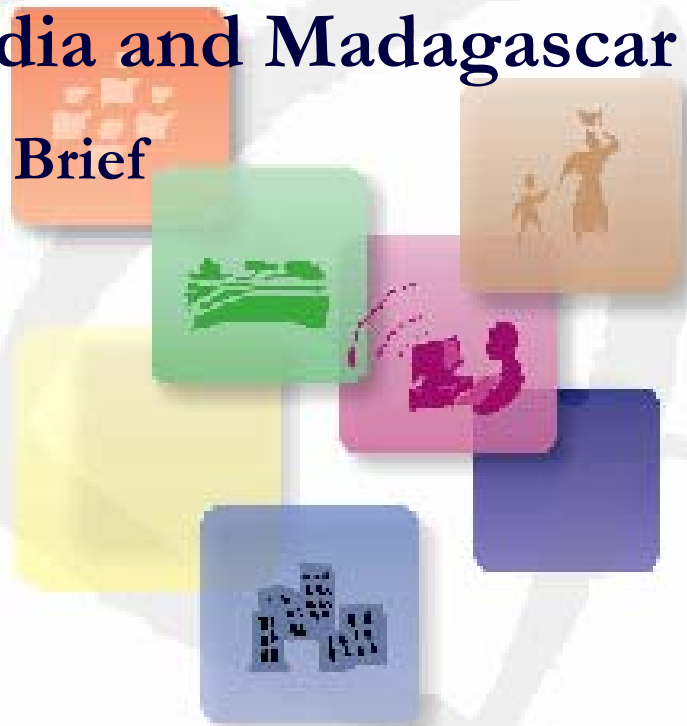


Towards a Policy that Pairs Micro-credit and Micro- Insurance Tools. What Impacts on the Fight Against Poverty and Risk Management?

**Lessons Learned from Experiences
in India and Madagascar**

Policy Brief



Towards a Policy that Pairs Micro-credit and Micro-Insurance Tools. What Impacts on the Fight Against Poverty and Risk Management? Lessons Learned from Experiences in India and Madagascar

Policy Brief

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For the

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1. SUMMARY

Microcredit and micro-insurance, considered within the larger microfinance current, are two risk management tools currently being developed by governments and international development agencies to reduce vulnerability associated with poverty in rural areas. Discussions about credit protection increasingly invoke the need to create linkages with insurance services that are tailored to the risks rural people in developing countries face. Once a country's financial and banking sectors have been developed, the pairing of these two instruments could do one of two things. It may present a veritable opportunity to emerge from the vicious cycle of poverty, or it may introduce an additional risk factor for the financial institutions that have developed this combination or the beneficiaries could risk becoming trapped in the new dynamics of excessive debt.

Based on experiences involving risk management in two countries, India, the champion of microfinance and Madagascar, whose banking sector is still very limited, this policy brief will venture to propose the arguments necessary in illustrating our point. Finally, we will demonstrate several risk transfer strategies, each differing according to the development level of the banking sector of the countries in question, which can serve as complementary elements to microcredit as a risk management tool.

2. INTRODUCTION

Objectives

The main objectives of this policy brief are to present the experiences of two very different countries, India and Madagascar, in microfinance. This brief specifically deals with the linking of microcredit and micro-insurance policies as an effective strategy for risk management, as well as the various ways in which this can be implemented, according to the characteristics of the country, the risks involved and the needs of beneficiaries. By providing examples of a variety of different mechanisms that make this linking possible, this brief aims to conclude that for each situation it is possible to tailor a risk transfer and risk management strategy by building partnerships among NGOs, the public/private sectors, donors, government and microfinance institutions in line with the development objectives of the country.

Target Audience

National Policy makers and Sector decision makers of developing countries who deal with agriculture, rural development, climate change adaptation and risk management

Required background

A basic understanding of microfinance, credit markets and economic risks would be helpful to provide the context and framework for this policy brief, especially as it relates to the rural poor in developing countries. However, it is not necessary to have a technical background in finance or economics to grasp the ideas and examples put forth in this paper.

Readers can follow links included in the text to other EASYPol modules or references¹. See also the list of EASYPol links included at the end of this policy brief.

3. MICROFINANCE AND RISK MANAGEMENT: ORIGINS AND DEVELOPMENT CONSTRAINTS IN RURAL AREAS

3.1. Microfinance, a risk management tool

Microfinance, encompassing a wide range of financial products offered to people in developing countries who until now have been excluded from formal banking and insurance systems, is now considered by international development agencies to be the flagship instrument in terms of risk management and the fight against poverty. Indeed, microfinance, the progressive expansion of microcredit into services including savings, insurance (on harvests, livestock, assets, life or health), means of payment and money transfers, would enable households to reduce their vulnerability to risk. In particular, credit increases the capacity of rural households to cope with shocks. It does this by providing an alternative to adopting “emergency strategies” such as the sale of their means of production or removing children from school. Other expensive and ineffective risk reduction strategies include sustaining one’s self by consuming proportionally high levels of one’s own crops, in turn grown in mediocre production conditions, or the accumulation of capital as savings with no added value (i.e. livestock, cash). Through microfinance, individuals would no longer have to “choose” relative poverty (a less risky but less profitable choice) and would be able to take on higher-yield activities.²

