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Microinsurance in the Philippines: Policy and Regulatory Issues and Challenges

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Abstract

This study assesses the state of micro-insurance in the country, identifies the players and their performance, and the challenges facing micro-insurance development. The term “micro” pertains to the capacity of a program to handle the small, sometime irregular cash flows of poor households, who have been excluded in the commercial insurance system for a variety of reasons. Micro-insurance products, specifically designed with the poor in mind, will help mitigate risks and reduce the vulnerability of poor households. The most prominent forms of micro-insurance are life insurance and health insurance (carried out as part of an overall health care package that links the health insurance to a health facility), which have been designed to be responsive to the need of poor households. The paper reports 17 players in the emerging micro-insurance industry, consisting of 12 cooperatives, three NGOs/MFIs, and two transport associations that are offering “home-made” micro-insurance. These “home-made” micro-insurance products continue to be provided despite their actuarial weaknesses and lack of financial capacity of the providers because of very strong demand from their membership for such financial products. Given their advantages over commercial insurance companies, the mutual benefit associations (MBAs) are the usual vehicles of micro-insurance programs. In 2004, 18 MBAs were registered with the Insurance Commission (IC) with accumulated assets of PhP14.8 billion. Members’ equity totaled PhP4.25 billion. The paper calls attention to the institutional, policy and regulatory issues and challenges facing micro-insurance.

Keywords: micro-insurance, risk protection services, insurance industry, life insurance, mutual benefit associations, social protection, micro-finance institutions, micro-insurance delivery

MICRO-INSURANCE IN THE PHILIPPINES: POLICY AND REGULATORY ISSUES AND CHALLENGES

Gilberto M. Llanto, Joselito Almario and Marinella Gilda Llanto-Gamboa

Introduction

Microfinance Institutions (MFIs) and similar organizations that serve the poor have come to recognize that their low-income clients do not only need loans but a variety of financial services as well, including insurance. Low-income clients face a variety of risks, e.g., accidental death and injury, illness, loss of property arising from natural calamities to name a few. Unfortunately, they are least able to procure adequate risk protection although some informal risk-coping measures have been observed among them.

The problem is that informal risk-coping measures or strategies are oftentimes insufficient. These would tend to cover only a small portion of the loss, thus failing to shield them against a series of perils (Churchill 2006). When risks are uncertain and losses are large, low income households find it hard or are unable to cope and manage the risks they face. Severe illness, injury, death of a family member and even man-made or natural disasters constrain the low-income clients' cash flow, liquidity and earning abilities, hence affecting their ability to repay their loans with microfinance institutions (Geron 2006).

In response to this need, microfinance institutions such as credit unions and non-governmental organizations have attempted to implement their informal micro-insurance schemes such as in-house mutual aid or benefit funds, "credit life insurance" and similar schemes that intend to provide some form of risk protection to vulnerable low-income clients. The target clientele are generally their own borrowers, mostly operating in the informal economy, who do not have access to mainstream commercial insurance or social protection benefits provided by the social insurance system, that is the Social Security System (SSS) for wage earners and employees in the private sector and the Government Social Insurance and Security System (GSIS) for those in the public sector. Various attempts by microfinance institutions, among others, to develop insurance schemes that are responsive to the needs of low-income clients have been generally labeled "micro-insurance" which should not be confused with the insurance schemes provided by established commercial insurers. Those efforts to develop micro-insurance products for low-income clients by the microfinance institutions are corroborated by the findings of Balkenhol and Churchill (2002) that it is uncommon to find evidence of indigenous mutual support in anticipation of future risks. For example, it is common for poor people pay for health care when they need it by direct spot payment to the health provider, e.g., doctor.

The first part of the paper provides the stage for a discussion of the emerging situation of micro-insurance and organizations providing micro-insurance schemes to low-income clients in the country. It draws from the literature to briefly explain the demand for risk protection in the informal economy and coping mechanisms used by poor households. The second part of the paper discusses the emerging situation of microfinance in the country and the challenges faced by organizations such as microfinance institutions (MFIs), mutual benefit associations (MBAs) seeking to provide such protection. The third part of the paper looks into the policy and regulatory issues that impact the provision of micro-insurance and concludes by providing recommendations concerning the identified barriers to micro-insurance and pointing out areas for future research and policy analysis.

At the onset, it will be important to clarify the meaning of the term micro-insurance. Following Churchill (2006), micro-insurance is generally for individuals who are ignored by traditional commercial and social insurance schemes. Those individuals, typically low-income, work in the informal economy and have irregular cash flows. Micro-insurance schemes would generally focus on life and health insurance because death risks and illness are the major risks faced by poor households. An important aspect of micro-insurance is that it can be delivered through a variety of different channels. Some examples of those channels are credit unions and other types of micro-finance institutions and community-based schemes. Finally, micro-insurance involves a risk-pooling element that enables poor or low-income households to cope with larger risks, e.g., death and health risks. Churchill further explains that "participating in a risk pool is a more efficient means of accessing protection than if households try to protect themselves independently"(page 14).

Demand for risk protection services in the informal economy

It is a widely held view that micro-insurance clientele generally belong to the informal sector. Many definitions of the informal sector have been put forward but rather than add another definition, it would be helpful to look at a typology of the informal workers to get a better sense of the clientele. The typology was constructed using 2 principal variables, namely, location of employment (urban or rural) and employment status (self-employed or wage earners). Figure 1 outlines the typology of informal workers, while Table 1 briefly describes the characteristics of and examples in each quadrant. The informal sector comprises 49% or 15.5 million of the Philippine labor force in 2005.

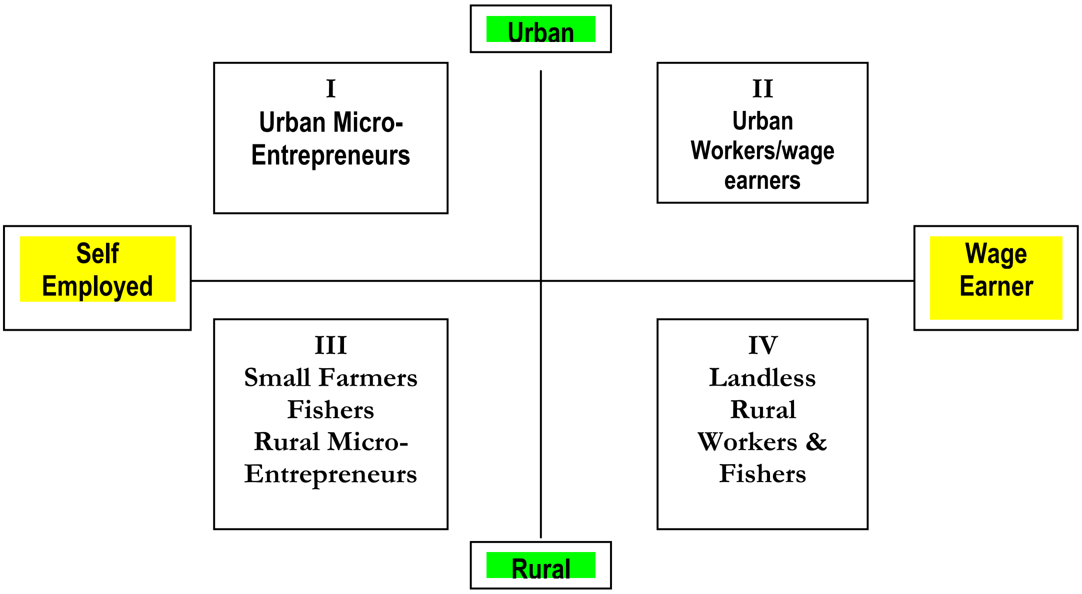


Figure 1: Indicative Typology of Informal Workers

Source: Almazan (2005)

Table 1: Characteristics of Informal Workers

Quadrant	Characteristics	Examples
I	Self-employed people or urban micro-entrepreneurs	Sari-sari store owners, ambulant vendors, market vendors, barter traders, small transport operators, etc.
II	Urban wage earners (regular or casual basis) Employed by the micro-entrepreneurs or in the formal sector (directly or indirectly) that are not compliant with existing labor standards and compulsory state social insurance schemes	Construction laborers, home workers, transport drivers, domestic helpers
III	Rural micro-entrepreneurs whose business line is similar to those of the first quadrant informal workers	Small farmers, forest dwellers, municipal fishers, small mining operators, grain millers, other agriculturally-related or resource-based enterprises
IV	Rural wage earners Employed in a seasonal basis and are migratory	Landless rural workers, fishers, small miners

Given the location and nature of their work, the informal workers are subjected to various work-related risks, which have a direct bearing on their social protection needs and on the manner by which they can arrange this social protection for themselves. Common risks that urban and rural workers face include poor work facilities, unsanitary and cluttered surroundings, sudden changes in season or climate, calamities, pest infestations, chemical poisoning, and environmental risks. Thus, they are more prone to accidents, food poisoning and other health risks.

Those in the informal sector are economically poorer than their formal sector counterparts due to the non-regularity of income, irregular cash flows and seasonal fluctuations in their earning capacities and their inability to cope with various risks that sometimes, may be catastrophic. With incomes hovering around the poverty line, they have little or no savings and possess very limited capacity to access social services on a regular basis. On top of this, an insurance market that caters to the needs of the informal sector is virtually absent.

