANA is creating a regulated non-bank financial institution to assume its lending activities, which will make it easier to access the financial markets. Yet despite the strong professional approach and the creation of a for-profit company, SPANDANA maintains the conviction that any profit accrued from its activities should be used for the larger societal good.

The growing momentum of its microfinance programme made SPANDANA realize the need for providing certain social security schemes to its clients. Such a realization emerged from its experience of witnessing clients slide down the poverty ladder because of unexpected crises. SPANDANA found savings and loan products to have limited potential to respond to uncertainties such as death and disease, especially for the poor. Hence, keeping in mind the welfare of the clients, and as well as its own loan security, SPANDANA moved into the business of microinsurance.

[7] This section is adapted from Sriram (2005), "Expanding Financial Services for the Poor: The Transformation of SPANDANA," Indian Institute of Management; and the M-CRIL rating report.

3.2 Socio-economic Profile of Clients

The *raison d'être* of all three MFIs is to empower poor people. All three organizations ensure that they serve the poor by conducting wealth-ranking exercises and excluding those whom the organizations feel are not poor enough to participate. Table 2 shows a distribution of clients by wealth for ASA and SHEPHERD.

Table 2. Comparison of Poverty Outreach[8]

Gender of Client	Poorest 25%	Poorer	Middle poor	Not-so-poor
ASA	50	25	15	10
SHEPHERD	20	70	10	Nil

ASA works in 6 drought-affected districts, primarily with *Dalit* workers, some of whom are landless. In these areas, the literacy rate is lower then the average for the State; ASA estimates that 40 percent of its clients are illiterate. When they joined, most of ASA's clients worked as day labourers in agriculture or in the accident-prone construction industry. Now the majority are self-employed, earning their livelihoods through income-generating activities supported by Grama Vidiyal. The average weekly income of a family is Rs 300 ($7), with an average family size of five. All of ASA's policyholders are women.[9]

SHEPHERD also works with much the same community as ASA and in similar areas (they both have head offices in Trichy). All of its clients are either *Dalit*s or poorly paid quarry workers. Most members are agricultural day labourers for whom work is quite limited due to the drought conditions. The microcredit activities are intended to provide alternative income sources.

Since the start of its operations, SPANDANA has consistently managed to sell 90 percent of its insurance policies to clients from households who earn less the $1 per household member per day. Although all the clients are women, because the product also covers spouses, its actual exposure is almost as high for both men and women.

The clients of these organizations face a similar set of risks, with health issues (and health care costs) topping the list. Without support from the MFIs, they would borrow from moneylender to meet the expenses, falling into a vicious cycle of debt. Research from FWWB shows that 30 to 40 percent of the outstanding debts of poor women were used to pay for health care. SHEPHERD's experience reinforces this finding; 40 percent of its SHGs' internal loans are used for health care.[10] Unemployment is another major concern, especially in drought areas where the demand for agricultural labourers has significantly declined. Although death occurs less frequently than health expenses and unemployment, it usually results in a more significant expense. Clients estimate that the cremation and funeral expenses are around Rs 15,000 ($333), although the figure is lower in some rural areas.

[8] For example, those in the poorest category live in an adobe hut and consume less than 1500 calories per day, whereas the non-poor live in brick houses and own their own land. Data for SPANDANA was unavailable.
[9] In 2004, 45 of the policies also covered spouses. ASA plans to cover all spouses in 2005.
[10] Internal loans are offered by SHGs to their members from their own savings, as opposed to external loans which typically come from banks to SHGs.

Traditionally in India, households would cope with these crises through social systems such as the caste or the extended family. Persons in need of assistance would be absorbed into other households. With the advent of nuclear families and migration, the situation has changed, even in rural areas. The need of alternative coping mechanisms, such as insurance, appears to be increasing.

These MFIs recognise the need to understand the socio-economic condition of their clients as this has many implications for product design. For example, they work with clients who have low literacy levels and so they require products with limited documentation. Their low incomes mean that they cannot afford to travel to distant branch offices, so the MFIs offer products that are sold and serviced close to the customer's home.

While these organizations are committed to understanding their clients' needs, there are hazards in collecting socio-economic data. SHEPHERD's participatory methodology has created pressure on the organization to meet all of, or at least most of, the expectations that members articulated. As a result, SHEPHERD has developing a multitude of products, which may be difficult to manage. In contrast, SPANDANA has focused on a few products and prioritised institutional efficiency over comprehensively meeting clients' needs. This prioritisation has allowed SPANDANA to grow quickly, at the expense of not meeting as many articulated social needs.

3.3 Risk Management Products

Insurance is one financial instrument among several that help the poor manage their risks. Emergency loans, accessible savings facilities, forward contracts, remittance services are all instruments that help the poor manage their risk. While much risk can be managed through financial services, it can also be managed through non-financial means, such as providing training or health screening to prevent risks from occurring. Where these measures help reduce the occurrence of an insured event, they may end up paying for themselves through lower claims ratios.

Of the three organizations, SHEPHERD has the most comprehensive strategy for risk prevention and risk management, which includes insurance among a range of interventions:

- **Food security**: Group members are requested to save a fistful of rice at each meeting; as this rice savings accumulates, group members can either borrow from it or it can be donated to more needy community members.
- **Income security through life insurance**: SHEPHERD's core business is the provision of savings and credit through SHGs, in which loans are typically used to support income-generating activities. To protect the household from the death of a breadwinner, group members (and their spouses) can choose between three different life insurance schemes.
- **Income security with livestock**: For SHG members that take loans for cows and other livestock, SHEPHERD promotes a three-pronged strategy: prevention, promotion and protection. **Prevention** is addressed through regular cattle care camps that the NGO organizes so that a veterinarian can identify and treat poor households' main assets. For **promotion**, SHEPHERD has trained barefoot veterinarians to educate SHG members to

properly care for their animals. For **protection**, SHEPHERD offers livestock insurance on behalf of an insurance company.

- **Health security**: In 2003, SHEPHERD introduced UniMicro Health Insurance in partnership with United India Insurance Corporation (UIIC) to cover in-patient treatments. To complement the insurance product, SHEPHERD organizes regular medical camps to conduct checkups for illness and disease. Through its Sugam Fund, SHEPHERD also offers loans for childbirth.
- **Asset security**: A rider on the UIIC UniMicro product includes hut insurance that pays a benefit of $100 if the policyholder's house burns down.

In addition, SHEPHERD provides multipurpose loans between Rs 2,000 ($44) and 10,000 ($222), at 0.6% per month for five months. These loans can be used to pay for festivals, school fees, marriage and emergencies.[11] Emergency loans are also available from the SHG's internal account and from the Sugam Fund. SHEPHERD promotes savings mobilisation, but the group keeps its own money, making it possible for members to access their savings if they experience a crisis. However, clients prefer borrowing to cover short-term cash flow shortfalls, and leaving their savings untouched, even though a loan is more expensive.

Although the insurance products are described in more detail in the following section, it is useful to note how the organization holistically conceptualises its risk management strategy, combining financial and non-financial services.

ASA has a similar, though less comprehensive approach, to provide or facilitate access to social protection services for poor women. Besides its life and livestock insurance, ASA provides voluntary savings and emergency loans that can assist members to manage risks, and has recently introduced a pension programme. The organization is also engaged in a wide range of non-financial services, such as education, training, advocacy, Internet kiosks and watershed development—however unlike SHEPHERD, these activities are largely not preventative measures that are directly tied to risk management or its insurance services. Instead, they tend to be more general economic and social empowerment efforts that would have an indirect effect on risk management.

In contrast, for the most part SPANDANA's approach to supporting its clients' risk-management needs is limited to the provision of financial services. It offers a current account, as well as various loan products that could be used to manage risks, although none of the loans are specifically intended for risk management. For example, the MFI offers a consumer loan, but it is used to purchase items such as televisions and fans from a sister company, and therefore cannot be easily used to cope with economic stresses.

The jury is still out on whether MFIs should only provide financial services. Focusing on a few financial services has allowed SPANDANA to grow exponentially. If however the MFI does do other tasks, then it would make sense to follow the example of SHEPHERD and ensure that the non-financial services complement the microinsurance work. An outstanding question, however, is how to finance such activities.

[11] The larger loans are for weddings, but these have a different repayment arrangement: half of the principle and interest needs to be repaid immediately after the wedding (from the presents) and the other half is spread over four monthly instalments.

4. Microinsurance Products

In their extensive experience with microinsurance, these MFIs have evolved considerably, learning very useful lessons along the way. But they have not evolved in the same direction. This section reviews the microinsurance history of each organization and describes the products that they are offering.