Ex-ante risk management measures (such as microfinance products) would indeed provide incentives in addition to the necessary means to reduce the impact of the risks vulnerable individuals face. Microfinance appears to represent a powerfully empowering instrument for individuals because it supports self-insurance through saving, allows access to credit, promotes the sharing of risk within communities and introduces insurance products designed for difficult circumstances. Having said this, it is not a fixed or perfect model. It will necessarily take different forms, which in turn will be more or less efficient depending on the level of the country’s financial system development and will exhibit varying limitations as a result of its resultant characteristics. The points made in this paper will be illustrated through the case studies of India and the island of Madagascar. We begin with the origins of the term ‘microfinance’ and its stages of development. In the second section, we will scrutinize the potential that a combination of microcredit and micro-insurance tools have in the context of the fight against poverty and risk management. The last section will attempt to widen the topic by determining different risk transfer strategies that can be adapted to the specific conditions of particular countries, beginning with microfinance.

¹ EASYPol hyperlinks are shown in blue, as follows:

- a) training paths are shown in **underlined bold font**
- b) other EASYPol modules or complementary EASYPol materials are in ***bold underlined italics***;
- c) links to the glossary are in **bold**; and
- d) external links are in *italics*.

² Dercon S., 2001.

3.2. Origins of microfinance: Stages relative to more or less developed financial systems. Examples of Madagascar and India

The microfinance industry has changed dramatically over the last twenty years. Indeed, at the end of the 1980's the term microcredit was used, not microfinance. At that time, the emphasis was placed on two things:

- the granting of reduced-price loans to small businesses in order to stimulate income-generation and job creation, and
- the ability of this tool to allow people to be autonomous as a result of its self-sufficient and sustainable characteristics.

Later on, organizations providing microcredit reconsidered the role they were playing as they realised that credit alone was insufficient to enable small business owners to achieve their development objectives. Indeed, credit alone will not necessarily allow the most destitute to build equity, nor will it allow the poorest to cope with emergencies. The use of microcredit to address development challenges in situations where the basis of people's subsistence has been destroyed or has become highly volatile has rarely been successful, as it then becomes more often a source of new indebtedness.

After the realization that the financial service needs of low-income communities are so diverse, certain credit cooperatives began to transform themselves into microfinance institutions (MFIs), offering savings services as well. Today, MFIs are considering integrating new financial instruments that are likely to be just as suitable for low-income populations as the MFI itself. The expansion of MFI activities will also logically extend into the development of insurance, a risk management tool that is newly considered indispensable as a result of the necessity of MFIs to diversify their credit portfolios and assist their clients to cope with the inherent risks. It is necessary, however, to acknowledge the difficulties in developing the insurance business, compared with that of credit or savings: these include problems of moral hazard; adverse selection; the need for an information-rich environment; the impossibility of covering covariant or infrequent risks; problems concerning the payment of claims in the case of an accident which undermines the good will of clients taking out an insurance plan, etc. Micro-insurance, a simple contract that is affordable and tailored to low-income clients, should be able to overcome the same difficulties as commercial insurance contracts in addition to the high transaction costs associated with their small scale. As is the case of microcredit, even if its development requires substantial subsidies, micro-insurance has the potential to provide a valuable service to low-income clients who would otherwise continue to be subjected to the rationing of the market.

Thus, we have to ask ourselves a question: which conditions are necessary to set up a combination of microfinance and micro-insurance and more specifically whether the adequate linking of these two instruments is likely or not to allow for a more holistic economic and social inclusion of destitute populations? The responses that this paper will provide will be very different depending on whether or not the country in question has a developed financial and banking system. Let us look at the two case studies, India

and Madagascar, countries whose levels of development are very far-removed from each other.

Microfinance activities in Madagascar were developed in the beginning of the 1990's to overcome the shortcomings of the formal financial sector in the rural areas. This market had been dominated for a long time by informal lenders who would only consent to lend to needy farmers at exorbitant rates, with actualised values that could reach up to 400% per year. With the support of the Malagasy Government and donors, microfinance institutions are rapidly becoming the second biggest actor on the rural financial market in the number of customers served. It is estimated that 50% of these institutions' borrowers are from rural areas, of which the majority are farmers. Counting all institutions combined, as of 30 September 2006³ the microfinance sector boasts close to 300,000 customers served via approximately 450 tills, counters, branches or service points. It mobilises approximately MGA 30 million worth of resources for its clients and incurs approximately MGA 40 million worth of credit (US\$ 20 million). However, the impact on the financing of agricultural activities is relatively weak (less than 40,000 farms were the beneficiaries of credit as of September, 2006, i.e. approximately 1.6% of producers and only for a total credit amount estimated to be approximately US\$ 15 million). The penetration rate of microfinance in rural areas is still highly limited, to about 5 and 6%. Indeed, its limitations as a financing tool are many:

- very high monthly interest rates (between 30 and 40% for MFIs);
- request for significant collateral the real value of which must be at least equal to 150, sometimes 200% of that of the loan;
- very little investment in the medium to long term, etc.