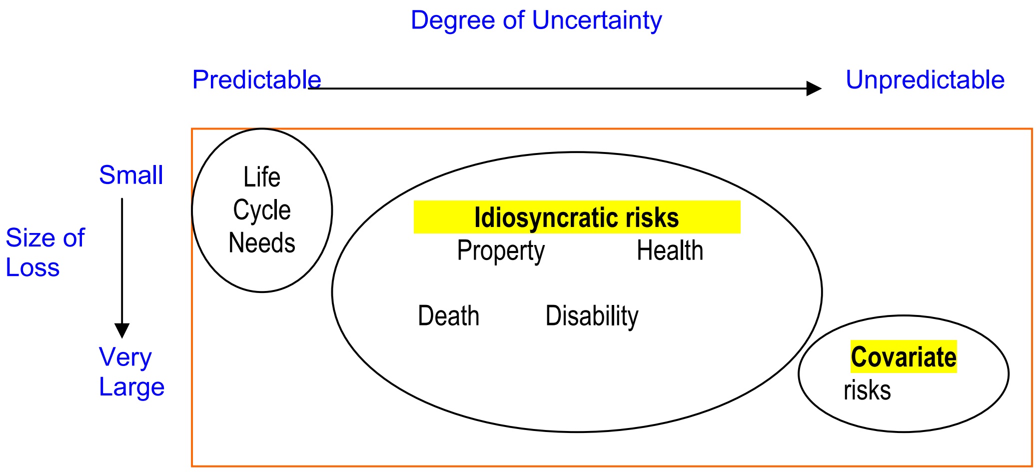
Within the informal sector, women and children are the most disadvantaged, and hence, face greater risks. The women, comprising 35% of the informal sector, work for lesser paid hours than men. At the same time they work longer hours in unpaid work (household chores). In the same manner, children are subjected to long working hours (sometimes unpaid) and are exposed to unhealthy environment and workplace hazards.

Those in the informal sector are more vulnerable to risks, which can either be predictable or unpredictable. Predictable risks pertain to risks associated with life cycle events such as pregnancy, birth, education, marriage, livelihood, food, housing, and retirement or old age. Also known as life-cycle needs, these erode the financial net worth of low-income households without effective risk-coping mechanisms, e.g., educational plans, retirement plans. In contrast, unpredictable risks are associated with illness, injury, death of a family member, natural and man-made calamities, and theft. They could also substantially erode the net worth of low-income households and their impact could be more devastating for the simple reason that they are largely unpredictable. The unpredictability of those risks underscores the great need of the poor for some form of insurance.

Risks can also be categorized as idiosyncratic or covariate. Idiosyncratic risks (individual risks) occur when only one or a few individuals or households in a community suffer losses. On the contrary, covariate risks (aggregate risks) affect a large number of households, which can be entire communities or regions within a country or countries. Consequently, all people are equally exposed to such risks. Examples of covariate risks include natural disasters (typhoon and tsunami), health epidemics (SARS and bird flu), environmental calamities (oil spill), political (civil war) or economic (oil crisis) risks. Figure 2 maps these risks in terms of the degree of uncertainty and relative loss or cost.

The more unpredictable the risk, the more havoc it wreaks on the socio-economic situation of low-income households in the informal economy. A deleterious effect on those households would be to miss out on growth opportunities, e.g., income earning opportunities when visited by such unpredictable risks. Thus, those households may be plunged deeper in the so-called “poverty trap”. Households would have to use available meager savings, liquidate scarce household assets, e.g., small equipment used for micro-enterprise activities or borrow in order to cope with the catastrophic event.

Figure 2: Predictable and Unpredictable Risks



Research by McCord[1] shows how low-income households rank the risks they face. Top rank are health risks followed successively by (a) death of breadwinner, (b) death of family members, (c) accidents and natural disasters, (d) loan repayment problems and (e) risks against access to education. Due to a variety of risks and inability to manage risks, many poor and near-poor households express anxiety about their perceived "vulnerability" (Narayan, 2000). The degree of vulnerability depends on the characteristics of the risk, the household's ability to respond to risk (which, in turn, depends on the household's asset base), and the time horizon.

Coping mechanisms of low-income households

Risk management can be categorized into *ex ante* and *ex post* actions. *Ex ante* actions are taken before a risk event takes place in order to: (1) reduce or eliminate risk (e.g., eradicate malaria-bearing mosquitoes); (2) lower exposure to risks (e.g. purchase mosquito nets); or (3) provide for compensation in the case of loss (e.g. buy insurance). On the other hand, *ex post* action involves activities to deal with realized losses after the occurrence of the risky event (e.g. selling assets, emergency loans, formal safety nets, etc.).

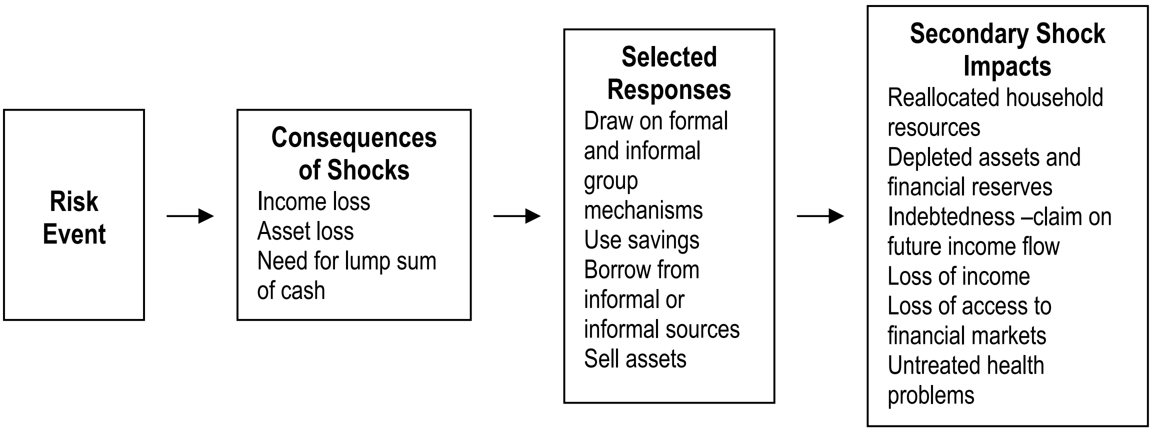
Table 2 lists the ways by which low-income households cope with the negative outcomes of risk events. The list is not meant to be exhaustive.

Table 2: Coping Mechanisms of Low-Income Households

Coping Mechanism	Description
Traditional Attitude of Fatalism	Raise money only when idiosyncratic risks occur (through support from relatives, loans from moneylenders, sale of livestock, etc.)
Indigenous Social Protection Schemes	Pre-payment aimed at covering the common risks or needs such as the *paluwagan*
Institutional Insurance Schemes	Social protection organized by the state such as SSS, GSIS, and Philhealth, and commercial insurers
Microinsurance Schemes	More organized and systematic than the indigenous schemes that are provided by microfinance institutions (MFIs), mutual benefit associations (MBAs), or cooperatives

A household might be able to mitigate or cope with risks in a given period, but unless the household is very wealthy, it has a limited ability to manage risk in subsequent periods, especially when assets are degraded (see Siegel and Alwang, 1999). Figure 3 traces the impacts of a risky event on and the selected responses of the poor.

Figure 3. Risky Event and Selected Responses by Low-Income Households



Source: M. Cohen and J. Sebstad (2003)

A demand-supply gap in insurance for low-income households

The extensive literature on insurance has examined the demand for insurance. For example, a paper by James R. Garven[2] (2006) explored the demand for insurance in the context of the logarithmic utility function. The paper shows that insurance will be purchased if and only if a level of coverage exists such that the expected utility of being insured is higher than the expected utility of being uninsured. Moreover, arbitrarily risk-averse consumers fully insure if the price of insurance is actuarially fair. The results of his paper are summarized in Table 3:

Table 3: The Demand for Insurance

Determinants of Insurance Demand	Comparative Static Analysis
Initial Wealth	If insurance is actuarially fair, then changes in initial wealth do not affect insurance demand since full coverage is optimal, irrespective of the value of initial wealth. If insurance is actuarially unfair, then there is an inverse relationship between insurance demand and initial wealth.
Accident Frequency	The demand for insurance is higher, the higher the accident frequency.
Loss Severity	The demand for insurance is higher, the higher the loss severity.
Price of Insurance	The demand for insurance is higher, the lower the price of insurance.

In general, the level of wealth, the probability of the occurrence of risk, the severity of loss due to the occurrence of risk, and the insurance premium determine the demand for insurance of an individual. However, in the case of the economically disadvantaged sectors in our society, other demand factors – perhaps more compelling than the determinants outlined above – come into play.

Because low-income households are more vulnerable to risks, there is an assumed logic that they have some unmet demand for insurance. Clearly, they are in great need of insurance given the limited social protection afforded to them and their exclusion from most formal types of insurance. However, needs do not automatically lead to demands when the price of insurance is too high. Institutional rigidities also suppress the low-income households' demand for insurance, who could otherwise afford to pay for insurance.

It can not be assumed, therefore, that their need for insurance will be translated into an effective demand for insurance? We must remember that these people barely earn a living, much less bring food to their table. What makes us think then that they will spend on insurance? Certainly, they need some form of social protection but are they too poor to demand insurance?

It is also important for low-income households understand what insurance is. The literature indicates that poor households may have some information or exposure to insurance but they do not necessarily have the means to access it. Various case studies of the Microinsurance Centre show that the poor either lack an understanding of insurance or have a negative perception of it (distrust). The poor are unsure about paying in advance for a service that they may or may not receive in the future from an institution that they do not know, at worst, do not even trust.