4.1 ASA's Microinsurance History

Historical Arrangements

ASA's first foray into insurance was an in-house scheme that it managed from 1993-1997. For this straightforward policy, ASA deducted from the loan Rs 10 ($0.22) for the first Rs 1000 ($22), and then Rs 5 ($0.11) for every additional Rs 1000 ($22). The benefit was a single payment of Rs 500 ($11) to cover funeral costs if the borrower died. Although there was a demand for life insurance, the initial product was fundamentally supply-led. This simple product was easy to implement and did not strain the organization.

The product then evolved. Members requested higher levels of coverage and, in 1997, ASA developed an in-house, one-year term life product that paid Rs 5000 ($111) in the event of a natural or accidental death. Members paid a premium of Rs 50 ($1.11) when they received their one-year loan. Another premium payment option was for clients to deposit a refundable Rs 500 ($11) into ASA Capital Insurance Fund, and receive coverage for as long as the money was in the account. However, too few members joined the Fund, so it could not generate sufficient income to pay for the premiums. ASA tried offering an instalment arrangement of Rs 100 ($2.22) per month for five months, but the administration became too complicated, and eventually the Capital Insurance Fund idea was scrapped.

During this period, several members were involved together as passengers in a truck accident. With its undercapitalised, nascent scheme, ASA realised that a few unexpected accidents could quickly exhaust the fund; it was vulnerable to covariant risks. ASA responded to this concern by collaborating with UIIC.[12] From 2000 to 2001, it continued to offer natural death policies in-house for a premium of Rs 60 ($1.33). If clients wanted to cover accidental death, they could purchase a UIIC policy for an additional premium of Rs 15 ($0.33) per annum.

At this stage, ASA's products were officially voluntary, as the premium was not deducted from the loan. In practice, however, essentially all borrowers bought the coverage, and discussions with clients revealed that they did not believe they had a choice and saw the premium as a condition for obtaining a loan. Indeed, the number of ASA borrowers very closely matches the total number of policyholders.

In 2000, ASA met with a representative of the Life Insurance Corporation of India, who convinced the MFI that it could provide a better value policy. ASA decided to partner with

[12] ASA also sells livestock insurance through the UIIC and the National Insurance Corporation (NIC). These are compulsory products for livestock loans.

LIC and sold its Janashree Bima Yojana (JBY) policy from January 2001 until May of 2002 (see Table 3). This policy is government subsidised, with a matching premium paid from a government trust fund. As an extra incentive, the product provides a limited number of education scholarships for children from 9th to 12th standard.

Table 3. LIC's Janashree Bima Yojana

Product Feature	Comment
Policy Term	One Year
Premium Payment	Rs 100 ($2.22) per annum[13]
Age	18 - 60 Years
Sum Assured	
Natural death	Rs 20 000 ($444)
Accidental death	Rs 50 000 ($1 111)
Partial Disabilities	Rs 25 000 ($556)
Total Disability	Rs 50 000 ($1 111)

Despite the more attractive benefits, ASA's experience with LIC was not positive. ASA found the insurer bureaucratic. Its policy document was lengthy and complicated, and claims settlement was particularly difficult. Policyholders also had problems with the fact that pre-existing illnesses were not covered, and death occurring during childbirth or by suicide, snakebite and drowning were excluded (which was not the case previously). Besides claims delays, it was also very difficult to get disability and accidental death benefit payments; the insurer would regularly find excuses to reclassify accidental deaths as natural deaths to pay the smaller sum assured. The final difficulty was that LIC settled claims by paying a crossed-cheque to the beneficiary, when meant that claimants had to open savings accounts to cash their cheques. LIC proved unwilling to change its procedures, so ASA reverted to a variant of its previous microinsurance policies.

ASA decided to provide natural death coverage in-house. It combined a cover of Rs 20,000 ($444) for natural death with an accidental death benefit of Rs 50,000 ($1,111) from the General Insurance Company (GIC) and ICICI Lombard—the latter was its first partnership with a private company.[14] The accidental death coverage cost Rs 27.25 ($0.61), so ASA charged its clients the same Rs 100 ($0.22) premium, and it kept the difference to cover the natural death benefits and administrative costs. The advantage of providing the insurance in-house is that ASA did not have to require a death certificate, which took beneficiaries a lot of time to access, sometimes requiring un-receipted payments to government officials.

Current Arrangements

Towards the end of 2002, the IRDA's rural and social sector obligations had come into force and insurers were knocking on ASA's door to enquire about partnering. The timing was good from ASA's perspective because it was feeling burdened by high claims and was quite keen on finally outsourcing all of the risk.

[13] This represents the cost to the client, but the government actually pays an additional Rs 100 for each policy.
[14] Private insurance companies in India often have double names because the only way that foreign insurers, like AIG, Prudential or Allianz, can enter the market is in partnership with an Indian company.

To select a partner, ASA decided to solicit bids from insurers. At the top of its list of criteria, it wanted a partner that would pay benefits directly to ASA and allow it to verify claims. The three companies that agreed to this arrangement were AMP-Sanmar, Allianz Bajaj and Max New York. ASA decided to work with all three companies, which were willing to offer the same simple product (see Table 4) as a means of hedging its risk in case one does not perform well (consequently, ASA has to complete paperwork for three companies rather than one).

Table 4. ASA's Current Life Insurance Product

Product Feature	Comment
Premium	Rs 125 ($2.78) (of which Rs 50 goes to the insurer)[15]
Insurable Event	Death of the client (due to any cause)
Age Limit	18-60 years
Screening	Visual screening by the Field officer
Waiting period	15 days
Exclusions	No Exclusions
Benefit	Rs 20 000 ($222)
Term	One year
Premium Collection	Yearly
Lapses	Any non renewal

By drawing up a list of the features that it needed, and inviting insurers to make their pitch, ASA took charge of the partner-agent relationship. It could do this in part because of its large client base, and in part because it had enough experience over the years to know what it did and did not want. Moreover, because of the Rural and Social Sector Obligations, the negotiations were strongly distorted in ASA's favour.

ASA has become a corporate agency for Bajaj Allianz, which means that it can sell all the products of that insurance company through out India. The insurance company establishes the commission and bonus according to the product. While such an arrangement could affect the MFI's mission—for example if it gets distracted selling individual insurance policies to the non-poor because they generate greater commissions—ASA has not gone beyond its core market. For now, it is focussing on providing social sector insurance for the benefit of its members and their families.

Customer Satisfaction

ASA has been on an insurance rollercoaster over the years, but hopefully the current arrangement will have some staying power. The rapid changes of partners and policies has confused clients and staff, and led to irregular customer service. For example, when ASA was providing insurance in-house, it could pay benefits rapidly, but when it partnered with LIC, claims could take several months and might even be rejected. When ASA provided in-house benefits, deaths due to snakebites or drowning were accepted; when it partnered with insurers, those risks were excluded.

In general, clients have responded favourably to the current life insurance product, although they do have some suspicions about the fact that the insurers are private companies, instead of government insurers. Perhaps the biggest complaint about the coverage is that the women

[15] The premium paid to AMP-Sanmar and Allianz Bajaj was Rs 36, but this was recently increased to Rs 50.

would also like to cover their spouses, an issue that ASA is addressing by including spouse coverage in 2005. Some claims payments still take too long, with 22 percent taking more than 3 months, but ASA and the insurers are discussing ways to improve the situation.

4.2 SHEPHERD's Microinsurance History

Unlike ASA or SPANDANA (as discussed below), SHEPHERD never considered managing microinsurance in-house. This had something to do with the passionate commitment of the NGO's founder to the idea of outsourcing. Peter Palaniswami's management philosophy is that people should stick to doing what they do best. This commitment to outsourcing is deeply entrenched in SHEPHERD—the organization does not even have a kettle since it is more efficient to outsource tea making to a local tea *wallah*! Besides not having the expertise to run an insurance scheme, SHEPHERD was also concerned about the legality of in-house insurance.

Life Insurance

Like ASA and SPANDANA, SHEPHERD's initial foray into insurance was in life insurance, beginning in 1999 with LIC. This occurred for a number of reasons. One was a clear need expressed by its members. Some SHGs had experienced deaths and members felt that the contributions that they were able to make to the bereaved family were insufficient. The other was a supply-side phenomenon, namely this was the main type of insurance on offer.

In 2001, SHEPHERD also entered into a partnership with HDFC-Chubb and ICICI-Prudential. This unhappy collaboration lasted for 2 years. SHEPHERD found both insurers uninterested in providing decent levels of after-sales service. Because of the low value of the premiums, the insurers were not really interested in spending much time servicing the policies. Peter Palaniswami also found that the insurance personnel were urbanites who flew down briefly for rare visits with little understanding of rural poverty.

