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Microinsurance: facilitating risk protection for the poor[1]

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The Philippine microfinance industry has developed over the years. From only a few large microfinance institutions (MFIs) with less than a million clients in the late '90s, the industry has now more than 2,000 MFIs with almost 7 million clients. Large commercial banks, which used to ignore the low-income sector as potential clients of financial services, have recently been providing wholesale funds to retail microfinance institutions.

With the development of the microfinance industry in the Philippines, MFIs face a growing demand for financial products and services, including risk protection services. Demand for micro-insurance products (i.e., insurance products for the poor) is growing in view of continuing risks to household welfare and the seeming inability of the government to address this issue. The MFIs have realized the need to assist their clients, consisting mostly of poor households and microenterprises, with financial products that will help them manage those risks. A number of those MFIs have started with informal means of risk protection; some have linked up with commercial insurance companies to deliver insurance products to their clientele and still others have established their own mutual benefit associations (MBAs).

Recognizing this need and having learned that provision of financial services to the poor can best be done by the private sector, the government in January 2010 launched the National

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Strategy for Microinsurance and the Regulatory Framework for Microinsurance. These documents, which provide the pillars for the development of the microinsurance market in the Philippines, called for greater role of the private sector in the provision of microinsurance products and services.

Given the need to protect the poor from risks, the paper looks at the roles of both government and the private sector in providing risk protection to the poor.

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1. The beginnings

The Philippines for many years has been implementing subsidized directed credit programs to provide credit to the poor. A survey conducted by the National Credit Council (NCC) in 1997 revealed that there were 86 directed credit programs (DCPs) implemented by various government agencies in various sectors of the economy. Despite the number of credit programs, however, it was found out that the low-income sector still does not have access to credit services. The modalities used in implementing DCPs result in large amounts of resource leakages that are mainly due to weak accountability, poor repayment rates, and hidden subsidies.

Succeeding studies conducted to evaluate the various DCPs showed the inefficiencies of government nonfinancial agencies implementing the credit programs. In view of this, the Department of Finance–National Credit Council (DOF-NCC), in consultation with the private sector, issued the National Strategy for Microfinance in 1997. The Strategy envisions the establishment of a viable and sustainable microfinancial market. The Strategy adopted the following policy principles: (a) increased role of the private sector (microfinance institutions [MFIs]) in the provision of financial services, (b) establishment of an enabling policy environment that will facilitate the increased participation of the private sector, (c) adoption of market-oriented financial and credit policies, and (d) nonparticipation of government nonfinancial agencies in the implementation of credit programs. Adoption and implementation of these policy principles led to several executive issuances and legislative acts that mainly direct all government nonfinancial agencies to stop lending and transfer their credit programs to government financial institutions that will in turn provide wholesale funds to retail financial institutions. This resulted in government moving away from the implementation of subsidized credit programs and toward the adoption and implementation of market-based credit policies to enhance access to credit. Government instead focused its efforts on the provision of the necessary basic support infrastructure and capacity-building services.

As a result, the Philippine microfinance industry developed over the years. Several microfinance institutions (i.e., rural banks, cooperatives, and microfinance nongovernment organizations [NGOs]) started to provide credit services to the low-income sector. From only a few large MFIs with less than a million clients in the late 1990s, the industry has now more than 2,000 MFIs with almost 7 million clients. Large commercial banks, which used to ignore the low-income sector as potential clients of financial services, have recently been providing wholesale funds to retail microfinance institutions.

2. Why microinsurance?

About 28 million Filipinos who live below the poverty threshold (Philippine Poverty Situation, 2006) are vulnerable to risks such as illness, physical injury, accident, or death; basic business risks; loss of property; loss of job; theft; and abrupt swings in the economy. Because of this, MFIs realized that gains resulting from continued access to savings and credit services are usually eroded when the poor are faced with these contingencies. Most microfinance clients confronted with these risks have to start from scratch all over again since they have inadequate or, in some cases, no access to risk-protection services. And if they have access, they are financially unprepared to cope with and mitigate these risks.