Granted that low-income households have been educated about insurance, their demand for insurance is also influenced by the availability of alternative risk management options. The common finance-based means of managing risk for low-income households to assist capital accumulation, help smooth consumption, and improve risk bearing include savings, credit, and insurance – otherwise known as the "finance trinity".

Given that low-income households have some demand for insurance, their access to insurance products now becomes a chief concern. What constrains them from buying insurance? Foremost in the list is the affordability of insurance. By affordability, we mean the insurance premium, coupled with the burden of making regular payments. Simply put, low-income households cannot access insurance provided by commercial insurers even if they have the demand for it because of their irregular cash flows and meager earnings since most of them belong to the informal economy. Lack of access may also be due to their economic or geographic remoteness.

Another point of view is offered by Ahuja and Jutting[3] regarding the poor's participation in insurance schemes. According to the authors, "for people living close to the poverty line, their apparent inability to join insurance schemes may not be the result of affordability per se, but the result of institutional rigidities such as credit constraint that prevent their latent demand from translating into effective demand for insurance". In simple parlance, if the poor individual is allowed to borrow against his future income, then his demand for insurance could go up.

Removing the rigidities will likely work mainly for low-income households who are currently able to meet their basic needs but face the risk of falling into the poverty trap in the future. But what about households who are way below the poverty line – the poorest of the poor as we call them? Would they concern themselves about insurance? For these people, easing of credit is unlikely to generate insurance demand. If they are allowed to borrow, they will, in all probability, use the loan to meet their current basic needs, e.g. consumption for pure survival, instead of for protection against future risks. Here, welfare or subsidies provided by government seem to be the more appropriate instruments.

To sum it up, factors affecting the demand for micro-insurance include an understanding of, perceptions and attitude toward insurance; risk management substitutes (product-demand match); affordability (cost of coverage and payment mechanisms); poverty level (purchasing power); frequency of risk occurrence; and institutional rigidities.

These demand considerations are only one side of the demand-supply picture. We now turn to the supply-side factors in insurance provision to low-income households.

The low-income households' demand for insurance has a corresponding "willingness-to-pay". They are willing to pay the pure premium, which is equivalent to the probability of risks plus expected losses. But the real cost of insurance, which determines insurance supply, is equal to the pure premium plus transactions costs, extra costs associated with uncertainty, and profits for the insurers and re-insurers. The sum of all these items constitutes the actual premium. The price of insurance that is affordable to low-income households may be less than the cost at which commercial insurers are willing to supply insurance. Hence, a demand-supply gap in insurance arises.

Why is the actual premium very high? Going back to the different items comprising actual premium, we can see the role that risks play in the calculation. We have discussed in the previous sections vulnerability of low-income households to predictable and unpredictable risks, but chiefly the latter. This vulnerability makes it almost certain that low-income households are prone to catastrophic losses. Moreover, the precariousness of their impoverished situation increases the extra costs associated with uncertainty.

Given the lack of infrastructure in areas where most of the low-income households can be found, the costs to collect premium payments, file and process claims, register and renew membership, keep members informed, and recruit new members increase. The transaction costs associated with insurance delivery are large indeed. Administrative costs also increase due to high drop-out rates. Other costs include those arising from asymmetric information, which gives rise to adverse selection and moral hazard problems that can easily put an insurance scheme out of business unless effectively mitigated by the insurer. Table 4 shows the important insurance risks and the mitigation measures adopted by traditional commercial insurers to cope with those risks. Those mitigation measures have the negative effect of excluding low-income households in the informal economy from mainstream insurance schemes.

Table 4 : Insurance Risks and Mitigation Measures

Risk	Definition	Mitigation
Adverse Selection	Tendency of persons with a higher-than-average chance of loss to seek insurance at standard (average) rates	Screening, underwriting, exclusions, waiting periods, limitations
Fraud	Intentional perversion of truth in order to induce another to part with something of value	Claims validation, operational audit, client visits, client complaints
Moral Hazard	Hazard arising from a policyholder creating additional risk because they are insured	Excess/deductibles, co-payments, exclusions
Covariant Risk	A risk or combination of risks, which affects a large number of the insured items/people at the same time	Exclusions and Limiting Cover

Source: McCord, M. "Key Issues in Insurance", (Undated)

In sum, traditional commercial insurers could but would not offer insurance services to the poor due to existing barriers to entry such as high transactions cost, costs related to asymmetric information and uncertainty, actuarial difficulties, aggregate risks, lack of information, and a restrictive regulatory environment. An example of the latter is the huge capital requirement needed to put up an insurance entity. This induces insurance firms to target the big rather than the small clients to compensate for the cost of capitalization. The implication is the exclusion of a large segment of the population from insurance.

Nevertheless, the formal insurance companies are becoming increasingly aware of the potential of getting into this uninsured segment of the population. One caveat to note, however, is that these commercial insurers may not be geared at the moment to address this segment of the market. Thus, in response to the demand-supply gap in micro-insurance, many informal micro-insurance schemes have emerged, operating without an insurance license.

Addressing the demand-supply gap

The poor have been excluded from existing formal and commercial insurance schemes due to supply-side and demand-side constraints. So far commercial insurance providers have not done much to reach out to sectors outside the formal economy. On the one hand, it seems that traditional insurance products have been designed with the middle and high income class in mind. On the other hand, despite their great need for some form of social protection, the poor lack the capacity to access formal insurance. In response to the demand-supply gap, informal micro-insurance schemes have emerged.

Indigenous social protection schemes such as *paluwagan*, if available, or insurance substitutes" such as neighbors' monetary contributions, savings, and asset liquidation may be inadequate to protect the low income households from external shocks. Microinsurance provides an opportunity for the self- employed and unemployed persons, who have no or limited access to traditional forms of insurance services provided by the formal, mostly commercial insurance sector, to avail themselves of insurance products. With effective micro-insurance, low-income households may have a useful coping instrument to meet the risks of illness, death and other unpredictable risks. Thus, the potential of micro-insurance emerges in situations of vulnerability and poverty of low-income households.

Microinsurance schemes as developed by MFIs, MBAs and other grass roots type organization are quite unlike mainstream commercial insurance that may grant a comprehensive insurance cover or even pay for extensive income replacement benefits. As stated at the beginning of this paper, typical micro-insurance schemes would address the main risks that low-income households fear: the unpredictable burden arising from death or health problems. Thus, depending on their earning capacities and other demand-side factors earlier identified, low-income households would tend to have a demand for life and health insurance products. The "premium contributions" required by micro-insurance providers (that is, cooperatives/credit unions, MFIs, MBAs and other types of organizations catering to low-income households) are generally affordable and are collection of those premiums depends on the cash flows of low-income households, e.g., small (and thus affordable) and periodic (adjusted to irregular cash flows) over a period of time.

Table 5 summarizes the main distinctions between microinsurance and commercial insurance.

Table 5: Comparison Between Commercial Insurance and Microinsurance

	Commercial Insurance	**Microinsurance**
Target Group	Those who have the capacity to pay large sums of money as premium	Those who do not have the capacity to pay large sums as premium Those who are costly to serve due to socio-economic status, location, and the like
Motive	Profit	Solidarity and Mutual Aid
Product/Services	Product menu is varied and complex aimed at individuals Highly restrictive	Product menu is limited and simple, aimed at the whole family of the member Limited or no restrictions
Delivery System	For profit, stock corporations	Mutual Benefit Associations, cooperatives & other forms of mutual aid organization
Ownership	Proprietors; stockholders	Membership-based
Decision Making	Proprietors; stockholders, depending on voting rights	Democratic; regardless of share capital or size of contribution, “one person – one vote”
Surplus	*Return on investments and dividend*	*Return on share capital, patronage refund as in cooperative, and membership equity value for MBAs*

Source: Adapted from Almazan (2005)

Microinsurance is an emerging new market for private sector insurance providers, which complements the public sector’s (weak) efforts towards social security for workers in the informal economy. It can link formal and informal mechanisms for providing risk management instruments that are designed for the poor. It can foster group management whereby it can perform the following functions: (a) define its own insurable risk; (b) organize financing of the insurance; and (c) exercise control over the flow and management of its funds (See McCord, 2000). Thereby, microinsurance could allow low-income households to make effective their notional demand for social protection in a manner that minimizes transactions cost and problems of asymmetric information.

An important element of micro-insurance schemes is the appropriateness of the delivery mechanisms that make them accessible to low-income households. Table 6 shows the different delivery models of microinsurance. These models offer ways to lower the transaction costs and address asymmetric information in the provision of insurance to the poor.

Table 6: Microinsurance Delivery Models

Institutional Options	Description	Advantages	Challenges
Partner-Agent Model	An established insurance company works with a distribution channel, e.g., MFI, that actively serves low-income clients Insurers bear the risk	Insurer is able to reach a market it cannot reach on its own MFI can provide members with better services at lower risk The poor get valuable protection that otherwise would not be accessible to them Most regulatory complications are eliminated	Trained staff to explain insurance in ways the illiterate poor can understand The distribution channel must still be licensed as an agent
Mutuality Model	Savings and credit cooperatives or credit unions offer loan protection insurance	Helps monitor moral hazard Reduces transactions cost Remains responsive to clients' needs and interest	Capacity issues
Direct Sales Model	Insurance companies directly serve low-income clients through individual agents on salary or commission-basis	Helps overcome control problems in the partner-agent and mutual models	Higher costs of a new delivery structure that only serves an insurance function
Community-based Model	Non-profit schemes that have voluntary membership Policyholders pre-pay premiums into a fund and are entitled to specified benefits Technical assistance and general oversight are given by a network support organization	Reaches not only the poor but also more of the poorest	Sustainability

According to Brown and Churchill[4] the preferred model for low-income insurance provision is the "partner-agent" model with established commercial insurers using MFIs, cooperatives, and other local institutions as distribution channels. Although experiencing significant problems, mutual insurance schemes are another option[5].