Therefore, SHEPHERD expanded its relationship with LIC. SHEPHERD felt that the LIC was right partner for two reasons. First, as a state insurance company, Peter Palaniswami believed it would be more likely to have the needs of the poor at heart than private insurers, which were more likely to be motivated by profit. Second, the government provided a subsidy for JBY, allowing it to contain more benefits per rupee of premium than most other microinsurance products. LIC's office in the vicinity was an added advantage.

In 2002, SHEPHERD phased out its relationship with the private insurers and phased in additional policies of LIC: Janashree Bima Yojana, Ordinary Group Insurance (OGI), and a Group Social Security (GSS) Scheme product. The products were similar except that some offered more benefits for a larger premium, as shown in Table 5.

Table 5. SHEPHERD's Life Insurance Offerings

Product Name	Group Social Security Scheme (GSS)	Ordinary Group Insurance (OGI)	Janashree Bima Yojana (JBY)
Term	1 year	1 year	1 year
Eligibility requirements	Age 18-59	Age 18-59	Age 18-59
Product coverage (benefits)	• Natural death Rs 5,000 ($111) • Accidental death Rs 50,000 ($1 111) • Permanent disability Rs 12,500 ($360)	• Natural death Rs 5,000 ($111) • Accidental death Rs 10,000 ($222) • No disability cover	• Natural death Rs 20,000 ($444) • Accidental death Rs 50,000 ($1 111) • Permanent total disability Rs 25,000 ($556)
Key exclusions	Murder and death caused by snake bites	Murder and death caused by snake bites	Murder
Pricing	Member pays Rs 35; Rs 25 goes to insurance partner	Member pays Rs 55 ($1.22); Rs 50 ($1.11) goes to insurance partner	Member pays Rs 100 ($2.22)
Commission	Nil	5% of premium	4% of premium
Number of policyholders	6254 (2002) 4982 (2003) 5228 (2004)	640 (2002) 4467 (2003) 3932 (2004)	0 (2002) 891 (2003) 1978 (2004)

One of the interesting features of SHEPHERD's life insurance menu is that it really is voluntary—unlike at ASA, where it is voluntary in theory, but compulsory in practice—and the members can chose between different options. It is, however, all or nothing at the group level, so the SHGs have to decide collectively if they want insurance, and if so which policy they want. Approximately 70 percent of SHEPHERD's members are enrolled in one of the insurance schemes and there is a 61 percent renewal rate.

Of the Rs 10 ($0.22) that SHEPHERD keeps on the GSS and OGI policies, Rs 5 ($0.11) is paid to the promoter as an incentive and Rs 5 ($0.11) goes into its Social Security Fund, which helps to pay for the preventative activities. There is no loading on the JBY policy, but SHEPHERD earns a 4 percent commission from LIC (and a 5 percent commission on OGI, but no commission on GSS). The JBY policy has been less popular so far, perhaps because it is more expensive or perhaps because staff do not earn an incentive for it. The GSS policies are only available for sale and renewal in July, so if new groups form at other times during the year, they either have to wait until July or take one of the other two options.

Like ASA, SHEPHERD soon had trouble with LIC, particularly two problems with claims settlement. First, LIC required a death certificate to verify the death of the insured, which is often difficult and costly to obtain. The second issue is the difficulty for beneficiaries to cash benefit cheques, either because they do not have bank accounts or because the nominee is a minor. Banks do not like to open up accounts in these situations because they know the client is likely to withdraw the cash and immediately close the account.

Instead of ending its relationship with LIC, as ASA and SPANDANA did, SHEPHERD tried to reform it. Peter Palaniswami felt that changing of insurers was not good for the clients who would get confused. In addition, he was very put off by the failed partnerships with HDFC-Chubb and ICICI-Prudential, and was weary of working again with private insurers.

To resolve the problems with LIC, SHEPHERD established good relations with its local branch office and requested that insurance staff visit SHEPHERD and meet with clients to hear their problems. The approach worked and had other positive spin-offs. Staff used the visits to answer questions they had about insurance, so essentially they received some informal training. The LIC personnel clarified outstanding questions about the claim settlement process. The visits were also a useful marketing tool since the interest taken by LIC employees helped build the clients' trust in the product. LIC recognised the marketing value of the visits and began to bring marketing materials with them.

Following this exchange, LIC agreed that SHEPHERD could pay claims in advance and be reimbursed by LIC. It also helped SHEPHERD with the development of an MIS database to monitor enrolment, claims, lapses and renewals. SHEPHERD even began offering life insurance polices to non-members on behalf of LIC, as described in Box 2, although this became limited to members' spouses.

Box 2. The Risks of Offering Insurance to Non-members

SHEPHERD also extends its life insurance coverage to non-members, including spouses, other family members, other non-members. Coverage for spouses is a logical and appropriate extension because SHG members—the ones that SHEPHERD is trying to assist—will receive the benefits. To prevent an adverse selection problem, however, it should be mandatory so that any enrolled member that has a spouse who meets the eligibility requirements is automatically covered. Currently there is not any medical clearance or declaration required.

SHEPHERD also experimented with a riskier strategy, allowing SHGs to recruit relatives, neighbours and friends to join the scheme. The big difference lies in the fact that these persons were joining to get insurance, and did so on an individual voluntary basis. They therefore posed a much higher risk than SHG members who form groups for savings and loan purposes, and the insurance cover is just an extra benefit, one that they have to take on an all-or-nothing basis. Adverse selection risk is minimal for SHG members, but huge for non-members. SHEPHERD recognised this risk and has since restricted its non-member coverage to spouses only.

Livestock Insurance

For some time SHEPHERD had been running a livestock insurance scheme with UIIC. Unlike ASA's livestock insurance, which is compulsory for its milch animal loans, SHEPHERD's coverage is voluntary and some members even continue their coverage after they have repaid their loan. In roughly half of the cases of persons taking out a loan for livestock, they also buy to the insurance. According to field staff, some of the reasons why clients choose not subscribe to the insurance scheme include:

- **Cost**: The premium is a one time payment of 4% of the animal's initial value (as determined by a veterinarian and also serves as the sum assured), which typically amounts to Rs 400 ($9);

- **Money down the drain**: If the animal does not die, it is much harder to justify "losing" the large premium than the smaller ones for life and health insurance;
- **Term**: The current policy is for one-year of coverage, but some members want the flexibility to sell the animal during the course of the year;
- **Extra formalities**: The availability of the vet to prepare the paperwork and assess the health and value of the animal is an additional complication that may also deter potential policyholders; and
- **Claims problems**: The claims process also discourages demand, again, because the vet is not immediately available—people do not like keeping dead animals around their houses.

As shown in Table 6, SHEPHERD has experienced a sharp drop in livestock insurance. According to field staff, fewer people are buying cows due to the drought.

Table 6. SHEPHERD Cattle Insurance

Product Feature	Comment
Group or individual product	Group
Term	1 year
Eligibility requirements	Veterinarian certificate of health, immunization and valuation
Delivery model	Partner-agent with UIIC
Voluntary or compulsory	Voluntary
Product coverage (benefits)	Value of animal as determined by a vet (usually around Rs 10,000 ($222)) upon natural or accidental death
Key exclusions	Intentional death caused by owner
Pricing	Member pays 4 percent of the animal's value; 2.25 percent goes to the insurance partner
Number of policyholders	350 in 2001 302 in 2002 85 in 2003 134 in 2004

SHEPHERD runs cattle care camps, funded through a surcharge on each insurance policy, to promote the proper maintenance of animals and to provide free immunization and de-worming. These camps are for the general public, not just members, and they are not just for cows either—all animals are welcome. Besides preventing claims, the camps also serve as a recruitment or marketing vehicle. The veterinarian suggests to people that they should insure their animals, particularly those that are yielding a lot of milk.

To control for adverse selection, the vet must assess the health of the animal before the ear is tagged, which shows that the animal is insured. All of the policies are for one-year terms, which help to control for moral hazard, so it is unlikely that the animal's market value will drop significantly below the sum assured during that period. Moral hazard is also controlled by having the vet determine the cause of death to ensure that it was not due to neglect or abuse. Apparently, in Tamil Nadu, cows do not have any salvage value for religious reasons—the death of a cow is almost as important a community event as the death of a person. This suggests that the chance of fraud is quite low since the villagers are likely to know when and why someone's cow died, or did not die.

Accidental Death and Hospitalisation

Since its members clearly stated that their biggest concern was health expenses, in 2002 SHEPHERD approached various insurers to see how they might meet its clients' needs. This request proved difficult as there were no insurers with appropriate off-the-shelf products. In addition, the development of a new insurance product in India is costly because it needs to get regulatory approval through the submission of a "file and use" document, which requires actuarial projections of profitability and stability (among other things). Few insurers are willing to go through the effort for the small revenues of a microinsurance product.