The situation in India is very different since it is a country that disposes of one of the largest networks of rural financial institutions in the world: more than 30,000 national commercial banks, close to 3,000 private commercial banks, 14,000 rural banks at the regional level, around 122,000 credit cooperatives, etc. Even though 45.9 million households in the country's rural areas (51.4%) do not have access to credit (NSSO data), microfinance still plays a very important role. Indeed, only 27% of all farmers rely on the formal banking sector (of which one third borrows from informal sources), and the rest borrow from informal financing mechanisms. Microfinance has thus developed exponentially over the course of the last several years: from 1993 to 2006, the average annual growth rate of the number of borrowers having received a loan is established at 82%. This represents 110% of the total amount allocated, both in terms of credit allocation and the mobilization of savings as insurance. This concerns 35 to 40% (depending on the district) of households excluded from the formal banking system.⁴

In the case of India, microfinance is not confined to the credit instrument. Over time, a large array of financial instruments was developed to meet the needs of low-income

³ Data from the pre-evaluation of the "Rural finance and risk management" working group of the PROSPERER programme.

⁴ Fouillet, Cyril and Augsburg, Britta. March 2007. *Spread of the Self-Help Groups Banking Linkage Programme in India*. Presented at the International Conference on Rural Finance Research, Moving Results, FAO and IFAD, Rome, Italy. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1285783, accessed on Jan. 29th, 2009.

populations. Let us take the example of micro-insurance. Three phases can be distinguished in its development. The first coincides with the introduction of targeted programmes fighting against poverty such as the Integrated Rural Development Programme (IRDP)⁵. These foresaw public sector support for insurance companies that extended their services to the poorer segments of the country's population. The second phase of this growth corresponded to making credit available to poor people, a movement brought about by institutions named Self-Help Groups (SHGs). This second step created a critical role for NGOs insofar as their support for the creation of MFIs. The third phase of development is linked to the creation of social security measures on the part of the government. Even though close to 90% of the population is excluded from any institutionalised form of social protection, the government recognises the necessity of expanding this coverage to excluded groups (belonging to the informal economy) through diverse strategies, one of which is the support for new micro-insurance systems⁶. This latter tool is becoming increasingly important today: according to the available information, out of 51 reported micro-insurance systems, 43 cover 5.2 million people. It is interesting to note that 66% of the micro-insurance systems currently in operation are linked to a microcredit service (whether or not as a part of a specialized MFI).

There is one recurring question to ask: Should MFIs offer insurance services, and, if yes, how can they make this insurance available to the most destitute? As we have indicated above, the answers will be conditional on the development stage of microfinance as it has been described above.

4. EMERGENCE OF MICRO-INSURANCE IN DEVELOPMENT: NEW ROLE FOR MFIs?

4.1. Analysis of the linking of microcredit and micro-insurance tools: Potentials and constraints

Contrary to microfinance, the question of micro-insurance as a development tool is a relatively recent addition to the economic literature on this topic. The question as to whether the pairing of micro-insurance (be it insurance on health, agricultural production or other household capital) with microfinance is relevant, with a consideration for certain similarities between the two, is thus posed. These similarities are notable with respect to beneficiaries; the small scale of proposed products; and accumulated know-how in the microfinance sector. How will the linking of these two instruments affect the microcredit system? How will it affect the micro-insurance system?

⁵ This programme foresaw public support for insurance companies who extended their services to poorer segments of the country's population. It included the following companies: Group Insurance Scheme for the Landless Agricultural Labourers (fusion with the Janashree Bima Yojana group in 2000); Cattle Insurance Policy; Kissan Agricultural Pump set Insurance; Grameen Accident Policy; Janata Personal Accident policy. The most serious risks covered by these mechanisms include of the poor in case of a loss of assets, an accident or death.

⁶ International Labour Organisation

It is clearly necessary to first underline the differences in conception and management between the provision of microcredit and that of micro-insurance. An article on this topic summarises: “regarding credit, it is the creditor to deal with the issue of having to enforce a contract, whereas in the case of insurance, the client faces this issue. Also, with credit, lenders and borrowers contact each other several times during the period of reimbursement, which implies regular transactions and control costs. In the case of insurance, the information cost comprised in the regular payment of the premium is limited. The insurer incurs very few transaction costs because the contract can easily be terminated when the premium is not payed; the transaction costs are irregular and only high when a claim for compensation arises”.⁷ The main differences between the two are highlighted in the following table.