Micro-insurance providers

MFIs have the potential to provide microinsurance to the poor. They have grassroots information about their clients that is crucial in developing appropriate products and delivery mechanisms. They also have built an infrastructure and acquired skills and capabilities that will make it less costly to deliver microinsurance products. In addition, the problems of adverse selection and moral hazard may be reduced with the screening mechanisms and social networks that MFIs have already set in place. Under a partner-agent model with established commercial insurance firms as providers, MFIs with stable credit portfolios, strong data-tracking abilities, and an established network of loan officers may be effective agents for reaching low-income households.

On the other hand, MFIs who choose to be insurance providers would face severe constraints. For one, MFIs lack the resources required to quantify and manage insurance risk. They are also ill-equipped to perform many of the activities required to achieve long-term profitability and client satisfaction in the insurance market. MFIs may have the capabilities and strategy to offer certain limited forms of insurance (such as the credit life insurance), but their core competence lies in microfinance operations. These may be undermined by more complex insurance products and create risks for those MFIs. Hence, there is a strong logic behind a partner-agent model of providing micro-insurance. In short, it will not be financially healthy for the MFI to mix insurance with micro-loans in its array of financial services for the poor.

This is not to say that the partner-agent model is the only viable delivery model. MFIs need not be the provider itself. There are other organizations or delivery models for micro-insurance. The success of a delivery model or of an organization seeking to be a micro-insurance provider would depend on a variety of factors that this paper would not be able to discuss in detail. Table 7 summarizes the relative strengths and weaknesses of the various types of organizations that provide microinsurance.

Table 7: Strengths and Weaknesses of Potential Microinsurers

Institution	Strengths	Weaknesses
MFIs	• Second most trusted type of institution for most low-income households • Existing distribution channels for credit and savings reach poor clients frequently at a relatively low cost • Already focused on reducing transactions cost • Potential for integration of insurance with other financial services • Pre-established groups for group-based insurance	• Lack of insurance expertise • Limited ability to finance the initial investment required to start up an insurance product • Lack of managerial expertise in running the operations of an insurer • Relatively small client base (for all but the largest MFIs) • Limited geographic scope (for all but the largest MFIs)
Governments	• Access to large population base • Ability to adopt regulations and legislation favorable to low-income	• Least trusted institution for most low-income households

	insurance provision • Potential for integration with other services provided to low-income communities	• Limited insurance expertise • Susceptible to political manipulation of funds and coverage of packages • Poor history of operating insurance programs • Increasingly limited resources to invest social security measures
Commercial insurers	• Substantial insurance expertise • Financial strength and access to global reinsurance markets • Reduced cost of producing insurance through economies of scale • Significant geographic scope	• Limited understanding of the low-income market • Limited access to low-income populations • Potential conflict between profit motive and development objectives • Potential lack of interest in serving the low-income market
Community organizations	• Most trusted institutions for most low-income households • Control by local households leads to greater understanding and integration of households' needs • Potentially low-cost access to low-income households • Pre-established groups for group-based insurance	• Limited access to required financing • Lack of insurance expertise • Limited management expertise • Limited geographic scope • Small existing client base (per institution)
Credit Unions and Cooperatives (CUs)	• Experience in offering insurance to low-income populations • Access to some financing through reinsurance with cooperative/credit union reinsurers • Potential for integration of insurance with existing financial services • Pre-established groups for group-based insurance	• Insurance expertise concentrated in relatively few institutions • Relatively small client base (for most developing world CUs) • Limited geographic scope (for most developing world CUs)

Source: W. Brown and C. Churchill (2000)

While microinsurance has the potential to close the demand-supply gap in insurance for low-income households, it is not without its own limitations and challenges. Potential micro-insurance providers should ask themselves the following questions:

1. Do the low-income households in target areas want assistance in reducing vulnerability to the risks to be covered by the insurance?

2. Is insurance the most appropriate financial service for providing this protection?
3. Are they willing and able to pay a price at which the insurance can be delivered profitably?

Table 8 presents a brief checklist of factors to consider in assessing an insurer's capability and capacity.

Table 8: Provider Capacity Checklist

Activities in Insurance Provision	Considerations/Questions to Ask
Actuarial Analysis (Pricing)	• Estimating Future Losses • Establishing Underwriting Guidelines • Establishing Reserves
Marketing	• Does the staff that will be marketing the product have the training, materials, knowledge, and time required to sell, educate, and train clients about the product? • How can the insurer ensure that clients are not being coerced or unduly pressured to purchase the proposed product, particularly if the product is mandatory for all borrowers or savers?
Underwriting	• Does the insurer have the capability to check or confirm the accuracy of information provided by the prospective insured? • Does the insurer have the capacity to monitor changes in the characteristics of the market and its portfolio, which may change the nature of the risk it has assumed? • To avoid adverse selection, will a large percentage of the market be insured?
Investment Management	• Will any portion of insurance premiums or reserves be invested in the insurer's capital fund? If so, have the liquidity and regulatory impacts of this decision been fully considered? • How will the insurance plan deal with inflationary cost increases, particularly in high-inflation environments?
Claims Management	• Have processes been developed to verify that only claims covered by the insurance are paid out? Does the staff responsible for verification have the knowledge and information needed to assess the validity of claims with accuracy and consistency? • Can the insurer reasonably ensure that claims will be processed in a timely fashion?
Product Management and Administration	• Does the insurer have the information technology and management systems required to collect and generate the information needed to manage an insurance plan effectively? • Does the management have the additional time and knowledge necessary to effectively manage a new insurance product? • How will premiums be collected?

Source: W. Brown, et al. (2000)

Many of the pioneering attempts to provide microinsurance have been closely linked to microfinance programs and MFIs. In the words of Paul Siegel[6], microinsurance is, to some extent, an extension of the microfinance model into the realm of insurance-to deal explicitly with risk management. But do the MFIs have the resources, skills, and infrastructure required to manage an insurance product profitably? It is not obvious that MFIs should be involved in the provision of micro-insurance and certainly, it is important to assess the capacity of would-be providers, not necessarily MFIs, using the framework outlined above.

Actuarial Analysis

Generally speaking, the areas where a potential micro-insurance provider (from henceforth, "provider" in short) plans to put up a new business provide little information on the historical loss experience of the intended market. This creates a significant amount of risk for the provider intending to offer a microinsurance product on its own because estimating losses will be a best-guess exercise. In the case of MFIs, the literature indicates that only a few MFIs use historical experience that can provide a reasonable estimate of potential future losses in setting prices. Add to this is the limited liquid reserves of MFIs, which will leave them amply exposed to unexpectedly high losses, most especially during the first few years of operation. Moreover, no reinsurance is available to MFIs.

Marketing

Marketing insurance, especially among poor, illiterate low-income households is multi-stage process because the provider will not only sell policies but must also educate prospective clients on the potential benefits, costs, and use of the product. Thus, marketing costs can be much higher than those of traditional insurance.

Marketing in itself presents unique challenges. Churchill and Cohen (2006) note that insurance may have a negative image in a community, especially if certain individuals who have had access to conventional insurance have negative experience, e.g., claims processing delay, rejected claims and lapsed policies. Further, low levels of literacy among potential clients make marketing the product even more difficult.

Underwriting

In the case of MFIs (cooperatives or NGOs), they typically have such small microfinance programs where the inclusion of even a handful of high-risk policyholders can lead to serious unexpected losses. Accordingly, the provider must have the capacity to track changes in the age of its insured portfolio so as to assess the change in the probability of claims. The inexperience and lack of capacity of MFIs in effective underwriting procedures creates problems of adverse selection.

Investment Management

Care must be given to how the funds are invested. There seems to be conflict of interest in MFIs investing funds in its loan portfolio. Loans are not liquid investments and the practice of investing funds in its own loan portfolio creates unnecessary risks for the MFI. In most regulatory structures, reserves cannot be co-mingled with the other resources of the insurer because doing so could increase the likelihood of a liquidity crisis and a potential collapse of the institution that provides both loans and micro-insurance.

Claims Management

Providers need to have procedures and systems to ensure that the local staff cannot collude with clients to submit fraudulent claims.

Product Management and Administration

Many MFIs (cooperatives and NGOs) are small and lack effective management information systems and management time/expertise. They generally possess manual accounting systems and processes that are in most cases inappropriate for all but the most basic forms of insurance. MFIs may be tempted to draw premiums from the insured's savings account. However, liquidity problems will arise if the insured terminates his saving relationship with the MFI. This will be exacerbated if the drop-out rate is high and no stand alone mechanism for premium collection has been developed..

Potential of micro-insurance and limitations

Understanding the need for risk protection, low-income households are willing to make regular premium contributions. Several surveys and focus group discussions conducted by Risk Management Solutions, Inc., (RIMANSI) show that 70%-90% of the respondents desired to participate in a microinsurance program. However, this should not be interpreted to mean that the respondents would automatically be willing to pay for the insurance service. There has to be a deeper study of demand preferences and other factors to ensure that the micro-insurance program will not be assailed by high drop out rates and inadequate levels of premium contributions (see Box 1).