SHEPHERD got lucky however, and found an insurer willing to collaborate, the government-owned United India Insurance Corporation. Having learned from its work with LIC the importance of having insurers meet with clients, SHEPHERD facilitated significant client interaction between its clients and UIIC. The insurer sent a small team to visit the organization and its clients in an effort to answer three main questions:

- What should the sum assured be, based on the average hospitalisation expenses that households had incurred and expected to incur?
- How much would households be willing to pay for the cover?
- Besides hospitalisation, what other types of cover would be important to people?

During the visit to SHEPHERD, the UIIC team was struck by the innocence of the clients; the field visits stimulated a strong desire by the insurers to assist. As the UIIC representative said, "by seeing them, it made us feel that we wanted to help these people." UIIC was quite clear that its primary motivation for partnering with SHEPHERD was to fulfil its regulatory obligation. However, this obligation can be fulfilled without going to the trouble of sending a four-person team to spend a week with an NGO to understand its clients, and assess the NGO's capacity and delivery methods.

Following this initial study, UIIC designed a bucket cover called UniMicro to provide benefits for hospitalisation, accidental death (including transport costs of the body), hut insurance, permanent disability, and a short-term allowance for lost wages for both disability and hospitalisation.

The health insurance component reimburses hospitalisation-related expenses; policyholders can go to the private hospital of their choice, as long as it has at least six beds, which reflects a minimum level of infrastructure and quality of care. The policy will also cover pre-expenses up to 30 days for treatments of an illness that leads to hospitalisation, as well as any post-expenses related to that same illness (i.e., follow-up outpatient visits, medication) for an additional 60 days.

UIIC presented three options to SHEPHERD: one just for the member, one for member and spouse, and a policy for a family of four. After consultation with its members, SHEPHERD decided to start with the member-only policy during the pilot phase since affordability was a major concern. Another option was whether to include child delivery in the policy; if it was included, the price would be roughly double and there would be a 9-month waiting period. The members chose not to include it primarily because of the extra cost, but also because it would only benefit some of the members. Members indicated that they could borrow from the Sugam for delivery expenses (see Box 3).

Box 3. Sugam Fund

The Sugam Fund is designed to assist pregnant women members of SHEPHERD. Capitalised by contributions from members along with a matching grant from FWWB, members can take a soft loan of Rs 2000 ($44) to 3000 ($55) from the fund. The money is kept at the block level federation so it can be easily accessible; the leadership of the SHGs is responsible for managing the fund. With every premium paid by the member, a Rs 5 ($0.11) contribution is made towards this fund so that it increases in value. The fund can also being utilised to provide support to the adolescent girls.

Besides child delivery, the UniMicro policy contains a number of exclusions, including pre-existing conditions that policyholders know about, injury or disease caused by war or invasions, as well as all expenses arising from or associated with HIV/AIDS. Glasses, contact lenses, hearing aids and dental treatments are not covered by the policy. During the first year of the cover, treatment for cataracts, hysterectomy, hernia, congenial internal diseases are not payable, but these are covered from the second year after. There is a 30-day waiting period for all hospitalisation costs except in the case of injury arising from an accident. Although pre-existing conditions were excluded, no medical tests are required for eligibility—insurance applicants merely need to sign a statement of good health

To develop the pricing for the UniMicro policy, UIIC pulled together bits of different covers into one product, although the core and the major expense is associated with the hospitalisation (see Table 7). Because of its volume, SHEPHERD could negotiate some discounts to the price, although from UIIC's perspective the pricing is on the conservative side since it would not want to cut its margins too tight when trying to serve a new and unfamiliar market.

Table 7. Pricing Components of UniMicro

	Premium
Personal Accident:	Rs 12 ($0.27)
Hospitalisation:	Rs 81 ($1.80)
Hut:	Rs 2.50 ($0.06)
Sub-Total:	Rs 95.50 ($2.12)
Less 5% Group Discount	Rs 4.75 ($0.11)
Sub-Total	Rs 91.03 ($2.02)
Less 15% Special Discount	Rs 13.65 ($0.30)
Total	Rs 77.38 ($1 72)
Add 8% service Tax	Rs 6.90 ($0.15)
Sub-Total	Rs 84.28 ($1.87)

One of the sticking points in the negotiation was the age brackets that UIIC proposed. Initially, the insurer wanted to offer a lower premium for members between 18 and 45, and charge those in the 46 to 60 age bracket a higher price. As is its custom, SHEPHERD took this proposal to its members and they voiced significant concerns, preferring instead for a uniform price. Given the complications that arise from trying to determine one's age in rural India, and the administrative costs and challenges of segregating policyholders into two categories, this was probably a fortunate choice. However, the combination of the bucket product and the uniform price created a sufficiently new insurance product to require regulatory approval from IRDA. Having gone to the trouble to get approval, UIIC is now marketing the product to other NGOs as well.

Table 8. SHEHPERD and UIIC's UniMicro Insurance Scheme

Product Feature	Comment
Group or individual product	Group—UniMicro Hospitalisation Insurance Scheme
Term	1 year
Eligibility requirements	Age 18 to 60 Declaration of good health
Delivery model	Partner-agent with UIIC
Voluntary or compulsory	Voluntary
Product coverage (benefits)	Rs 15,000 ($333) accidental death Rs 15,000 ($333) permanent disability Rs 250 ($5.55)/month up to max Rs 750 for subsistence allowance Rs 5,000 ($111) hospitalisation expenses Rs 5,000 ($111) for house fire and allied perils
Key exclusions	30 days waiting period (except for accidents); exclusions for the hospitalisation cover include childbirth, pre-existing conditions known by the policyholder, and HIV/AIDS
Pricing	Member pays Rs 100 ($2.22); Rs 84 ($1.87) goes to the insurance partner (an additional Rs 20 ($0.44) is charged for thatched roof houses)
Number of policyholders	401(2003) 5228 (2004)

Having learned from its LIC experience of the difficulties of claims management, UIIC and SHEPHERD established an Insurance Review Committee, consisting of five representatives from UIIC (2), insured members (2) and SHEPHERD (1). This committee meets at least once every two months to ensure that the underwriting procedures and claims management processes are properly implemented. If there are any problems, delays, rejections, etc., the committee will suggest measures to make the service more effective. The insurer has committed to settling claims within 15 days.

Customer Satisfaction

In SHEPHERD's initial experiences with the UniMicro product, it found greater receptivity among people who live closer to urban areas, where persons are more literate, more open to insurance, and have slightly higher incomes.

SHEPHERD has listened very carefully to its clients and has tried to meet their varied and complex needs. Its members certainly appreciate the efforts, especially its participatory approach—they really feel like SHEPHERD is responding to their concerns. Two changes in particular were direct responses to customer requests: 1) the life insurance coverage for their spouses, since that provides better security for the women and their children; and 2) the introduction of health insurance. It makes sense to the clients that the health insurance only covers hospitalisation—they can find little bits of money here and there for smaller health care expenses, but they have significant difficulty paying hospitalisation expenses. Their next request is to include other family members under the health insurance scheme, although they still have to asses the affordability of covering more persons.

The cost of the premiums does appear to be a problem for a small number of SHEPHERD's clients, although on closer examination the problem may stem from the fact that the premiums are paid annually and SHEPHERD does not have a mechanism to allow members to save up to pay the premiums. Certainly, SHGs could do this on their own, but they seem reluctant to do so and would need SHEPHERD to encourage them. Another possibility, although less attractive than saving up to pay the premium, would be a loan to pay it.

There seemed to be a wide range of client perceptions regarding insurance. Some definitely understood the idea of risk pooling and had strong feelings about their sense of solidarity: "if I don't benefit from insurance, my payment will go to help someone else in need." While others complained that they did not get any money back at the end of the year. This latter perception stems from the familiarity with LIC's endowment policies, which some of their husbands have.

It is unclear whether the sum assured of Rs 5,000 ($111) for a natural death is sufficient. Further research on the costs associated with death and how beneficiaries use the payout might be useful to shed more light on this issue. Some people are borrowing from friends, family and sometimes moneylenders, to pay for the difference between the benefit and their actual expenses. One of the purposes of life insurance should be to ensure that households are not poorer when someone dies, at least as it pertains to funeral costs (loss of income from a dead breadwinner is another matter). The sum assured should at least cover the funeral costs, and have something left over for children or to stimulate income generation.