As a result, MFIs realized the need to assist their clients in accessing financial products that will help them manage these risks. A number of MFIs started with informal means of risk protection—that is, providing in-house insurance products to their clients. Some have linked up with commercial insurance companies to deliver insurance products to their clientele and still others have established their own mutual benefit associations (MBAs). In view of this, the need to complement microfinance (i.e., savings and credit products) services with a financial product that can provide financial relief when contingent events occur was highlighted. The need to provide for the future and unexpected financial needs of the poor was recognized. Thus, the birth of microinsurance.

3. What is microinsurance?

The term "microinsurance" refers to the insurance, insurance-like, and other similar business activity of providing specific products and services that meet the needs of the poor for risk protection and relief against distress, misfortune, or contingent events. Under Insurance Memorandum Circular 1-2010, microinsurance is defined as follows:

1. *Microinsurance* is an activity providing specific insurance, insurance-like and other similar products and services that meet the needs of the low-income sector for risk protection and relief against distress, misfortune and other contingent events. This shall include all forms of insurance, insurance-like and other similar activities, as may be defined by concerned regulatory bodies, with the following features:

   1.1. Premiums, contributions, fees or charges are collected/ deducted prior to the occurrence of a contingent event; and

   1.2. Guaranteed benefits are provided upon occurrence of a contingent event.

2. *Microinsurance product* is a financial product or service that meets the risk protection needs of the poor where:

   2.1. The amount of premiums, contributions, fees or charges, computed on a daily basis, does not exceed five (5) percent of the current daily minimum wage rate for non-agricultural workers in Metro Manila;[2] and

   2.2. The maximum sum of guaranteed benefits is not more than 500 times the daily minimum wage rate for non-agricultural workers in Metro Manila.[3]

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[2] The 5 percent ceiling for premium for microinsurance considers improved efficiency in the Insurance Industry resulting from better and improved mortality rates and technology, and the increased number of insured thereby spreading risks to a greater number and lowering costs of insurance delivery.

[3] The maximum coverage can provide 16.5 months (500 days) of lost income resulting from any unforeseen or contingent event happening to the insured. This is deemed sufficient to augment the needs of the family of the insured. This insurance coverage can be provided with the maximum 5 percent ceiling.

Since microinsurance is a financial product designed to meet the risk-protection needs of the poor, the same circular prescribes specific product features that are tailor-fitted to the needs of the poor. These are as follows:

1. Microinsurance contracts should clearly state the benefits and terms of coverage.
2. Microinsurance providers should ensure the following: (a) contract provisions can be easily understood by the insured and printed in English and/or Pilipino; (b) documentation requirements are simple; and (c) manner and frequency of collection of premiums, contributions, fees, or charges coincide with the cash flows of the insured and are not onerous.

The key features of a microinsurance policy contract are shown in Appendix 1.

4. Public-private sector partnership in microinsurance

Having learned from microfinance that the provision of financial services (i.e., savings and credit services) to the poor can best be done by the private sector, the government in January 2010 launched and issued the National Strategy for Microinsurance and the Regulatory Framework for Microinsurance.[4] These documents provide the pillars for the development of the microinsurance market in the Philippines. Both documents were crafted in partnership with the private sector and generally call for increased private sector participation in the provision of risk protection to the low-income sector of the economy.

[4] These two documents were developed and formulated by a technical working group (TWG) comprised of representatives from the government and the private sector. The members of the TWG are DOF–National Credit Council (DOF-NCC), Insurance Commission (IC), Cooperative Development Authority (CDA), Bangko Sentral ng Pilipinas (BSP), Securities and Exchange Commission (SEC), National Anti-Poverty Commission (NAPC), Chamber of Mutual Benefit Association Inc. (CHAMBAI), RIMANSI Organization for Asia and the Pacific Inc. (RIMANSI), Coop Life Insurance and Mutual Benefit Services (CLIMBS), Cooperative Insurance System of the Philippines (CISP), Philippine Life Insurance Association (PLIA), Philippine Insurers and Reinsurers Association (PIRA), Microfinance Council of the Philippines (MCPI), German International Cooperation (GIZ), and Asian Development Bank (ADB).