Box 1. Conditions for Microinsurance Success

The limited empirical evidence on microinsurance experience does suggest some important conditions for success:

1. Simple insurance instruments
   - Can be assured through contract standardization
   - Lower premiums increase participation but transactions costs discourage it

2. Low transactions cost
   - Cost-minimizing monitoring systems
   - Efficient incentive schemes should make us of and contribute to social capital

3. Affordability
   - Transparent benefits/payments
   - Flexible payment schedules improve participation

4. Location
   - Microinsurance provider located close to the client base
   - To obtain information, build confidence, and be receptive to participant needs

5. Financial literacy
   - Can be facilitated through group involvement in management decisions

6. Role of government
    - Provide information
    - Provide appropriate regulatory framework for insurance and reinsurance
    - Promote financial literacy through education
    - Provide political, technical and financial support for microinsurance

Source: P. Siegel, et al. (2001)

As presently structured, micro-insurance has several limitations. It may be an acceptable means of managing a few limited forms of risk, but not all. The effectiveness of any risk management instrument will depend on the nature of risks, household and group characteristics, their dynamics, and the availability of alternative risk management options whether these be informal, market-based, or publicly provided (Siegel et al., 2001). A limited understanding of insurance needs can alienate significant segments of the market with poorly designed products, hence, a need for market research.

Microinsurance programs may respond well to “idiosyncratic events in the view of their limited scope of operation area-wise and community-based nature. Covariant risks may be detrimental to such schemes unless these are replicated in several areas extending beyond regional boundaries and federated at a higher level so that reinsurance or co-sharing of risks can be effected” (Abad 2001).

Often, microinsurance providers cannot charge high enough rates since the demand for insurance is softer than the demand for credit. Generally speaking, high premiums will result in limited coverage. In this regard, catastrophic losses are usually not covered unless there are subsidies and/or external financing of the resource pool. A trade-off exists between the cost of premiums, the value of benefits and the depth and spread of coverage. The risk pool is not well diversified across geography, occupation, age, etc. There is scope for re-insurance for effective risk management.

Philippine micro-insurance

<u>Severe data constraints</u>

Severe information and data problems weigh down a precise discussion of the situation of micro-insurance in the country. What we have are anecdotal evidence of demand situations in the emerging “industry” quite unlike the situation in the mainstream insurance industry as indicated in Annex A. Mainstream insurance industry deals with the formal sector and thus, both demand conditions for life insurance and related products, e.g., type of policies held, terms of coverage, claims paid and projections of future demand for insurance, on the one hand, and supply conditions, e.g., number of insurance firms, value of policies, asset size and net worth of such firms, may be established within reasonable bounds.

The target clientele of micro-insurance potentially include the members or clients of the microfinance institutions themselves or the broader low-income community, including the vulnerable. Observers point out a unique aspect of microinsurance, which is to be broadly inclusive in contrast to mainstream commercial insurers who generally limit their exposure by excluding high risks such as older persons or those with pre-existing conditions (Wipf and others (page 153, 2006). However, not all micro-insurance schemes are broadly inclusive because some micro-insurance providers practice exclusion techniques, e.g., age ceilings put at 60 years old at VimoSEWA and 67 years old for ServiPeru's hospitalization benefits (ibid., page 154).

The microfinance institutions, including potential commercial insurers who want to provide micro-insurance to target clientele in the informal economy have to understand customer needs, preferences and develop appropriate delivery mechanisms and risk management techniques to ensure sustainable services. It should be pointed out that microfinance institutions and other types of organizations who are involved in one way or the other with the provision of some form of micro-insurance schemes, conduct their own surveys of target clientele in their areas of operation. For example, a large non-governmental organization, the Center for Agriculture and Rural Development, conducted a survey of potential clientele in Bicol region to establish a data base for decision making. The findings of the surveys can manifest different demand conditions, which reflect varying local characteristics and nuances.

Anecdotal evidence on micro-insurance

The informal sector represents roughly half to three-fourths of the Philippine economy, labor force, and overseas work. The micro and small enterprises, constituting 90% of all business establishments, are the biggest employment generators. The formal sector has been subcontracting most of their production and service requirements to the informal sector as external providers in response to fierce competition in global markets. The sector is weakly monitored given a weak labor inspectorate (820,000 establishments inspected by 250 labor inspectors on average). The Asian financial crisis and a general weakening of the economy have contributed to more informal economic transactions in the market. With a very large informal sector there is a need for responsive social protection services for many small and micro-entrepreneurs and wage earners in the sector. Given the location and nature of their work, the informal workers are subjected to various work-related risks, which have a direct bearing on their social protection needs and on the manner by which they can arrange this social protection for themselves. Within the informal sector, women and children are the most disadvantaged, hence, face greater risks. The government's huge fiscal deficit has led to substantial cutbacks in public expenditures for social services and formal safety net programs. The public sector can not provide, therefore, the social protection needed by poor households.

The informal sector seems to be a growing phenomenon in the Philippines, which must be accompanied by a corresponding expansion and coverage of responsive social protection services. Among the alternative social protection schemes, microinsurance should be looked into more seriously as a program that can provide more viable social protection coverage for those in the informal sector.

Studies by the Microinsurance Centre indicate that the Philippines is only one of a few countries that provide microinsurance. Based on a survey conducted by RIMANSI, 17 in-house providers, consisting of 12 cooperatives, 3 NGOs/MFIs, and 2 transport associations, have been offering "home-made" microinsurance. The scheme was named as such since they had a membership base of less than 3,000 and 60% had assets of less than P300,000. In addition, their microinsurance programs are not being operated according to sound actuarial principles. This is quite risky because it assumes that clients' insurance needs are homogeneous and unchanging. Consequently, there is little room for customizing and scaling up products and diversifying risk to heterogeneous clientele. Nonetheless, these "home-made" microinsurance products continue to be provided despite their actuarial weaknesses and lack of financial capacity of the providers because of very strong demand from their membership, who continue to be excluded from mainstream commercial insurance.

Given their advantages over commercial insurance companies, the mutual benefit associations (MBAs) are the usual vehicles of micro-insurance programs. Table 9 presents the differences between MBAs and commercial insurance companies. In 2004, 18 MBAs were registered with the Insurance Commission (IC) with accumulated assets of PhP14.8 billion. Members' equity totaled PhP4.25 billion. There is a current move among MBAs to strengthen their ranks in view of the huge potential of micro-insurance in providing risk protection to the informal sector and also because of its profit potential. The successful experience of CARD MBA (summarized in Box 2) has inspired the rest of the MBAs to move into the direction of corporate strengthening and improvement of governance.

Table 9. Comparison and Contrast of Commercial Insurance from MBAs

PARTICULARS	MUTUAL BENEFIT ASSOCIATION (MBA)	COMMERCIAL INSURANCE COMPANY
Policy Making Body	Board of Trustees composed of members of the MBA who know the needs of their co-members	Board of Directors composed of private individuals who have invested in the company
Orientation	Service to the members	For profit, stock company
Contributions/Premiums	Paid contributions stay with the association Level contributions, level benefits	Higher premiums generate more benefits
Catastrophic Claim	Has to shell out a lot of funds but bankruptcy can be avoided through reinsurance facilities	
Payment of Claims	Can be done as early as 2 to 3 days from the time of notification but no longer than 1 week if claim documents are complete Simplified documentation	Most insurance companies can settle claims within one month from date of claim Several documents are required, which vary from one insurance company to another
Coverage	All legal dependents of the members are covered	Only the policy holder with option to cover family members but with additional premium
MBAs can work well with the commercial insurance companies through reinsurance treaties.		

Source: Adapted from Abellera (2005)

Box 2. The CARD MBA Experience

The experience of CARD-MBA tells us that microinsurance can be sustainable largely if there is a wide and functioning microinsurance distribution channels, low overhead expense of , say, 15% to 20% and an effective premium collection mechanism.

The following lists the key success factors in the success of CARD MBA:

Large Membership Base

- At least 8,000 members
- Compulsory life insurance and retirement coverage to prevent adverse selection
- Clients well distributed throughout the archipelago to minimize co-variant risk

Affordable Contributions and Effective Collection Mechanism

- Level contributions, level benefits

Low Administrative Cost

- Less than 20% on administration and marketing
- Can be done by pairing up with an MFI

Separate Institution to Handle Microinsurance Operation

- To prevent co-variant risk

Sound Technical/Actuarial Basis

- MIS to track members' history and to gather data for periodic actuarial analysis
- Technical assistance provided by RIMANSI

Professionally Managed

- For the development of products designed to meet members' needs
- For proper implementation of the rules and regulations of the association

Effective Information, Education Campaign Strategies

- A very good understanding of microinsurance leads to its wide acceptance among members and strong willingness to pay.

Safe and Sound Investment Policies

- Sense of protection of members' individual interest in the association

Adequate Reinsurance

- Depends on the size of the MBA and products

Regulatory environment for micro-insurance

Traditional insurance is a mature industry and there are regulatory laws, rules and regulations designed to ensure the stability of the insurance system and to protect the interests of the insured. However, those laws, rules and regulations have developed over time with traditional insurance in mind. In this paper, traditional insurance is synonymous to 'commercial insurance' which is accessible mostly for the non-poor. The supply of commercial insurance to low-income households in the informal sector seems constrained by overly restrictive regulatory environments. Minimum capital requirements, licensing, and investment restrictions that are often designed for higher-income markets seem to limit the providers' ability to offer insurance to low-income customers.