Table 1: Major differences in management and design between microcredit and micro-insurance tools to be considered in the case of pairing these two instruments:⁸

	MICROCREDIT	MICRO-INSURANCE
Risk-taking	Microfinance agency must trust the small business owner, as it bears the risks associated with the contract	The beneficiary must trust the micro-insurance institution to pay the indemnity claim
Decision of the beneficiary to subscribe to the mechanism	The offer must be superior to what informal credit and savings markets offer (cheaper, better quality, better tailoring of the products offered)	Association of the perception that the cost of the coverage falls on the insured (and will depend on the disposable liquidity of the beneficiary)
Management of liquidity	Predictable reimbursement cycle	Disasters/accidents do not follow such a predictable cycle
Cultural proximity	MFIs provide better monitoring Used to a deposit guaranteed within the communities. More attractive financial service.	The concept of pre-paying a premium is foreign to informal prediction practices. A pooling of risks is less attractive for the beneficiary.

⁷ Labie M., Ngongang I., Nyssens M., Wele P., 2006. Analysing the link between microfinance and health micro-insurance: Study based on three cases in Benin. Economics and management documents. *Working paper 2006/2*. Warocque Research Centre. Université de Mons-Hainaut, Mons, Belgium.

⁸ Source: Idem.

4.1.1. Some possible effects of linking microfinance and micro-insurance on the provision of both credit and insurance

- Reduction of non-repayment of loans on the part of borrowing clients as a result of a health shock, a shock on the means of agricultural production or on assets serving as savings, etc.⁹
- Microcredit enables low-income families to expand their activities. However, in a time of crisis that forces individuals to sell their assets (use of savings if any, sale of livestock and of productive tools, etc.) and blame several years of accumulation linked to credit, insurance could prove itself to be a complementary tool that is indispensable to credit.
- It will be necessary, however, to make sure that this linking of tools does not lead to additional costs (compulsory insurance in order to have access to credit, insurance training, etc.), which itself would lead to an exclusion of certain beneficiaries who would no longer be able to afford to take credit.
- Micro-insurance is becoming ever more accessible to households thanks to microcredit. Indeed, the clearing of liquidity problems (additional cost of contributions with the integration of interest rates within the total cost of credit, complementary loans, etc.) and its result on income from income-generating activities could help the household to take on the responsibility for the insurance premiums¹⁰.

4.1.2. Institutional effects of this combination and caveats/risks:

- Savings on transaction costs, including direct administrative costs and marketing expenses.
- However, it is necessary to put this advantage into perspective, considering the risks involved in providing these two services together, i.e. in terms of liquidities management; management of assets/liabilities is riskier and less transparent (insurance must not become a cheap source of financing); the utilization of savings to cover claims linked to insurance contracts when the premiums are not able to balance the system. In addition, the risk that the individual who is denied a claim decides not to reimburse his/her loan as a way of seeking justice for him/herself or who, not having received sufficient financial provisions, withdraws from the micro-insurance system are not to be overlooked.
- Finally, we must recognize the effect on the mission of the organization, as in recent years, microcredit has taken a business dimension whereas micro-insurance increasingly highlights the public interest dimension.

To sum up, by taking the necessary precautions, the effects of pairing these two tools can be very beneficial for all stakeholders. The benefit for an MFI is the ability to focus on its grassroots' activities while diversifying its products; a clearly defined investment cost; and a relatively quick project launch time. For the client, products designed by insurance

⁹ Miller and Northrip (2000) ; Lai (2000) ; Churchill (2004) ; Brown and Churchill (2004)

¹⁰ Fonteneau 2004

professionals can be more interesting and less expensive than those developed by MFIs¹¹. For the insurance companies, the benefit is the ability to focus on a clientele which would otherwise not be directly accessible, thanks to the role of the MFI. The latter, however, must consider whether it is necessary in terms of its own activities to develop insurance products to complement its savings and credit services. Indeed, there are two other classic microfinance products that could allow MFI clients to manage risk, especially when there is little damage and only an occasional risk involved: on demand savings accounts and emergency loans. These could be preferred strategies, depending on the nature of the risk and the development levels of the people in question¹².

4.2. Models of possible combinations – Indian and Malagasy case studies

Now that the constraints have been taken into account and the issue of the relevance of linking the two tools has been posed, we will continue with the analysis and discuss the issue of the type of pairing. The different institutional models for the distribution of micro-insurance products are regrouped in the table on the next page.