In line with the National Strategy for Microfinance adopted in 1997, the Strategy for Microinsurance also envisions the development of a viable and sustainable microinsurance market. This shall be achieved through

a. Increased participation of the private sector in the provision of microinsurance services;
b. Establishment of an appropriate policy and regulatory environment for the safe and sound provision of microinsurance by the private sector;
c. Mainstreaming of informal insurance, insurance-like, and other similar activities/schemes; and
d. Institutionalization of financial literacy (learning/education) that will highlight the importance of microinsurance, the applicable rules and regulations, the duties and responsibilities of the providers, and the rights of the insured. [National Credit Council 2010]

Clearly, the strategies to be pursued highlight the distinct roles of both the government and the private sector in protecting the poor against risks. To encourage private sector participation, the Regulatory Framework calls on the regulatory authority—the Insurance Commission—to provide a regulatory space for insurance providers that are going into microinsurance.[5] These are

a. Lower guaranty fund requirement for MBAs wholly engaged in microinsurance,
b. Lower capitalization requirement for commercial insurance companies and cooperative insurance societies wholly engaged in microinsurance,
c. Expanded admitted assets for entities engaged in microinsurance, and
d. Appropriate risk-based capital (RBC) framework for entities providing microinsurance products only.

Since "insurance is sold rather than bought", a massive insurance literacy campaign shall also be conducted by the government in partnership with

[5] As a first step, the Insurance Commission issued on 10 January 2010 Insurance Memorandum Circular 1-2010 providing for the regulation of microinsurance products and services.

the donor community[6] and the private sector.This aims to develop a strong insurance culture among the Filipino people, especially those in the low-income sector. Since insurance has mostly been associated with those who have the financial capacity to pay for the premiums, a change in the mindset of all concerned stakeholders is necessary.

5. The microinsurance market: salient features

5.1. The demand

The most recent poverty statistics show that 27.6 million Filipinos are living below the poverty line. In terms of families, this is translated to 4.7 million families. In a focus group discussion conducted by Llanto, Geron, and Almario [2009], most of those interviewed neither availed nor planned to avail themselves of any insurance product. They, however, consider illness and sickness in the family to have very serious financial impact on them and thus express great interest in some form of risk protection. They underscored affordability as a major concern.

Among low-income households, there is some form of reluctance to purchase insurance products either because of mistrust in insurance companies or a negative image of insurance. Many of those in the focus group discussions do not want to avail themselves of any type of insurance products due to past bad experiences with a big commercial insurance provider. Some, however, are just not aware of what insurance is and who the providers are.

5.2. The supply

In the Philippines, microinsurance is provided by both formal and informal sources. Formal providers are those institutions that have the necessary license from and are regulated by the Insurance Commission, while informal providers are those institutions that may or may not be

[6] The Asian Development Bank (ADB) Developing Microinsurance Project and the German Technical Assistance (GTZ) Microinsurance Innovations Project for Social Security are both providing technical assistance and funding support to the government in the development and implementation of the "Roadmap to Financial Literacy on Microinsurance".

legally registered and do not have any license to sell insurance policies from the Insurance Commission.

Formal providers of insurance in the Philippines are composed of commercial insurance companies, mutual benefit associations, and cooperative insurance providers, which use a variety of distribution modalities.

5.2.1. Commercial insurance companies

These are insurance companies registered with the Securities and Exchange Commission (SEC) under the Corporation Code. Insurance companies are required to meet the minimum capital prescribed by the Insurance Commission and must obtain a certificate of authority from the Insurance Commissioner prior to operation. At present, there are 30 life insurance companies, and 83 nonlife insurance companies in the country whose certificate of authority has already been released.

While there are 37 life insurance companies in the country, only a few are offering microinsurance products as of latest statistics. To date, the Insurance Commission has already approved 16 microinsurance products. These products comply with the provisions of Insurance Memorandum Circular 1-2010.