The evolving insurance product called 'micro-insurance' tries to address the existing gap in risk management capacity of households, particularly poor households. The providers of micro-insurance are not the typical commercial insurance providers but are mostly community-based or grassroots type of organizations, e.g., MBAs. Because of the evolving nature of micro-insurance and the involvement of non-traditional providers that seem to be more capable of dealing with the insurance demand of low-income households, the application of existing rules and regulations that have been developed for commercial insurance does not appear to be straightforward. A general issue is the lack of understanding of micro-insurance among various players, stakeholders and the regulatory authority. Since micro-insurance is an evolving industry, there is yet no acceptable definition of what microinsurance is, its characteristics and features, both from points of view of the regulator, on the one hand, and the clients' and the practitioners' side, on the other hand. Lessons from the experience of the microfinance sector would show that a conducive and effective regulatory environment can be formulated if there is a defined and workable definition of micro-insurance.

There is a dearth of information on appropriate regulation for micro-insurance. Is it the same product as the typical insurance product but differentiated only by the size of insurance given and the type of client (poor clients) served? Or is micro-insurance as it evolves a different product which merits a different treatment? There is it little or no single authoritative information on micro-insurance regulation because the subject of micro-insurance regulation is a new and emerging field. There is a general agreement though that regulation can either be a barrier or an effective tool for the promotion of micro-insurance but slowly, research is being undertaken to establish an appropriate regulatory framework for micro-insurance[7].

The regulatory authorities are still grappling with the issue as there is insufficient understanding or knowledge on what micro-insurance is. Insufficient understanding may bring about a regulatory environment that is not conducive for micro-insurance, which might stifle innovation and the flow of micro-insurance products to the poor. Thus, there is a need to review the regulatory framework to reduce or eliminate constraints on providing insurance in small amounts to low-income households without sacrificing the institutional and client protection objectives of regulations. In other words, there need not be a trade-off between expanding micro-insurance services to low-income households in the informal sector and ensuring the viability of the institutional providers in particular and the insurance system as a whole.

There exists some similarity between microfinance and microinsurance that necessitates some form of supervision and prudential regulation. In both instances, financial intermediation exists and deposit or savings mobilisation form part of their operations. In the case of microfinance, MFIs take in savings deposits that are then used for their lending operations. In the case of micro-insurance, the insurer accepts insurance premiums and/or contributions that are then used for payment of insurance benefits and claims of insured clients.

There is no doubt, however, that those providing micro-insurance products and services require a different kind of approach and discipline compared to microfinance providers. Running an insurance business would entail different technical competencies particularly in the understanding and management of risks and in the design of non-traditional micro-insurance products that would suit the needs of poor clients. This includes knowing and understanding the complexities of re-insurance and appropriate sharing of risks.

The primary function of insurance regulation is to protect consumers and Wiedmaster-Pfister and Chatterjee (2006) enumerate at least three different ways to do this:

- Protecting policyholders in general by ensuring solvency of the insuers, which includes determining that insurance products may only be offered by licensed entities (both insurers and intermediaries) that remain financially sound and meet their obligations;
- Protecting individual policyholders, including prospective policyholders from mis-selling and improper handling of claims, and ensuring that their grievances are redressed in a timely fashion; and
- Developing insurance markets by improving market efficiency and including persons who currently have no access to or are unable to afford insurance through appropriate product design and delivery mechanisms.

The Philippine Insurance Code

Insurance rules and regulations are designed to ensure the stability of the financial system, to promote good governance, and to guarantee the efficient and effective financial operations of insurance entities in order to protect the general public from fraud and unscrupulous practices. The ultimate objective is the protection of the general public.

The enabling law governing the establishment and operation of insurance entities in the Philippines is Presidential Decree No. 612 (otherwise known as the Insurance Code) that was issued by then President Ferdinand E. Marcos on December 18, 1974. The Code generally requires all insurance providers, regardless of type and ownership structure, to seek a license from the Insurance Commission. Granted the sole authority to issue rules and regulations to implement the provisions of the Code and to conduct regular examination and supervision of licensed insurers is the Insurance Commission. Issuance of additional rules and regulations by the Commission is subject to the approval of the Department of Finance.

The Code also specifically sets the parameters and conditions by which the Insurance Commission may grant license to entities that intend to engage in the insurance business in the Philippines. It sets guidelines, prudential rules and regulations in the operations of insurers to ensure that these entities will be able to provide the benefits due to the consumers as indicated in the insurance policy contracts.

Specifically, the Code contains provisions that define the:

- Types of insurance products that a registered insurer may provide depending on the license that was applied for and approved;

- Criteria, particularly the minimum capitalization, for the granting of the license and the documentary requirements needed for registration and licensing;

- Ownership structure of the insurer and the qualifications of persons that may engage in the insurance business;

- Qualifications for licensing of agents and brokers;

- Form, terms and conditions of a legitimate insurance or policy contract and procedures for settlement of claims and determination of unfair claims practices;

- Rules governing reinsurance transactions; and

- Conditions for suspension and revocation of license, appointment of conservator, proceedings upon insolvency, and merger, consolidation and mutualization of insurance companies.

The Insurance Code generally identifies four (4) types of insurers: 1) life insurance provider; 2) non-life insurance provider; 3) composite insurance provider; and 4) mutual benefit associations. Past regulations required no less than Php 50 million capitalization for a life insurance entity. For non-life insurers, capitalization should also not be less than Php50 million. To provide both life and non-life insurance, capitalization requirement is doubled and should not be less than Php100 million. The Insurance Commission has recently increased the minimum capital requirement for all new insurance players.

The minimum capital requirement for new insurance and reinsurance companies has recently been increased. Life or non-life insurance companies are required to have a minimum capitalization of Php1.0 billion, of which at least fifty percent (50%) consists of paid-up capital and the remaining portion thereof as contributed surplus, which in no case shall be less than Php200 million. Reinsurance companies should have a minimum capitalization of Php2.0 billion, paid in cash, of which at least fifty percent (50%) consists of paid-up capital and the remaining portion thereof as contributed surplus, which in no case shall be less than Php400 million.

The reason behind the increase in required capital is to ensure that insurance providers are sustainable institutions. With the large minimum capital requirement, commercial insurance providers will tend to focus their operations toward the middle- and high-income brackets in order to recover their initial huge financial investments at the soonest possible time.

There is no doubt, however, that the insurer must have adequate financial muscle to sustain the vagaries of the industry. However, it is noted though that it may be a blunt instrument to ensure the viability of the institution concerned. Developing performance standards for micro-insurers and developing appropriate supervision such as risk-based supervision, which has been effectively implemented in the bank supervision, will be an important first step in developing an appropriate regulatory framework for micro-insurance.

<u>Delivery channels of micro-insurance</u>

There are three options by which the delivery of micro-insurance can be undertaken: (a) commercial insurance firms become the direct micro-insurance provider; (b) MFI acts as broker or agents of insurance firms or partners with a registered insurer; and (c) MBAs or insurance societies cater to members.

The problem with commercial insurers is that they shy away from the lower income market. Their limited understanding of this market has stifled their ability to design applicable products for the poor. Moreover, large insurance companies may find the micro-insurance sector financially unattractive and costly as they have to deal with small insurance policies, large volume of transactions and will have to operate in remote areas to service the poor.

On the other hand, MFIs are faced with certain limitations when acting as brokers or agents of insurance companies. Generally, only persons or individuals may be licensed by the Insurance Commission to act as insurance agents or brokers. Although the Insurance Commission is authorized to grant license to entities as general agents or brokers, such entities will have to provide the specific list of persons or individuals who may act in their behalf. This is clearly provided in Section 364 of the Code that specifies "A license issued to a partnership, association or corporation to act as an insurance agent, general agent, insurance broker, reinsurance broker, or adjuster *shall authorize only the individual named in the license who shall qualify therefore as though an individual licensee.. .*" There is a need to review and clarify this regulatory provision. Some MFIs collaborate with Cocolife to insure more than 300,000 low-income households. Those MFIs are not registered agents and do not receive commissions but receive "administration fees" for the effort.

Realizing the risks and complexities of providing in-house micro-insurance, most MFIs have acted as insurance agents or brokers of commercial insurance entities. This, however, has its own limitations. Most commercial insurers do not have the appropriate insurance products that would suit the needs of MFI clients. It is noted though that the problem of licensing MFIs to act as brokers or agents remains since licensing of insurance agents or brokers are limited to natural persons or individuals. With these limitations, MFIs will have to create and maintain a separate staff of licensed insurance agents or brokers within its organization in order to service the insurance demand of thousands of small clients. This may turn out to be costly and organizationally cumbersome for the MFI.

Allowing MFIs (cooperatives and NGOs) to be micro-insurance providers may create unnecessary risks both for those MFIs and their respective clientele. Significant problems may arise when one combines mirofinance operations with the delivery of micro-insurance. Microfinance and micro-insurance are different types of products that require different technical skills and expertise, management know how, systems and financial requirements that may be beyond the capacity of MFIs to provide.

MBAs represent one type of micro-insurance insurance delivery organizations. Recognizing the unique members-only ownership structure of mutual benefit associations, the Code provides special provisions to govern the registration and operation of MBAs that are separate and distinct from the general provisions governing insurance entities. As a matter of fact, MBAs are classified differently from the term "insurer" and "insurance company" as defined in the Code.

Section 184 of the Code specifically provides that "For purposes of this Code, the term *"insurer"* or *"insurance company"* shall include all individuals, partnerships, associations, or corporations, including government-owned or controlled corporations or entities, engaged as principals in the insurance business, *excepting mutual benefit associations. . ." (Underscoring supplied).*

Under the law, an MBA is **"**any society, association or corporation, without capital stock, formed or organized not for profit but mainly for the purpose of paying sick benefits to members, or of furnishing financial support to members while out of employment, or of paying to relatives of deceased members of fixed or any sum of money. **. ."** In essence, an MBA is a non-stock, non-profit organization organized to benefit its members.