¹¹ Brown and Churchill 2000

¹² Brown and Churchill, 1999

Table 2: Possible institutional models for the distribution of insurance products; selected benefits and limitations

"Total Insurance" model	"Partner-Agent" Model	"Savings and Credit Mutual & Mutual and Cooperative" Model	"Supplier" Model	"Franchised" Model
<p>Description: The insurer is solely responsible for the principal functions of the insurance service (design, subscription and distribution of insurance policies, technical and administrative management of the product, settlement of claims). The insurer may also sell policies through a network of salaried or commissioned (independent but representative) agents.</p> <p>Benefit: The MFI does not take on any risk here. On the other hand, it is thanks to the MFI that the insurer has access to a market that is otherwise closed to him/her. This model is generally favoured when clients default often or are untrustworthy.</p>	<p>Description: Based on collaboration between a commercial insurance company and a distribution agent (MFI or other) who provides services to a low-income clientele. The MFI acts as an agent by selling policies in the name of the insurer in exchange for a commission. The MFI is responsible for providing services after the sale of the policy (accident investigation, presentation of indemnisation claims). The insurance company supplies the financial assets, sets the premiums, supervises the claims and guarantees the respect for legal obligations while taking on the risk. The agent is responsible for the distribution and facilitates the rational transfer of risk, resources and expertise between the formal and informal sectors. Each entity remains distinct, keeping its professional characteristics.</p> <p>Benefit: The MFI is able to serve as an effective intermediary network, without taking any risks. Agreements on sharing commercial premises and client files allow savings on transaction costs. Compared to commercial insurance, the benefit is the ability to overcome not being used to working with low-income populations and legitimacy issues vis-à-vis these populations. The partnership allows the MFI (or other organizations not specialized in insurance), to redress its lack of technical expertise and avoid a long and costly training period on insurance products for credit agents.</p>	<p>Description: Subscribers are also the owners and managers of the insurance system. Microcredit and micro-finance structures are fused into a single organization: the cooperative. Members are involved in the design, development and sale of products. In the case of health insurance, they are also able to negotiate with external health service providers.</p> <p>Benefit/Limitation: Members have a keen understanding of their needs, so will be able to appropriately adapt the products. Cooperation among members can be a way to save on costs. The limitation of this model is an issue of scale: sound management of a mutual insurance company presupposes limiting the number of members. However, in order to mitigate risk and make the activity profitable, it is well within the insurer's interest to extend his/her client base as much as possible. Moreover, mutual insurance companies can face governance weaknesses as it is a self-managed system (conflicts between elected and salaried employees, fringe benefits that favour certain elected officials), if tailored safeguards are not put in place.</p>	<p>Description: This is a model for health insurance whereby the insurer absorbs all or part of the health care, and hospitals/clinics have a contractual agreement with the insurer. The model is based on risk-sharing.</p> <p>Benefit/Limitation: The benefit is that the insurer can control the quality of the health care provided, which is a critical component of retaining customer loyalty. The weakness of this model is the difficulty in making both the insurance system and the health care financially viable; in order to do this, there must be a very high number of insured clients.</p>	<p>Description: The professional insurer rents his/her license, allocates a portion of his/her capital through a confidence agreement with the franchised party (if necessary) while the latter (generally an MFI) is responsible for the product design, setting its price and all recorded losses and gains.</p>

The following is a description of several ways it is possible to consider outsourcing risk-transfer models¹³:

- **Entrust the micro-insurance activity to an insurer (“partner-agent” model):** Key elements for the success of this model are the choice of partner and a good relationship between both parties. This strategy has the highest development potential today as it has the greatest potential to be a “win-win” relationship.
- **Outsourcing the risk by creating an insurance portfolio within the MFI:** The MFI buys a policy which will protect its loans’ portfolio against the death of its borrowers. This solution allows the MFI to limit the risk on its loan portfolio but provides only a limited protection to the MFI’s clients (this formula does not really allow the MFI to provide insurance products). In addition, if the MFI makes death insurance compulsory to access credit, clients may have an adverse reaction and refuse credit.
- **Outsourcing through a separate commercial entity:** This presupposes the creation of a subsidiary or company, to whom the MFI entrusts its insurance activities. The sharing of tasks and responsibilities then becomes similar to first case of establishing a partnership with an insurance company. The benefit here, as compared to the former scenario, is the potential for mutual interests and stronger bonds (notably in terms of profit-seeking). The MFI is, here as well, relieved of its risk. This option could be especially suitable for large MFIs, providing the regulatory environment allows for it.
- **Outsourcing the risk through re-insurance:** An insurance service for insurance companies, re-insurance allows the MFI to limit its risk (limit its exposure to covariant risks such as climatic risks or risks of epidemics, etc.) The re-insurer fills the role of technical assistance provider, as well as that of supervision to anticipate certain MFI-related risks (adverse selection, moral hazard, fraud) and to evaluate its institutional strength. The best-suited re-insurance policy for an MFI is that which covers excess losses: the re-insurer takes over the risk related to accidents above a pre-determined amount. The difficulty is that non-approved micro-insurers rarely have access to the re-insurance market. On the other hand, it is possible for the MFI to establish a partnership with a formal insurance company who accepts the role of re-insurer.
- **Outsourcing specific insurance activities:** In this option, the MFI entrusts a consulting firm or an insurance company with a few recurring duties that it prefers not to manage directly: subscriptions are carried out by an insurer; pricing entrusted to an actuary; internal monitoring conducted by an audit firm; collection of premiums and payment of claims dealt with by a bank; management (including filing and analysis) of data entrusted to specialized consultants. This could be a temporary situation, until the MFI acquires the necessary competence to manage these aspects on its own. Again, the quality and the competence of the partner are decisive factors.