Also related to the cost issue is people's willingness to spend money on insurance. One client said, "If I have income, I will not mind paying the premiums and not getting anything in return. But if money is tight, I will feel that I have wasted my Rs 100 ($2.22) if I do not go to the hospital that year."

4.3 SPANDANA's Microinsurance History

Of the three organizations, SPANDANA's insurance products are the simplest and evolved in the most straightforward way. SPANDANA's first move in microinsurance was in 1998, with LIC, with whom it partnered for a brief time. Like ASA and SHEPHERD, it found that LIC's products were unworkable in practice. In particular, SPANDANA found the claims process too onerous and ineffective. SPANDANA's solution to LIC's inadequacies was to offer insurance on its own. In addition to believing it could provide a better service without LIC, SPANDANA also believed that insurance was a good source of additional revenue.

SPANDANA used its experience with LIC to design its own insurance product. Using its mortality experience from the LIC product, which at the time was 1.5 deaths per thousand, SPANDANA decided to calculate a pure premium based up a more conservative estimate of 4 deaths per thousand—the latter rate being closer to the mortality rate used by most Indian insurers in their work with the poor. Unlike ASA and SHEPHERD, which are offering term insurance, SPANDANA's is essentially a credit life insurance on the disbursed loan amount, plus two additional benefits. SPANDANA added a small amount of hut insurance and then included members' spouses in the cover, although for a relatively low sum assured. The reason for the addition of these benefits was that management felt that the product was generating too much surplus. Instead of reducing the premium, SPANDANA decided to add benefits (see Table 9).

Table 9. SPANDANA's Life Insurance Product

Term	Loan Term
Eligibility requirements	SPANDANA borrower
Voluntary or compulsory	Compulsory
Product coverage (benefits)	• Loan amount if the borrower dies (less the outstanding balance) • Rs 5,000 ($111) if spouse dies • Rs 1,000 ($22) for hut damage
Pricing	1 percent of loan amount or Rs 50 ($1.11), which ever is higher

Being a non-registered insurer, the MFI could not obtain reinsurance, so it dealt with the threat of covariant risk in two ways. Firstly, SPANDANA has excluded death or destruction caused by epidemics or natural disasters. Secondly, it capped benefits. For example, for hut insurance, SPANDANA retained the risk in the case of a fire destroying many huts simultaneously, but caped the benefits at Rs 1,000 ($22) per member.

For borrowers to be eligible for the insurance coverage, they have to go through a screening process. They have to meet specific age criteria and they have to be accepted by the other members of their borrower group. Women can join up to age 55 and can continue participation indefinitely; there is no age limit on husbands. As these restrictions do not apply to their spouses, this lead to an adverse selection scenario in which women with sick husbands can join the scheme.

The scheme did indeed generate significant profits (despite the high claims rate for spouses). As a non-profit organization, SPANDANA ought to have redistributed the surplus to those that had paid the premiums, or used surplus as an insurance reserve—a particularly wise solution in the absence of reinsurance. Instead, SPANDANA, perhaps wishing to offer a similar insurance-scholarship combination as LIC's JBY product, took a rather unorthodox approach of using the funds to begin a scholarship scheme for some of its members. It advertised the scholarship and then interviewed vast numbers of applicants to make it selection. This was both a costly and inappropriate use of the funds. Essentially member's premiums were being used to pay for a scholarship scheme.

One of the greatest benefits of providing insurance in-house was the massive improvement in settling claims. In 2004, 73% of all claims were settled in 7 days. Because the loan officers settle claims themselves, there is a prospect of fraud. SPANDANA controls this risk by monitoring the claims managed by each loan officer and looking for unusual trends. It also conducts random audits on insurance claims.

5. Financial Results

5.1 In-house

When it established its in-house scheme, SPANDANA set the premium on its life policy without the assistance of an actuary. It set the premium at round figures, the greater of Rs 50 ($1.11) or 1% of the loan. The premium was loosely based on rate charged by LIC.

In March 2004, upon the strong suggestion of GTZ, SPANDANA contracted an actuary, Denis Garand, who for the first time developed an income statement for its insurance activities (see Table 13). In Garand's report, he concluded that with "an average loan of Rs 7,400 ($164), expected premium is Rs 74 ($1.64) per loan. Cost of claims is Rs 66 ($1.47) with administrative expenses at Rs 4 ($0.09), leaving a margin of Rs 4 ($0.09) per loan. In addition, the fund's assets are invested, earning Rs 4 ($0.09) for the fund." As can be seen in the income statement (Table 10), SPANDANA was generating a profit on its insurance scheme.

Table 10. Income Statement for SPANDANA's Insurance Fund (Year ending Feb-2004)

	Rupees	% of Earned Premium
Premium	7,642,550	169%
Unearned premiums[16]	3,125,062	69%
Earned premium	**4,517,488**	100%
Investment earnings	677,106	15%
Total income	**5,194,594**	115%
Claims Paid	3,966,000	88%
Change in IBNR	130,000	3%
Incurred claims	**4,096,000**	91%
Direct expenses	90,000	2%
Indirect expenses	100,000	2%
Total expenditures	**4,286,000**	95%
Net income	908,594	20%

5.2 Partner-agent

The premiums on the current products of SHEPHERD and ASA were set by actuaries, although the price may be distorted because of the pressure to meet rural and social sector obligations. The insurers indicated that they just want to break even with their rural and social policies, although it is conceivable that they may be willing to accept small losses as a cost of doing business.

[16] For policies that remain in-force, a portion premium must be reserved for claims that might occur on those policies in the future. It is called the Unearned Premium Reserve (UPR).

In the partner-agent model, when speaking of the financial success or failure of programmes, one needs to consider the financial impact for the insurer *and* the agent. Although it is usually difficult to get financial details from the insurers, Bajaj Allianz was forthcoming with results on its policy with ASA. At the end of 2004, the insurer had received Rs 2,086,848 in premiums and the total claims payment were Rs 1,220,000. After deducting 22.5 percent of premiums for expenses—commission to ASA 7. 5%, administrative expenses and profit assumption 15.5%—the insurer still has 19 percent of premiums as additional profits.

The other set of costs that need to be considered are the expenses incurred by the MFIs. Are they are earning enough from commission (or premium loadings) to cover their delivery costs. Based on data from ASA, Table 14 provides an overview of the costs associated with delivering its insurance products. Table 15 then compares the amount of premium that it keeps with the costs to assess the product profitability.

Table 11. ASA's Cost per Policy (January 2005)

Category	Annual Expense (Rs)	Annual Expense (US$)
Staff Costs	1,500,000	33,333
Non-staff costs (e.g., stationary, rent, computers)	1,460,000	32,445
Branch incentive fee	1,325,250	29,450
Total Annual costs for all policies	**4,285,250**	**95,228**
Total number of policies sold	53,010	
Total servicing cost per member	**Rs 80.84**	**$1.80**

Table 12. ASA's Profit/Loss per Policy (January 2005)

Insurance Company	A) Premium Received from the client	B) Premium retained to cover expenses	C) Profit or loss per policy (Column B – Rs 80.84)	D) No. of policies	E) Profit or loss on all policies (Rs)	F) Profit or loss on all policies ($)
AMP-Sanmar	125	89	8.16	26,444	215,822	4,796
Allianz Bajaj	125	89	8.16	18,218	148,686	3,304
Max New York	125	75	-5.84	8,348	-48,740	-1,083
Totals				**53,010**	**315,768**	**7,017**

As shown in Table 12, despite loading the premium by almost three times the amount it hands over to the insurance company, ASA's surplus is very modest. Indeed if ASA were to charge clients Rs 10 ($0.22) less per policy, it would have made a loss of over $4700.

Unlike ASA, SHEPHERD does not maintain separate accounts for its microinsurance products. More importantly, SHEPHERD does not try to cover its costs at the moment, although it hopes to in the medium term. It loaded a small amount on some policies, Rs 5 ($0.11) as a fee that would go to the sellers of the policies, and another Rs 5 ($0.11) to pay for prevention activities like the health care camps. SHEPHERD's approach is to provide insurance at the lowest possible cost, to avoid undue hardship for its poor customers. Therefore, unlike the other MFIs, for the time being, it is almost entirely dependent on donor funding to generate revenues for its own administrative expenses. Its current pricing arrangement covers claims costs, but it does not cover the costs of sales and servicing.

5.3 Pricing Lessons

Without actuarial calculations, premiums are either likely to be set too high—which means that clients are getting poor value for money—or too low, which can place the entire scheme in jeopardy.

Without an accurate costing analysis, an MFI will not be able to determine how much it needs to earn, in commission or through premium loadings, to cover its administrative expenses. While ASA’s loading seems high, it just covers its costs. SHEPHERD on the other hand is at the mercy of donors to subsidize its insurance activities because it is not yet earning a sufficient commission.