Aside from the required guaranty fund, there are prudential requirements that are imposed on MBAs as provided for in the Insurance Code, namely:

1. At least 10% of total assets shall always be maintained in the Guaranty Fund;
2. At least 50% of members' contributions shall be set aside as reserve requirement;
3. Liabilities shall not be more than 80% of the MBA's non-risk assets; and
4. An examination of books has to be undertaken at least once every two years.

Insurance Memorandum Circular no. 2 – 2006 has recently increased the amount of guaranty fund of mutual benefit associations from Php10,000 to Php12.5 million for currently operating MBAs. For new MBAs, the guaranty fund shall not be lower than 25% of the minimum paid up capital of new insurance companies or Php125 million.

In addition, the Cooperative Code authorizes co-operatives to organize co-operative insurance societies for their members. Requirements on capitalization, reserves and investments of insurance societies can be modified by the Insurance Commission upon consultation with the Cooperative Development Authority (CDA) and the co-operative sector. However, such requirements shall in no case be reduced to less than half of those provided for under the Insurance Code and related laws. The rules and regulations to implement this provision of the Cooperative Code are currently being worked out by the CDA and the Insurance Commission.

The MBAs and the cooperative insurance societies are part of a two-tier system for providing insurance devised by legislators. The first tier consists of the traditional, mainstream insurance companies while the second tier comprises MBAs and cooperative insurance societies. The problem with most MBAs is that they have remained small and inadequately capitalized. The increase in required guaranty fund may be a first step for financial strengthening. The licensing of MBAs provides some protection to members but in practice, the Insurance Commission has not really taken much cognizance of these small micro-insurance providers until lately. The Insurance Commission tends to devote its supervisory resources to the larger, first tier insurance companies for obvious reasons. This "practical" approach seems to endanger consumer protection at least as far as members of MBAs are concerned.

MBAs and cooperative insurance societies have the greatest potential to be the main vehicles for the delivery of formal micro-insurance services because they have the distinct advantage of knowing their market and understanding the insurance needs of the poor. However, they have to be strengthened and adequately supervised.

Informal micro-insurance schemes

Given the pressure to meet the demand by the informal sector for micro-insurance services, MFIs (particularly cooperatives and NGOs) have instead designed informal micro-insurance schemes outside the ambit of the regulation and supervision of the Insurance Commission. Without government regulation, there are risks of fraud, mismanagement, unsound financial practices, and failures. While ostensibly the informal micro-insurance schemes fill a perceived gap in the market, they tend to create risks both for clients from the informal sector and the very institution that provides the insurance.

What seems to be surprising is that despite the more relaxed licensing and capitalization requirements for MBAs and cooperative insurance societies, there seems to be no compulsion or incentive among small informal micro-insurance providers to become formal and be placed under Insurance Commission regulation and supervision. Policy makers and the Insurance Commission have to look at this situation more closely because the objective of providing more households, especially low-income households, with access to micro-insurance products may be defeated by the instability and financial weaknesses of the informal "micro-insurance providers." It is not just a matter of providing the poor with access to finance and micro-insurance services but also an issue of ensuring consumer protection through the stability and financial adequacy of the those providers.

Concluding remarks and recommendations

When markets and the state fail to provide efficient risk management alternatives, micro-insurance emerges as a substitute solution for the poor. However, there is a need for a greater understanding of the implications of providing micro-insurance through different models and organizations. Insurance requires entirely different skills and institutional capacity from credit and savings, which is frequently lacking in developing countries such as the Philippines. The current tendency of MFIs (cooperatives and NGOs) to undertake micro-insurance programs should be examined in view of their lack of institutional competence and financial capacity to provide micro-insurance products. The path taken by a successful MBA, the CARD MBA to provide viable micro-insurance services seems to indicate a path for other MBAs that are seekig to expand or strengthen their micro-insurance operations. CARD MBA was able to show that it is possible to provide viable microinsurance schemes provided the following basic features are observed: (a) level contributions, level benefits; (b) frequent and affordable premium payments; (c) simple product design; (d) uniform benefit packages; and (e) low overhead expenses. A deeper study of the different delivery models has to be undertaken for the benefit of would-be providers of micro-insurance and the regulatory authorities as well.

It is important to review the regulatory issues facing micro-insurance in order to develop a regulatory environment that is supportive of micro-insurance operations. The question that needs to be raised is whether the regulatory framework in the country is conducive to protecting policy holders and developing insurance markets that include the low-income segments of the population (Wiedmaier-Pfister and Chatterjee, 2006).

An inclusive micro-insurance operation will enlarge the risk pool and thus will address the adverse selection problem and co-variate risks but this could also mean higher transaction costs, voluntary exclusion by wealthier participants in the risk pool. Craig (2006) asks whether inclusion is feasible for market-based micro-insurance. The costs of identifying high-risk persons such as those with pre-existing illnesses, may be higher than the benefits of excluding them in the first place. One view is that certain individuals cannot be integrated into such micro-insurance schemes unless their premiums are subsidized since no resource pooling can be formed by selling insurance to them. This merits a closer study.

There are several delivery models but it seems that it is important to have a separate entity that provides microinsurance. Insurance products are not the same as the typical micro-loan products of MFIs. Policy holders must be protected from the insolvency of a MFI that does not have institutional competence and sufficient financial capacity to act as insurer.

There is also a need for a regulatory environment that would be conducive to protecting holders of micro-insurance policies and developing insurance markets that cater to low-income households.

At the end of the day, perhaps the most pressing question to answer is whether or not microinsurance will strengthen household risk management capacity and whether or not access to microinsurance improve their level of welfare. Client-based measures of success, e.g., lower household vulnerability should be no less important than measures of the institutional sustainability.

In view of the foregoing, the following are recommended

1. Documentation of existing micro-insurance schemes, practices and delivery models for deeper study and identification of viable institutional models that could address the demand for insurance by low-income households, with focus on emerging informal micro-insurance schemes.

2. Review of the current regulatory environment, identification of barriers to sound micro-insurance and the formulation and adoption of appropriate rules and regulations and guidelines for the safe and sound operation of institutions providing micro-insurance and for the protection of policy holders.

3. Review of the technical capacity and capability of the Insurance Commission to effectively supervise and monitor the operations of micro-insurance providers.

4. Identification of policy changes, revision of existing rules and regulations, if necessary, for the efficient and effective functioning of the micro-insurance market. This will include the setting up of benchmarks and performance standards.

5. Strengthening of MBAs and cooperative insurance societies with regard to management, technical skills and financial capacity to perform their functions as micro-insurance providers.

6. Information and education campaign among low-income households on the need for risk protection through such schemes as micro-insurance.

Annex A

INSURANCE INDUSTRY BACKGROUND

According to the 1994 Philippine Standard Industrial Classification (PSIC), the Insurance Industry includes long- and short-term risk spreading with or without a savings element. It is broadly categorized into Life insurance and Non-life insurance.

Life insurance (including reinsurance) consists of long-term insurance, with or without a substantial savings element, involving the collection and investment of funds. Alternatively, non-life insurance involves the insurance and reinsurance of non-life business such as accident, fire, property, crop, motor, marine, aviation, transport, pecuniary loss and liability insurance.

Though not included in the scope of this paper, it would be worthwhile to mention the activities that are auxiliary to the insurance industry. These are activities involved in or closely related to the management of insurance other than financial intermediation such as the activities of insurance agents, average and loss adjusters, actuaries, and salvage administration.

On a different note, the Insurance Code identifies four types of insurers, namely: (1) life insurance provider; (2) non-life insurance provider; (3) composite insurance provider; and (4) mutual benefit associations. The basic difference among the four lies in the amount of capitalization and the different types of risks that are provided cover.

During 2004, the number of certificates of authority and certificates of registrations to insurance companies, insurance intermediaries, agents, underwriters, actuaries and adjusters – totaling 43,104 – expanded by 22.98% over 2003.

Demand Conditions

Coverage

Insurance density is defined as the amount of premiums per capita. It corresponds to the average amount spent on insurance by each person and signifies the current state of the industry. Table A.1 shows that per capita expenditure on insurance grew by roughly 40% from PhP593.50 in 2000 to PhP827.90 in 2004. Life insurance comprised almost three-fourths of the total per capita expenditure on insurance, while the remaining one-fourth is taken up by non-life insurance. Households in the Philippines spend a total of roughly PhP38 billion on life insurance and retirement premium (FIES, 2003). Estimated Life Insurance Coverage averaged 14% from 2000-2004.