The choice of one or another solution will depend greatly on the size and effectiveness of the banking and financial markets of the MFI’s home country. Indeed, the linking of

¹³ International Labour Organization, 2004

microcredit and micro-insurance tools is currently more developed and more feasible in India than it is in Madagascar, where the required conditions for opening a simple bank account are prohibitive and difficult to meet for the majority of the rural poor (identity card, a minimum deposit that is usually at its highest for poor populations, etc.). The profile of the MFI (NGO, regulated financial institution, national bank, etc.) will also impact its ability to offer insurance services. A relatively new or small institution which does not yet dispose of efficient management procedures to collect savings/provide credit or finds itself in an operational deficit, will not be ready to diversify its activities into insurance services, and will find it difficult to play an effective intermediary role for an insurance company.

At the moment, the Malagasy banking sector is not a conducive environment for the expansion of such mechanisms linking microcredit and micro-insurance. However, it is necessary to qualify this statement by differentiating between the different insurance products. Some insurance products are easier to implement than others: short-term insurance contracts are easier to manage; life insurance is very often easier to implement than health insurance or insurance on property (accident verification; compensation estimate; asymmetrical information). Thus, it is still possible to retain several risk management systems tied to the principle of linking credit and insurance from the Malagasy experience:

- **Mortality insurance on FERT dairy cows:** This is a system that allows producers to simultaneously access credit for the purchase of an animal (dairy cow) and an insurance policy (compulsory or optional) in exchange for the payment of dues, the percentage of which has been pre-calculated on the capital owed.
- **Leasing on credit of CECAM, associated with a life insurance policy:** Credit leasing association (LVM-CECAM) involving the productive investment in a dairy cow from the TIKO company and insurance on the borrower's life (FIFATA insurance), allowing for the coverage of the borrowers' heirs up to the residual value of the remaining capital to be reimbursed at the time of his/her potential death. This life insurance contract does not create any additional cost for the borrower. TIKO provides a bonus on the interest rate of the loan contracted by the farmer (this bonus is paid out entirely on the first day of the loan on a CECAM account, remunerated at approximately 9%). The interest due to URCECAM under the terms of the loan will be paid in 24 monthly installments by URCECAM. During this period, the amount of the provision made by TIKO generates interest as well, which supplies an insurance fund that serves to insure the risk of the borrower's death.

In India, a growing number of MFIs are taking an interest in micro-insurance to better serve the demands of their clients; retain their loyalty; and reduce their own risk by protecting their borrowers against various hazards. The exponential development of microfinance and the diversity of the MFIs amply illustrates the creativity involved in risk management in that country. The majority of MFIs use the "partner-agent" model. The MFI ASA (Activists for Social Alternatives), for example, boasting 60,000 members in 2004, has an excellent understanding of the insurance service concept and its requirements. ASA offers both a non-compulsory life insurance (the sum insured is constant no matter what the cause of death in order to simplify claim payment procedures) and livestock insurance in partnership with New India Insurance (compulsory insurance for any loan destined for a livestock-related activity). Between 1998 and 2003, ASA collaborated with six different partners and in 2004

had two insurers (Allianz-Bajaj and AMP Sanmar) who were working in different regions compete in order to decide which of the two partnerships would be the most beneficial for the institution. This strategy eventually led AMP Sanmar to remove its exclusionary clause on suicide (applicable in the first year of the loan), abandon that of the need for medical certificates and work disability, raise the age limit and reduce its prices. On the other hand, after significant delays in settling claims for indemnisation, another MFI, SPANDANA, broke its contracts with insurance companies and is now offering its own products. It is now offering a life insurance product on credit, a compulsory insurance which benefits the MFI by generating a stream of additional income while diminishing the credit risk. The additional coverage on the insured person's spouse was a significant selling point. It also offers house insurance (Credit Life).

The banking and insurance markets in India were able to allow the MFIs to open their activities to insurance and adapt their benefit schemes (between insurance and self-insurance when clients are vulnerable to covariant risks) to the constraints of the low-income populations they were targeting. The experience of these organizations indicates that the "agent-partner" model is far from being perfect, but there is room for improvement through negotiation. In addition, micro-insurance should only be considered as one feasible risk management strategy among many. In the last section of this paper, we will elaborate on these multiple strategies, while continuing to support our points with examples from the Malagasy and Indian experiences.