Setting the premium too low initially is probably far worse than setting it too high. For example, it would probably easier for SPANDANA to lower its premiums (or provide more benefits, which it has done) than for SHEPHERD to raise its premiums—clients accustomed to premiums subsidized by donors may (at least at first) be unwilling to pay a cost-covering price.

These MFIs have used two ways to generate income for themselves: through commissions from the insurer and by loading the premium charged to the client. It is unclear which is more appropriate, although the insurance regulator would probably prefer the commission approach. Insurers pay a fee to the regulator based on total premiums collected; but if premiums collected by the MFI are not remitted to the insurer, then the regulator will not see its portion.

Pricing is not only a problem for MFIs, but also for insurance providers. They do not have specific data for the microinsurance target market, so instead they price their products based on projections from the Indian population in general. The difference between coverage from insurers and an MFI’s in-house scheme is that for the former, some small losses on its microinsurance portfolio can easily be covered by its other commercial business (or in the case of LIC, by accessing government funding as a reserve). In contrast, the MFI cannot afford to lose money on its insurance scheme, so it has to price more conservatively and hence overcharge its customers, as appears to be the case with SPANDANA.

6. Conclusions

This section revisits key questions presented in the introduction and tries to answer them using the evidence from three MFIs.

6.1 Mission, Vision and Outcomes

What impact did the organization's mission and vision have on its insurance provision?

While on the surface all three organizations have similar missions and are serving similar target markets, in practice they have very different approaches. SPANDANA has adopted a minimalist approach, at least by Indian standards, focusing on reaching as many people as possible, with dramatic results. In sharp contrast, SHEPHERD has a comprehensive approach that equally emphasizes risk management and income-generation. While the poverty alleviation impact of SHEPHERD's efforts may be greater than SPANDANA's, SHEPHERD's approach is only benefiting a relatively small number of people. Between them, the two organizations clearly demonstrate the depth versus breadth dilemma.

ASA falls somewhere in between, perhaps striking a balance between the two. It is engaged in numerous non-financial activities of a diverse and perhaps not always coordinated nature. Yet by establishing Grama Vidiyal Trust, a separate organizational structure for microfinance, it has been able to focus that effort on achieving scale.

How do their motivations affect the type of insurance that they offer?

These organizational characteristics have a significant bearing on the types of insurance that they offer. Consistent with its minimalist approach, SPANDANA's insurance coverage is quite basic, with an emphasis on credit life. While motivated to assist its customers, the organization has not gone out of its way to develop an appropriate insurance product. For example, once it realized that it was generating a significant surplus, rather than reducing the premium, it created a scholarship scheme that generates positive public relations but does not benefit the people paying the premiums.

ASA's motivations for offering life insurance appear to be evenly divided between helping the family to repay the loan and assisting the household to cope during a crisis, at least that is what Sathianathan Devaraj and his senior managers say. In practice, the coverage that ASA offers is not significantly different from SPANDANA (although ASA's is cheaper and has a larger sum assured), with most of the attention focused on a term life product for members (not even for spouses). This is beginning to change as ASA is embracing a broader approach, including spouse coverage, pension, and even health insurance. ASA recognizes that clients have lots of needs, but they cannot afford to have protection for everything. According to Sathianathan Deveraj, the challenge for the MFI and its clients is to figure out the most cost-effective solutions to their primary problems.

True to form, SHEPHERD's commitment to its members' diverse needs has resulted in a range of insurance products covering a variety of insured events, including death, disability, livestock death, house fire, and hospitalization among others. Perhaps more impressive than its menu of insurance products, is its clear emphasis on providing voluntary coverage, to let members choose which life insurance product works best for them. While such an approach comes with challenges, including higher transaction costs and vulnerability to adverse selection, it is nevertheless commendable.

Organizations often treat their mission and vision statements as PR documents. These cases demonstrate, however, that the MFIs' mission and vision significantly influenced which products were selected and how they chose to sell and service them. When internalized by staff, mission and vision statements help ensure consistent decision-making with respect to the choice of insurance products and delivery mechanisms.

There appears to be a trade-off between reaching many people with a simple (mandatory) product and reaching fewer people with more complex, varied, and voluntary insurance.

SHEPHERD's mission also encouraged the organization to invest in prevention strategies, such as cattle and health camps. While the NGO did not introduce these events to reduce claims, they probably have that effect. Indeed, prevention strategies are an area that is not given sufficient attention by many MFIs and microinsurers.

How did the MFIs' insurance schemes cater for the special needs of women and children?

These organizations all work exclusively with women; however, that does not mean that their insurance products are designed to meet the needs of women. While life insurance coverage for members shows poor women that their lives have value, it does not really help them directly—besides providing peace of mind—since they have to die to benefit.

For that peace of mind to be legitimate, a woman must have the freedom to name a beneficiary that she can trust to use the funds according to her wishes. Unfortunately, that is not always the spouse. The researchers encountered a number of narratives about husbands who used the benefit to pay for a new wife (for example). To avoid this problem, some women list their children, particularly daughters, as nominees, under the expectation that the benefit would pay for their education or wedding.

MFIs should examine who is likely to receive the benefit. By encouraging practices that ensure that children receive the benefit, the product could be more attractive to women. An additional benefit is that if the husband is not the nominee, it also reduces the potential moral hazard problem of husbands killing their wives for the benefit.

Perhaps the biggest issue is that women should be able to benefit directly through coverage of their spouses. Based on feedback from their members, both SHEPHERD and SPANDANA have addressed this issue, and ASA is in the process of doing so. Indeed, for organizations that are serious about their mission to empower women, assistance to widows should be among the top priorities. In many societies, widows are the most vulnerable segments of the population as most or all of their legal and social status was conveyed through their husbands. Insurance covering their spouses' lives will not solve the problem, but it is a start.

For women to really benefit from life insurance, the coverage should be on the lives of their husbands.

When considering the special needs of women, it is important to understand how risks affect women differently than men. From the experience of these organizations, men tend to be more vulnerable to accidents, because of the type of work that they are involved in, whereas women tend to be more vulnerable to illnesses due to poor nutrition and gynaecological problems. Consequently, SHEPHERD's entry into health coverage can be seen as a response to women's needs, especially since, for now, it just covers the members.

Insufficient property rights for women and little control over assets hampers the success of property insurance such as huts or livestock. This problem cannot be solved through microinsurance alone, but has to be complemented by strengthening the role of women and registering the property in their name. These organizations address these issues in the context of their empowerment programs.

6.2 Delivery Mechanisms

What was the rationale for selecting particular delivery models?

One might expect that SPANDANA, with its relentless drive to achieve scale and efficiency, would prefer to partner with an insurance company rather than be distracted from its core business. There are two ways that SPANDANA justifies the in-house approach. First, insurance is not a separate product, but rather a benefit of the loan product. Members can only get insurance when they have a loan, so it is a component of the core business. The other justification is that the insurance scheme is a money maker, so why should it share the proceeds with an insurance company?

ASA has the answer to that question. It has flip-flopped between the partner-agent and full-service models several times over the years, sometimes even combining the two, but now appears firmly committed to partnering with insurance companies. Part of this commitment is due to its experience; it recognizes the risks of in-house insurance without reinsurance. Another factor, perhaps, is that ASA has had enough experience with insurance partners that it now knows what to ask for and how to manage the relationship—and it has the volumes to be a little demanding. As a result, ASA has designed its own product to meet its needs, generate a little bit of income, and let someone else take the risk.

What is perhaps missing from ASA's approach, which comes through so clearly with SHEPHERD, is a link or coordination between the financial and non-financial activities.

SHEPHERD's reliance on the partner-agent model—which builds on existing structures rather than creating new ones—is consistent with the organization's vision of itself. SHEPHERD sees itself as a facilitator of services, both financial and non-financial. Only in situations where it cannot find appropriate services for its members, will it actually provide the services. Even then, it might rather help the members to create a fund to meet their own needs, like the Sugam Fund, instead of SHEPHERD providing the services. The two challenges to the facilitation (rather than institutionalization) approach are: a) can the model be designed to cover SHEPHERD's costs through commissions or facilitation fees; and b) is this an approach that can be taken to scale? At present, its costs are not being met and the scale is limited.

What were the consequences of their delivery model choices?

At some point in their histories, all three organizations provided microinsurance in cooperation with LIC. When they experienced difficulties, they each had a different solution.

SPANDANA decided to go ahead on its own, assuming that it could be more effective and efficient. It has generally been successful, although its product provides fewer benefits for more rupees. That said, SPANDANA has yet to experience a covariant event that is not excluded. It remains to be seen how it would cope with such a situation.