5.2.2. Mutual benefit associations

MBAs are entities (that is, any society, association, or corporation) organized for the following purposes: (a) paying sickness benefits to its members, (b) providing financial support to members out of employment, and (c) paying relatives of deceased members a pre-agreed amount of money when a contingent event befalls the member. One has to be a member of the MBA, regularly paying a fixed amount of contribution, to be able to avail himself of the benefits.

Various types of institutions and associations organize their own MBAs. These institutions and associations organize MBAs to provide for the risk-protection needs of their members. Most recently, a few MFIs have organized MBAs to provide microinsurance product for their members. MBAs organized by MFIs are distinct and separate entities with their own board of trustees. MFI clients are encouraged to become members of the MBA to be able to avail of the microinsurance products offered by the MBA.

A number of MFIs prefer to use the MBA structure in addressing the risk-protection needs of their clients because, as an association organized by its members, MBAs offer the following advantages: (a) MBAs can design a system that is more responsive to the claims payment of members, and (b) are able to develop a better product fit for the members. Members are also proud to be co-owners of a mutual benefit association. However, microinsurance MBAs have to develop their management, technical, and financial capacities in order to provide better and sustainable services to members.

At present there are already 20 licensed microinsurance MBAs.

5.2.3. Cooperative insurance providers

Cooperative insurers in the Philippines are registered under Republic Act 9520, the Cooperative Code of the Philippines, which provides that "existing cooperatives may organize themselves into a cooperative insurance entity for the purpose of covering the insurance requirements of the cooperative members including their properties and assets … the cooperative insurance societies shall provide its constituting members different types of insurance coverage consisting of, but not limited to, life insurance with special group coverage, loan protection, retirement plans, endowment with health and accident coverage, fire insurance, motor vehicle coverage, bonding, crop and livestock protection and equipment insurance … The provisions of the Insurance Code and all other laws and regulations relative to the organization and operation of an insurance company shall apply to cooperative insurance entities organized under this Code. The requirements on capitalization, investments and reserves of insurance firms may be liberally modified upon consultation with the Cooperative Development Authority (CDA) and the cooperative sector. But in no case may the requirements be reduced to less than half of those provided for under the Insurance Code and other related laws …"

It is unfortunate though that to this day, the Insurance Commission and the CDA have yet to issue clear and specific guidelines to implement the provisions of the Cooperative Code allowing cooperatives to organize cooperative insurance societies.

At present, two registered cooperatives provide insurance services to their members: (a) the Co-operative Insurance System of Philippines (CISP) and (b) the Coop Life Insurance and Mutual Benefit Services (CLIMBS).

5.2.4. Informal insurance schemes

Microinsurance products or insurance-like products are also provided informally through mutual fund schemes. Mutual fund schemes are in-house insurance schemes usually offered by microfinance institutions such as NGOs and cooperatives.[7] Most of these informal schemes started as a *damayan* practice wherein members only contribute a certain amount of money when the need arises and the total amount collected is given to the affected family. This scheme, however, has evolved over time. Unlike the original damayan practice, the scheme now requires each member to contribute a predetermined amount to a fund on a regular basis and members are assured of a guaranteed amount of benefits when a risk or contingent event occur. These mutual fund schemes are not licensed nor approved by the Insurance Commission. The products they offer have not benefited from any actuarial computations and review.

At present, a number of cooperatives implement in-house "insurance" schemes, but the Cooperative Development Authority, regulator of cooperatives, does not have an accurate registry of those providing in-house "insurance" schemes. According to CDA, there are about 22,000 operating cooperatives. Of these, CDA estimates that at least half, or 11,000, are offering informal, in-house "insurance" schemes.[8]

In view of the huge number of entities perceived to be engaged in the conduct of informal insurance schemes and the perceived risks associated with informal insurance schemes,[9] the Insurance Commission, the SEC, and the CDA issued Joint Memorandum Circulars 1 and 2 requiring all entities engaged in the provision of informal insurance schemes to formalize their

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[7] Rural banks do not engage in the provision of informal insurance schemes inasmuch as this is explicitly prohibited by the Bangko Sentral ng Pilipinas. Universal or commercial banks are only allowed to promote or sell insurance of commercial insurers if they are affiliates or subsidiaries of these banks.