5. MULTIPLE STRATEGIES TO MERGE CREDIT SERVICES AND RISK TRANSFER

5.1. Self-insurance through savings and microcredit

Low-income populations may be assisted in protecting themselves in conjunction with an adaptation of insurance products to their needs: "Self-insurance presents a significant possibility, on the condition that instruments that are more effective because better suited to poor people are proposed."¹⁴ According to the author, the major problem with the self-insurance of assets is developing risky mechanisms that are heavily correlated with income. Financial savings products are typically not well-adapted to poor people, offering low or negative returns, and involving very high transaction costs as well as the unwavering credibility of the institution¹⁵. Today, initiatives to develop savings instruments are rare, as flexible savings for preventive purposes is generally not encouraged. Developing a risk management strategy through saving does not mean the abandoning microcredit: on the contrary! "Increasing assets and income through credit, which in turn will allow for an increase in savings, is a virtuous cycle that introduces a buffer against future hardships"¹⁶. In this way, the pairing of insurance and credit instruments becomes relevant by allowing MFIs to supply flexible products which in turn allow poor people to have access to credit even though they face a significant risk.

¹⁴ Dercon 2002

¹⁵ Morduch and Sharma 2002

¹⁶ Dercon 2006

5.2. MFI's Emergency credit funds: Malagasy case study

The realization of certain risks, disasters (hurricanes, production drought, etc.) or disabilities (illness, accident) contribute to reducing the poorest households' resilience to manage shocks, whether by saving, or credit-insurance links. Thus, emergency credit funds or social credit can be set up and later mobilized in the event of a disaster or health-related shock. These credit funds are financial reserves, usually established by an initial grant from a donor. They are later released so that MFIs are able to allocate credit to victims and thus satisfy the immediate demand for liquidity on the part of affected households: "In theory, clients benefit from a facilitated access to liquidity in times of need, and the MFIs in turn benefit from a reduction in arrears and an improvement in customer loyalty. As for the donors, they are expected to take advantage of higher efficiency in the disbursement of support funds, and the development of proactive and permanent mechanisms providing relief to victims of disaster, thus replacing the ad hoc responses usually put together in times of crisis"¹⁷.

5.2.1. Emergency credit funds can be managed by:

- **The MFI itself:** The donor injects initial funds in an MFI so that the latter may disburse credit to affected households. The donor retains a certain responsibility in terms of monitoring the results of the fund, but the MFI is for the most part responsible for all other activities.
- **Multiple institutions:** The funds developed by CARE and the IDB, for example, could be of service to several MFIs. After examining requests for funds by the MFIs, the donors distribute credit to them. They in turn re-lend the funds to clients affected by the disaster. Similarly, with respect to recovery, the clients reimburse their credit to the MFI, who then reimburses the credit fund.
- **A partnership between the MFI and multiple institutions:** Donor organizations provide the initial funds to each participating MFI as a non-renewable grant. Each MFI is then responsible for the ongoing management of the fund.

For example, in Madagascar, the CECAM network's "social credit", at first named "bail-out credit", was launched by the MFI itself, without financial or external technical support. This social credit takes into consideration the constraints of family economics: the urgent, unforeseen need for non-productive funds (health problem, for example). In 2002, this credit was open to the financing of school costs. Even though it is very expensive, social credit is widely appreciated because of the rapidity with which it can be released. Interviews have reported very few defaults on the principal. This credit can be obtained within a few days and enables people to cope with emergencies. Most users emphasized that they were able to avoid selling off their capital and that they preferred to take out this credit and pay its high interest rate rather than sell an asset which would be harder to retrieve later on. The opening up of credit to financing school costs was perceived very positively. The proportion of social credit remains very limited (2% of CECAM credit disbursements in 2002) considering a 4% monthly interest rate, which seems even higher to borrowers as they are requesting this credit under grave circumstances (illness, hospitalization, death, etc.). The

¹⁷ Brown W., Nagarajan G., 2000. *Emergency Credit Funds for MFIs : An Ongoing Experiment*, Calmeadow.

other problem that is very often raised in interviews regarding this credit is the fact that the amount of the interest is removed at the moment that the funds are disbursed, cutting into the amount obtained.¹⁸ The length of reimbursement is considered too short by a number of households (the rate of reimbursement of social credit confirms this information: poor at 0 days, it is considerably improved at 30 and especially at 90 days). Some members report that they have difficulty in obtaining a medical certificate from the health services, which is necessary for receiving health credits (because of distance to health services, corruption, etc.) Social credit is also not easy to use in the long term (i.e. for chronic illnesses). Social credit is used and recognized by all groups, irrespective of their level of economic affluence. It is mobilized for health expenses as well as schooling. The weight of the interest rate is obviously too heavy to bear for a poor household. However, households do recognize that when the only other alternative is a moneylender with rates that are two, three or four times higher than those of CECAM, social credit becomes the viable option.