ASA initially followed a similar logic, but its experience with self-insurance has led it back to the partner-agent model. Then it started cycling through partners, looking for one that met its needs and dropping those that did not. This process caused some confusion among clients and staff. ASA has, however, used it size to negotiate good deals from insurers, and appears to be settling down—although it is unclear what advantages are gained by partnering with three insurers all offering the same product. The most reasonable explanation is that it wanted to create competition between the insurers so that it could ensure excellent service from them. Since that does not seem to be the case, and claims payments are not as efficient as the MFI had hoped, another possible explanation is that the insurers only wanted to cover a certain number of clients to meet their quotas.

SHEPHERD stuck with the partner-agent model from the start. It has sought to improve the situation with its insurance partners through discussions and observations visits. SHEPHERD seems to have succeeded in establishing constructive working relationships with state insurers, both LIC and UIIC, and has gotten them to work toward achieving service standards.

SPANDANA's main reasons for selling insurance in-house were because the MFI believed it to be more profitable and because LIC was an unreasonable partner. By changing partners or by building relationships with them, ASA and SHEPHERD are overcoming the difficulties of slow claims payments and receiving benefits in a form that is useful to clients (i.e., not a crossed cheque).

There is therefore little to justify SPANDANA's selection of in-house insurance, especially as it operates in a legal vacuum and is vulnerable to some covariant risks. In India, where insurers are legally compelled to sell insurance to low-income clients, it is difficult to see the advantages of an MFI selling insurance in-house.

How have delivery model choices impacted upon organizational efficiency?

In SPANDANA's case, there are minimal operational costs for insurance because it is mandatory and integrated into the loan delivery system. Besides a brief explanation of the insurance benefits to borrowers, the only additional work is verifying and processing claims. Even claims processing is not too onerous, on the MFI or on the client, because it is processed in-house so its requirements are streamlined. Consequently, because SPANDANA offers a simple product on its own, it is very inexpensive to deliver and servicing can be quite responsive—73 percent of claims paid in a week is a very impressive result.

ASA's management of its partnerships proved highly disruptive and inefficient, but this was for the most part a consequence of its rapid cycling between partners rather than something inherent in the partnership process. While it is excellent that ASA knows what it wants and calls the shots, the frequent changes to its products and partners have created administrative and marketing challenges.

As for SHEPHERD, its experience shows that it is possible to work with an insurer to develop an efficient relationship. SHEPHERD unfortunately has not focused on maximizing efficiency in general, which perhaps reflects its NGO culture, its participatory approach and its comprehensive effort to meet clients' needs. It is pretty difficult to provide a range of financial and non-financial services in an efficient manner to large numbers of people.

The UniMicro product is a good example. While it offers valuable benefits, which have been vetted with customers for their feedback and customization, it is still a complex product that is difficult to explain. The marketing challenges are complicated by the fact that it is introduced in the context of SHEPHERD's myriad of risk management services, including three life insurance options, cattle insurance, the Sugam Fund, multipurpose loans, etc.

In all likelihood—although there is no evidence to back this up—field staff probably explain a fraction of UniMicro's benefits, exclusions and procedures. If staff do not mention certain benefits, then clients will not claim those benefits if the insured event occurs. If staff do not explain the procedures, and if clients are not given something in writing that they can refer to, then the process of making claims is also likely to be extremely inefficient for all involved.

The reasons for efficiency and inefficiency were less dependent on the delivery model than the simplicity of the product or product menu. While the partner-agent model can be made more efficient over time through relationship management, the products have to be straightforward and the MFI has to assume responsibility for claims processing.

Can claims processing in the partner-agent model work properly?

The experience from these MFIs highlights claims processing as the weak link in the partner-agent model. Claims documentation is burdensome, often requiring un-receipted fees to government officials; processing can take months; claims are rejected for reasons beyond the control of the MFI or the clients (e.g., names are misspelled on official documents due to an ancient typographical error); claims are rejected due inappropriate exclusions (e.g., snakebites are not accidents?); claims are downgraded from accidental to natural deaths (seemingly) arbitrarily, without clear appeals processes; payouts could not be cashed because the beneficiary was a minor or did not have a savings account…the list could go on and on without exaggerating the difficulties, and the frustrations, for MFIs and their clients.

Such problems are likely to continue as long as insurers think like insurers and not *micro*insurers. Microinsurers recognise that fraud and moral hazard can be controlled through the involvement of the community in assessing the claim; they know that official documentation—which can be bought—is not any more valid than a letter from a respected member of the community. Microinsurers appreciate the public relations damage that can occur among policyholders—who already lack confidence in insurance—when claims are delayed or rejected. Microinsurers realise that claims for small sums assured to not justify laborious and expensive processing procedures.

To help its insurance partners understand *micro*insurance, SHEPHERD invited LIC and UIIC to visit members and get to know their needs. This step has gone a long way toward warming the relationship, and making claims processing personal rather than bureaucratic. SHEPHERD's other innovation was the creation of the Insurance Review Committee to identify and solve problems in claims processing.

Perhaps most importantly, SHEPHERD has convinced LIC to let the MFI pay the claims and then be reimbursed, which significantly expedites claims processing. In fact, to streamline the process, the insurer has even helped to create a management information system for the MFI.

In the partner-agent model, to get good products and processes at a decent price, MFIs need to know what they want and they have to take the driver's seat in the negotiations. While the rural and social obligations certainly biases negotiations in the favour of Indian MFIs, still they need to drive a hard bargain and demand the features that are most critical to the success of the relationship—the more clients they have, the more demanding they can be. An efficient claims processing system is one of the most important points for negotiation, and MFIs should insist that they pay the claims based on documentation that is appropriate for their clients.

How can MFIs overcome the market's natural reluctance to purchase insurance?

There are perhaps three marketing and customer education lessons from these organizations. Firstly, when a claim is paid, the MFI arranges a special ceremony to make a spectacle, sometimes even involving the District Collector or other local officials, to demonstrate to others that they are true to their word. This event creates significant public relations value and word-of-mouth marketing.

Secondly, in the case of SHEPHERD, it involved the UIIC and LIC in client interaction. The insurers regularly visited villages. The broad purpose of the visits was information dissemination and awareness building about the insurance company and its products. In particular, they helped clarify issues of claims settlement, rejections, exclusions, etc. This proved an effective marketing tool and an informal capacity-building exercise for the MFI's field staff.

The third marketing strategy was also used by SHEPHERD—it is not surprising that the marketing lessons come primarily from the only one that offers voluntary insurance. Through its cattle and health camps, the NGO is able to market its services to non-members who may come to have their animals or themselves inspected by vets and doctors, respectively.

6.3 Product Design

How did MFIs design their products?

In practice, many MFIs start with life insurance because it is relatively easy to provide and it directly meets the MFIs' needs to control credit risk for borrower death. Often what happens, as in the case of ASA and SPANDANA, is that the organization continues to supply life insurance because there is a demand for it and it has a history of providing it.

Yet it may make sense to evaluate whether life insurance is actually the most needed of insurance products and if other products might also be appropriate. From what little demand research has been done, there seems to be a disconnection between the clients' needs and the types of insurance being provided. The evidence suggests that health insurance is the greatest priority. Thus far, only SHEPHERD is addressing this issue, although the other two organizations are exploring the possibilities.

Interestingly, neither ASA nor SHEPHERD has credit life insurance. If a borrower dies with an outstanding loan, the benefit goes to the family and they are supposed to repay the debt. Consequently, the benefit amounts that they offer have to be discounted to some extent since the beneficiary is likely to repay some amount to the lender.

To ensure that it has the right product or product features for its clients, SHEPHERD has a strong commitment to involving its members in the product development process. For example, the members made significant contributions to determining the benefits of the UniMicro health insurance product and even influencing the pricing structure (e.g., uniform pricing for all members).

Of course, health insurance is one of the most difficult products to offer, so the organizations' reluctance to enter this field is well founded. UniMicro is a hospitalization coverage, and not comprehensive health insurance, but it is a start. More importantly, it helps households to cope with the large expenses that they could not deal with on their own. By limiting the benefits to hospitalization, the UniMicro product is affordable to the poor.

> It makes sense for MFIs to start with a simple life policy to learn about insurance. However, once MFIs have learnt about insurance and have knowledge about how to manage insurance risks, then it makes sense to move on and provide coverage that better meets clients' needs.

> While the link between insurance and the loan can significantly improve efficiencies, such as reducing administrative expenses, it also has significant limitations. Of the three, only SHEPHERD has concluded that insurance should not be linked to microcredit since risks can happen when people do not have an outstanding loan.