[8] This may be an overestimate because nobody really knows the exact number. What is sure is that many cooperatives have mutual aid funds, called locally as "damayan" funds, which are not insurance products.

[9] The large-scale informal insurance activities among the cooperative sector have two implications for the market. First, it leads to more limited consumer protection—this type of insurance operates unregulated, without proper actuarial assessment or external monitoring. This leaves consumers vulnerable, as the promised benefits may not be delivered. Second, large informal market activity implies that little innovation takes place in the formal sector for low-income market expansion. Unless the formal market players have an explicit incentive to actively pursue the low-income market, it is traditionally regarded as the domain of the informal sector, unviable from an insurer's point of view [RIMANSI and Genesis Analytics 2008].

insurance and insurance-like activities. Entities are given several options[10] on how they can formalize their informal insurance and/or insurance-like activities.

To date, a number of cooperatives have already partnered with commercial insurance companies or either of the two cooperative insurance providers for the microinsurance needs of their members.

Table 1 below shows some microinsurance estimates for the Philippines in 2007.

Table 1. Microinsurance market estimates for the Philippines

Microinsurance market	Estimate (millions of adults)
Microfinance clients of rural banks with credit life insurance	0.84
Members of microinsurance MBAs	0.55
Microinsurance provision outside of the MFI market*	0.31
Total formal	1.7
Informal estimate: 50% of members of financial cooperatives	1.2
Total market (millions)	2.9
Adult population, 2007 (millions) [PRB 2007]	54.1
Total microinsurance market share in adult population	5.4%
Formal microinsurance market share in adult population	3.1%

* It was assumed that this is will amount to only about 10 percent of the existing MFI clients (total 3.1 million as of August 2007).

Source: RIMANSI and Genesis Analytics [2008].

6. Challenges ahead

History shows that a strong insurance culture has yet to take root in the Philippines. Compared to its ASEAN neighbors, the Philippines has one of the lowest insurance penetration rates. In 2008, the proportion of the premiums to GDP was only 1.05 percent [DOF-IC 2008]. The Insurance Commission also reports that only 13.92 percent (10.79 percent group;

[10] An entity engaged in informal insurance scheme can take any of the following options for formalization: (a) partner with a commercial insurance company by being either an agent or a broker; (b) join an existing MBA or a cooperative insurance society; or (c) organize its own microinsurance company, MBA, or cooperative insurance provider.

3.13 percent individual) of the Philippine population has life insurance. In terms of access by the poor to insurance products and services, only about 2.9 million of the 26.7 million Filipinos living below the poverty line in 2006 were reported to have some kind of risk protection [Llanto, Geron, and Almario 2009]. About half of those with risk protection were provided through informal schemes.

In view of the foregoing, there is a need for a nationwide educational and information campaign to increase awareness of the need and importance of insurance especially among the poor. The campaign should not only focus on existing and potential clients of microinsurance but also include the insurance providers and the insurance intermediaries inasmuch as they are not used to having the low-income sector as market for insurance. Similarly, since the private sector is strongly encouraged (and of late has shown great interest in the market), there is also a need to conduct information campaign among concerned government institutions (e.g., LGUs, concerned national government agencies) on the appropriate support that should be provided for microinsurance. Such support should encourage and not crowd out private sector participation.

Considering the peculiar needs of the low-income sector, there is also a need to develop simple, innovative, and affordable microinsurance products tailor-fitted to the needs of the poor. Existing insurance products are often not suited to the needs of the low-income sector. The definition of a microinsurance product, as well as the key features of a microinsurance policy contract issued by the Insurance Commission, is expected to provide insurance providers the necessary guidance in developing the appropriate microinsurance product. In this regard, insurance providers need to have a paradigm shift in the way they do things if they want to cater to the low-income sector.