The Malagasy experience of the CECAM network, which remains very restricted, would doubtless require external support- of a financial nature on the one hand, and technical on the other - from donors or the government. This emergency credit mechanism still opens the floor for several important questions: Do all MFIs need protection of this nature? Should emergency credit funds be designed as a mechanism providing protection from disasters, or should they have a limited life cycle? Do the funds not run the risk of pushing MFIs to take less preventative measures against losses associated with disasters?

5.3. Case study of the Indian MFI SHEPHERD: Multiple strategies for risk management:

SHEPHERD, an Indian MFI created in 1995 in Tamil Nadu, has been combining credit and insurance products for more than a decade. This MFI, part of a Self Help Group (SHG) network, is unique in that it has adopted a holistic perspective to help low-income people manage their risks. In this way, not only does it centre its activities around new insurance products, but also includes savings and credit products. These are services that are used to manage risk just as well as non-financial risk prevention services (i.e. veterinary services; health centres). This global coverage named UNI MICRO and designed with the United Indian Insurance Company (UIIC), also includes insurance among a whole series of contingency plans:

- **Food security:** Members of credit groups are called on to set aside a handful of rice at each meeting; as these reserves accumulate, it becomes possible to lend some to participants or to distribute it among the neediest.
- **Protection of income through life insurance** (including funeral transport costs): Provision of savings and credit through self-help groups, with credit activities typically constituting a way to support income-generating activities.
- **Protection of income through livestock:** Livestock insurance product implemented through UIIC are based on three principles: (i) prevention occurs through the

¹⁸ Wampfler B., 2003. *Analysis of the impact of the CECAM network: Principal results from the first year of study*. CIRAD, Paris, France. ; 2007. Scientific colloquium. ROR (EPP/PADR), IRD et GIE DIAL. *Rural Dynamics in Madagascar : Social, economic and demographic perspectives*. INSTAT

consistent grouping of livestock for maintenance purposes (planning and veterinary provided by the MFI) ; (ii) offering “barefoot” training where veterinaries teach SHGs how to care for their animals and administer treatment if necessary; and (iii) protection by offering insurance on the animals (covering accidental or natural death of the animal).

- **Health care coverage:** UNI MICRO Health Insurance Scheme: coverage for the treatment of patients; hospitalization costs; permanent disability and short-term hospitalization premiums. In addition to the insurance product, SHEPHERD organizes established medical check-ups (first diagnosis) and offers emergency credit specifically for childbirth.
- **Asset guarantee:** Addition to the product offered by UNI MICRO which includes insurance over the place of residence.

Thus, UNI MICRO, who was covering 15,000 beneficiaries in 2005, combines different risks and keeps a uniform price for all age groups. By following the “agent-partner”, SHEPHERD is linked to two public insurance companies who bear all product risks.

It is from this Indian experience and in this logic of plural and flexible risk management that MFIs could create credit, savings and insurance products when they are able. Indeed, risk management tools are relatively easily integrated into many intervention environments (food security, land-use planning and development, industry support, adaptation to climate change, etc.)

6. CONCLUSION

The ensemble of ex-ante risk management measures that are credit, savings and insurance can provide significant and even critical protection to individuals and their families, in case of a shock on their income or on their health. There are many alternatives and the correct choice of strategy is of prime importance. In order to extend its microfinance network, Madagascar should in some cases develop its micro-insurance products but this strategy should not be devised on its own. Several other measures could indeed improve the low penetration rate of microfinance in the Malagasy rural areas: subsidy mechanisms on the cost of credit; partnerships between the financial establishment and towards the goal of sharing risk; refinancing and guarantee mechanisms supported by public funds and adapted to the informal rural sector, etc. Finally, the insurance mechanism that is currently being considered in the framework of the June 2007 pre-evaluation of the Support to the Rural Small Businesses and Regional Economies Programme (PROSPERER). This programme has indeed raised the possibility of implementing a permanent and affordable insurance mechanism to cover risks incurred by Rural Small Businesses as part of their activities in addition to a risk-sharing mechanism that includes various public/private partners (insurance and re-insurance companies, Malagasy state, and donors).

Let us conclude by noting that ex-post measures providing transfers (targeted aid programmes, self-selection, work-for-food programme) to those affected by a non-insured

risk, will always be necessary as part of a social protection system that targets risk in order to be able to guarantee social protection and a minimal standard of living to all.

7. REFERENCES AND FURTHER READING

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Metadata Table

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English	Towards a policy that pairs microcredit and micro-insurance tools – What impacts on the fight against poverty and risk management?
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English	Lessons learned from experiences in India and Madagascar Policy Brief
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4. Summary	
<p>Microcredit and micro-insurance, considered within the larger microfinance current, are two risk management tools currently being developed by governments and international development agencies to reduce vulnerability associated with poverty in rural areas. Discussions about credit protection increasingly invoke the need to create linkages with</p>	
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<p>Louis Bocker, Agriculture Policy Support Service, Policy Assistance Division, FAO, Rome, Italy</p>	
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10. Training path

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