What is the right sum assured amount?

Over the years, the term life insurance benefit for these organizations has ranged from Rs 500 (ASA's first product) to Rs 50,000 for the JBY accidental death benefit. This wide spread suggests that the organizations do not have a good handle on benefit that their members actually want and are more concerned with keeping the price low. Life insurance benefits, however, are not just a function of the price. When a breadwinner dies, households need different amounts of money to cope with the situation. Ideally, the households should have an opportunity to choose which benefit suits their needs. SHEPHERD's array of life insurance options is a step in this direction. It is also important to recognise that some of the benefit is repaying the loan, so the beneficiary cannot use the full sum assured.

> To get the product right, MFIs have to know what clients need and are willing to pay for. It is also important to recognise that the target market is heterogeneous, so it is wise to offer a couple of different options of sum assured amounts as long as it does not overly complicate the marketing message.

How can MFIs collect premium payments to maximise renewals, minimise costs, and still provide customer value?

The most efficient way to collect premiums is to link the insurance with a loan so that premium collection occurs at disbursement. But such an arrangement goes against the customer value agenda since policyholders have to have a loan to have insurance.

Insurers in India often require annual or bi-annual premium payments. This can be a problem for those using the partner-agent model as their clients often have small amounts of money, but not large lump sums. ASA's Capital Insurance Fund was an interesting strategy for overcoming this problem. Even though it did not work, it does not mean that the approach was fundamentally flawed. The idea was to reduce the transaction costs of collecting annual premiums by having clients deposit a larger sum with the organization, and then the interest on that account would pay for the premiums. With proper actuarial analysis, an effective MIS to monitor the situation, and appropriate investment options (i.e., besides the MFI's loan portfolio), such an arrangement certainly deserves a further look.

Changing products – are riders a prudent way to go?

Adding riders to a product is a seemingly easy way to modify a product without requiring significant administrative changes. Riders also ostensibly have marketing advantages. For example, many life insurance products provide a higher sum assured for accidental deaths. This allows the insurer to claim that its product has a big benefit in its advertisements, but in reality, beneficiaries rarely receive the large amount. In practice, this approach can have negative effects by misleading clients into thinking that the benefits are greater than they are, and clients and their beneficiaries may feel cheated.

Although on the surface such a rider may appear easy to administer, this was not the case in ASA's experience. In its most recent life product, it eliminated the distinction between natural and accidental deaths because it was so difficult for claimants to prove an accidental death.

> MFIs should only include benefits that their clients can claim without difficulty.

Both SPANDANA and SHEPHERD have a hut insurance rider on their products. Ideally, policyholders would have the option to choose which benefits they want based on transparent pricing for individual components. That is not currently the situation, perhaps because the additional marketing and administrative work involved would reduce the viability of the products. It is unclear whether there were significant marketing advantages to the hut rider.

SPANDANA added a spousal coverage to its life insurance product, but without underwriting the spouses. The result was adverse selection with claims on the spousal rider proportionally much higher than claims on the main policyholder.

> In general, simple products work best because they tend to be easier to administer and easier for clients to understand. Adding riders is fraught with difficulties. Even small riders may can have large consequences, as is the case of the high claims rates of SPANDANA's spouses.

How did they control their adverse selection risks?

The primary mechanism these organizations use to control for adverse selection risks is by offering coverage to their clients who have come to them for loans. The credit screening done by the MFI or peer group can be used as a proxy for insurance underwriting. SPANDANA and ASA controlled for adverse selection by making the product mandatory. In SHEPHERD's case, the products are voluntary, but enrolment is all-or-nothing at the group level, which controls adverse selection. SHEPHERD got into potential problems with adverse selection, however, when it sold policies to individuals who were not in the SHGs. Finally, by selling life insurance policies to its existing clients, it is not necessary to exclude pre-existing medical conditions, a common means of protecting against adverse selection, although a waiting period is prudent.

One of the main advantages for insurers to partner with an MFI, as opposed to an organization that does not lend, is that its credit screening can be a proxy for life insurance underwriting.

How did they control their moral hazard risks?

Some of the life insurance products have exclusions for suicide to control for moral hazard. A common method in rural India of committing suicide is by causing a snakebite or by drowning. In several policies, these causes of death are excluded, but the exclusions proved unpopular when deaths occurred by unintentional drowning or accidental snakebites. These exclusions worked to the disadvantage of the MFIs. If the insurer rejected a claim because of an exclusion clause, the MFI had to be the bearer of bad news to the bereaved family. Not only does the MFI have to tell the family that the claim was rejected, but then it also has to ask the family to repay the loan. This is another argument in support of keeping products simple.

The experience suggests that, in the partner-agent model, MFIs should try to persuade insurers to drop as many exclusions as possible, and even pay a higher price for it if necessary. ASA has succeeded in negotiating such an arrangement with its current partners.

In most parts of the world, cattle insurance is usually infested with moral hazard problems. Most frequently, if the value of the cattle drops below the benefit then an incentive is created to let the insured animal die. The cattle insurance of both ASA and SHEPHERD proved relatively successful. It would be unwise to draw any global conclusions from this case study, however, because of the specific religious compulsion to care for cattle. In places where religious compulsion to look after cattle is weaker or non-existent, the schemes as devised by ASA and SHEPHERD may not work.

What were the fraud risks and how did they control for them?

Fraud in cattle insurance is usually a massive problem, but again, in rural Southern India, the religious significance of cattle make it difficult to engage in fraudulent acts, such pretending that cattle were stolen when in fact they were slaughtered or lent to a neighbour. In addition, groups members know each other and each other's possessions, including cattle (especially since they do not own very many). Thus fraud with a cow would not be unnoticed—which is different to goats, as even poor families sometimes own a large herds of goats. Furthermore, cattle are tagged and photographed which makes fraud complicated.

The risk of fraudulent claims in life insurance is relatively low because it is hard to fake a death, especially in a rural community where people tend to know one another. None of the organizations reported much experience of fraud from staff, except for SPANDANA, which dealt with the problem by monitoring the loan officers' claims, looking for unusually large numbers of claims.

One unusual fraud experienced by ASA was caused by the insurer. In the late 1990s, the MFI opened up a new branch and the branch manager negotiated a life insurance relationship with a local agent of New India Assurance. The agent pocketed the cash premiums that were paid to him, not forwarding any on to the insurance company. This fraudulent behaviour only came to light several months later, after ASA tried to figure out why claims were not being paid. ASA cautions others to beware of unscrupulous agents and recommends that MFIs pay premiums directly to the insurance company, not to agents, through demand drafts, not in cash.

Appendix 1. Social Security Schemes in India

Contingency	Public Employees	Private Sector Workers	The General Poor	Comment
Medical Care	Free treatment in state hospitals and drugs	Free treatment in Employees State Insurance hospitals and dispensaries; reimbursement of drugs	Treatment in public hospitals. Free supply to a limited extent of through primary health centres	The quality of care is low, so low in fact that there is a massive private health care industry
Sickness	Medical leave on Full Pay for up to 2 years in a 3 year period	Same if covered under the ESI	Nil	Since many Indians fall into the general poor, loss of income form sickness remains a significant concern.
Maternity	Maternity leave 12 weeks on full pay	Same if covered under ESI or the MBA	Social Assistance under the National Social Assistance Programme	
Unemploy-ment	Retrenchment benefits under Renewal Fund for employees of public sector enterprises	Retrenchment benefits under the Industrial Disputes Act	Public employment generation schemes	
Work related injury	*Ex-gratia* relief plus benefits under the ESI and the Workmen's Compensation Act	ESI and the Workmen's Compensation Act	Social Assistance from welfare funds for those engaged in hazardous occupations in certain states	
Invalidity	*Ex-gratia* relief plus benefits under the ESI and the Workmen's Compensation Act	ESI and the Workmen's Compensation Act	Pensions for the physically handicapped in certain states	
Old-age	Pension and Gratuity or contributory provident fund and gratuity	Payments under the Employees' Pension Scheme, 1995 and under Payment of Gratuity Act	Old age pensions provided under the NSAP and state governments for the destitute poor	EPF payments described as " woefully inadequate to meet any kind of retirement need… offer no protection against inflation… contributions made by employer on employees behalf cannot be claimed by employee" (Outlook Money, 2003)
Survivor (widow, orphan)	Subsidised group insurance for death while in service; family pension in the case of death after retirement	Deposit Linked Insurance and Family pensions under the EPF	Subsidised life insurance under the NSAP and limited accident cover available; survivor benefit and relief schemes available in certain states; pensions for windows in each of the states; compensation under the Motor Vehicles Act	

Adapted from Ginneken 1998