Alternative delivery channels are also needed to ensure a wider network for microinsurance. It is important to allow institutions that are familiar and have the proximity to the low-income sector to become intermediaries. Since those in the low-income sector are often reluctant and are not aware of the value of insurance, it is important to use institutions that the poor are already familiar with. These alternative delivery channels should not only be selling microinsurance products but also be engaged in providing the necessary insurance literacy among the poor. Community-based organizations that are already working in poor communities may be used and tapped for this.

With the establishment of an enabling policy and regulatory environment conducive to greater private sector participation, an increasing number of private financial institutions are expected to be interested in the provision of financial services (microinsurance included) to the poor. Recognizing the huge untapped market for microinsurance (i.e., the low-income sector), the private sector has already shown interest in providing the necessary financial product for risk protection.

As more institutions become interested in the provision of these services, establishment of standards of performance that will set the benchmark for prudential and market conduct behavior becomes imperative to ensure that the poor are appropriately protected. Such performance standards should provide the regulators the necessary information and enable them to determine the viability and sustainability of entities engaged in the provision of microinsurance products and services. Ensuring safe and sound institutions engaged in microinsurance would protect existing and potential clients of microinsurance. As this happens, the clients themselves become the advocates for microinsurance. As envisioned in the Roadmap to Financial Literacy, "they shall convince others to buy microinsurance because they themselves are convinced of its value".

The foregoing shows that there is a huge space for continued partnership between the government and the private sector in the provision of appropriate risk protection for the poor.

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Appendix

Key features of a microinsurance contract

I. The following features are applicable to life and non-life microinsurance contracts:

A. *Coverage* – A microinsurance contract shall cover the insured and, at his/her option, may include his/her immediate family (i.e., his/her spouse, children, and in the case of single persons, his/her parents and siblings) and his/her assets.

B. *Period of cover* – The term of the microinsurance contract shall be determined by the provider and shall depend on type of coverage.

C. *Risk and contingent events covered* – A microinsurance contract may cover any of the following:

1. Death (may be bundled with memorial plan, mortuary, or burial benefits)
2. Accident and illness
3. Fire and other extended perils
4. Calamities/disasters/catastrophic events (e.g., typhoon, earthquake, infestation, volcanic eruption, flooding and other convulsions of nature)
5. Casualty (e.g., personal accident, motor vehicle, and money security and payroll robbery)
6. Other contingent events as may be determined by the concerned regulator

D. *Terms and conditions* – A microinsurance contract shall clearly state the face amount, benefits, and terms of insurance coverage. Contract provisions shall be clearly stated in simple terms. The manner and frequency of premium collections shall, if possible, coincide with the cash flow of the insured and may be collected daily, weekly, monthly, quarterly, semi-annually, and annually, whichever is applicable.

E. *Effectivity* – A microinsurance contract becomes immediately effective only upon full payment of the first premium, contribution, fees, or charges.

F. *Claims settlement* – Claims for a microinsurance contract must be settled within 10 working days upon receipt of complete documents by the provider.

G. *Dispute resolution* – Disputes related to microinsurance contract shall be settled initially through alternative dispute resolution mechanisms.

II. The following apply to life microinsurance contracts only:

A. *Grace period* – During the effectivity of the contract, the insured is entitled to a maximum grace period of 45 calendar days from due date of premium/contribution payment.

B. *Contestability* – The contestability period for a microinsurance contract shall be one year.

C. *Suicide Clause* – The provider shall be liable if the insured commits suicide after one year from the effective date or date of last reinstatement of the contract. Suicide committed in the state of insanity will be compensable regardless of the date of commission. Where suicide is not compensable, the liability of the provider will be limited to the return of premiums.

III. In the case of non-life microinsurance contract, the provider shall send notices to the microinsurance clients at least 45 calendar days prior to expiration of the contract. Such notice shall include in clear terms whether the contract may or may not be renewed and any changes to be made thereon, if renewed.

Source: Regulatory Framework for Microinsurance, 2010.