INSURANCE INDICATORS	2000	2001	2002	2003	2004
Insurance Density *(Per capita expenditure in PhP)*	**593.5**	**654.4**	**768.4**	**810.7**	**827.9**
Life	347.8	387.0	457.9	495.5	505.0
Non-Life	245.7	267.4	310.5	315.2	322.9
Insurance Penetration *(Premiums as % of GDP)*	**1.16%**	**1.17%**	**1.27%**	**1.30%**	**1.27%**
Estimated Life Insurance Coverage	**13.01%**	**12.80%**	**13.65%**	**18.31%**	**13.11%**

Source: Insurance Commission

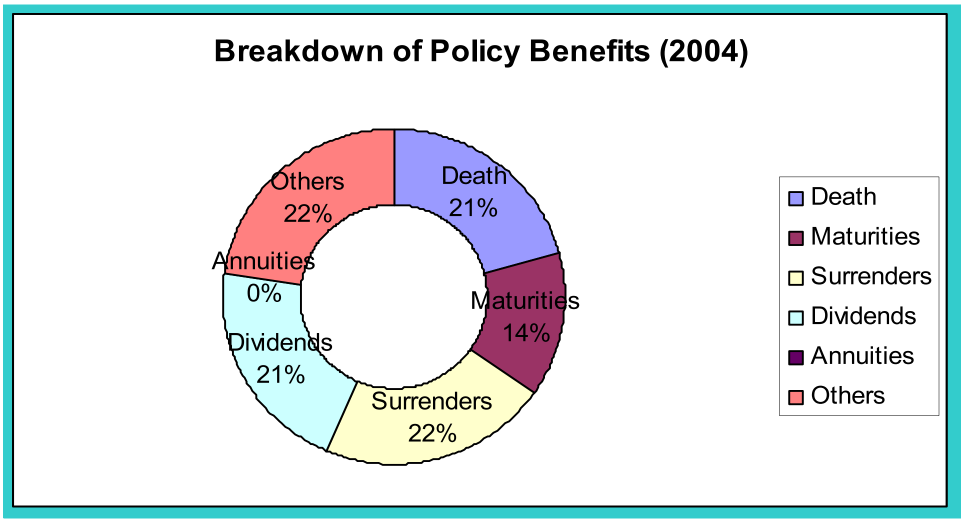
Table A.1: INSURANCE DEVELOPMENT

Despite declarations of formal schemes to extend cover to the majority of the population, especially the poor, the existing social insurance schemes fail to cover the informal sector. Philippine Health Insurance Corporation (Philhealth), GSIS, and SSS statistics show that the majority of their members belong to the formal sector and they are mostly regular employees. Three-fourths of Philhealth's members are employees from the private and government sectors. Currently, there are 1.4 million GSIS members. As of December 31, 2004, SSS coverage amounted to roughly 25 million formal workers. Only 10% of the 658,000 domestic helpers in the Philippines in 2005 are covered by SSS.

Claims paid

Life Insurance

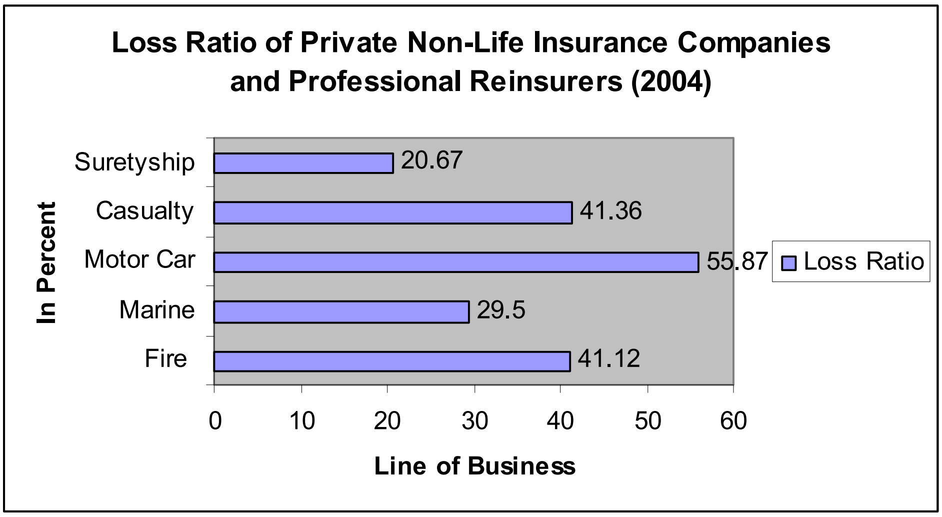
In 2004, the life insurance sector rewarded PhP19.11 billion in benefits to policyholders. The figure below shows the break down of benefits provided to policyholders, e.g., 'other benefits' (22.71%), surrender benefits (21.72%) and death benefits (20.88%). By type of plan, ordinary life insurance claimed the majority of the benefit payments with 85.29% share, followed by Group (14.62%) and Industrial (0.09%).



Source: Insurance Commission

Non-life Insurance

For 2004, total losses/claims rose by 14.05% from the 2003 level. The overall claims ratio increased to 45.90% in 2004 from 44.28% in the previous year. Among all lines, the motorcar business had the worst claims experience with a 55.87 loss ratio. On the other hand, the marine business showed a better claims experience with a 29.50 loss ratio.



Source: Insurance Commission

Potential demand and growth of demand

Insurance penetration and density are common measures of the level of insurance provision and uptake in a country[8], albeit imperfect ones. Insurance penetration is defined as the total premiums divided by GDP. It measures the importance of insurance activity relative to the size of the economy; hence it can be a rough indicator of growth potential.

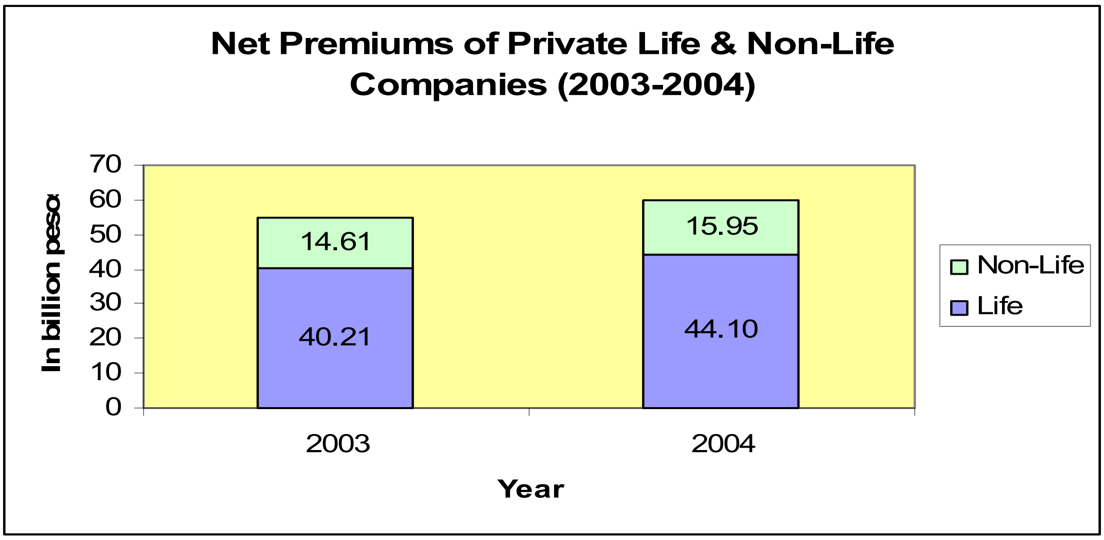
Insurance penetration in the Philippines is slightly more than 1% from 2000-2004 (See Table A.1), while insurance density ranged from US $11 to US $14 in 2000-2004. The Philippines compares poorly with Thailand, India, and Malaysia, but slightly better than Vietnam, Indonesia, and Pakistan. In short, the growth of the Philippine insurance industry is not keeping pace with economic growth. This seems to indicate a significant room for growth of the insurance market in the Philippines.

Extent of poor households without insurance

There is a dearth of information on the extent of poor households without insurance cover. Here we can only cite as source of information a market research by RIMANSI in June 2002 among 527 families in areas where a large non-governmental organization, the Center for Agriculture and Development (CARD) is operating (17 cities/towns in Southern Tagalog and Bicol). The CARD survey provides a rough picture of the insurance market among poor households. Fifty-four percent (54%) of the surveyed families are covered by some form of insurance; 39% have on-going insurance policies, while 15% have previously bought policies but stopped buying. We can surmise that a big portion of Filipino households are not covered by insurance or do not even have exposure to insurance. As a matter of fact, there seems to be a huge demand for insurance as evidenced by 73% of the respondents who have expressed interest in the micro-insurance products of CARD-MBA (mutual benefit association).

Supply Conditions

In 2004, the insurance industry posted a growth in combined life and non-life insurers' net premiums of 9.54%, albeit lower than the 10.81% posted a year before. The life and non-life sectors realized a net premium growth of 9.67% and 9.17% percent, respectively, over 2003 levels. The increase in premium was due to both renewal and the good performance of new business.



Source: Insurance Commission

Number of Players

Table A. 2: Number of Licensed Companies

	2000	2001	2002	2003	2004
Life	39	37	33	32	34
Non-Life	110	107	99	102	97
Composite	3	3	4	4	4
Professional Reinsurers	4	4	3	3	2
Number of Licensed Companies	**156**	**151**	**139**	**141**	**137**

Source: Insurance Commission

As Table A.2 shows, the number of licensed insurance companies has consistently dropped since 2000. By the end of 2004, there were only 137 licensed insurance companies from 156 in 2000. The drop could be attributed to one of the following factors: (1) non-renewal of business; (2) mergers; and (3) issuance of Cease and Desist Orders (CDO) by the Insurance Commission for failure to comply with certain regulatory requirements.

Non-life insurance companies constitute the bulk of licensed insurance companies at 71% on the average, followed by life insurance companies at roughly 24%. The composite insurance companies and the professional re-insurers account for the 5% residual.

As of December 31, 2004, four composite insurance companies existed – 3 domestic and 1 foreign – which offer both life and non-life insurance business. The number of professional re-insurers went down to 2 as the Malayan Reinsurance Corporation and Universal Reinsurance Corporation merged, which is now known as the *Universal Malayan Reinsurance Corporation*.

Value of policies

Life Insurance

Notwithstanding the 8.73% reduction in the total value of life insurance in-force from PhP2,049 trillion in 2003 to PhP1,878 trillion in 2004, the number of policies in-force rose moderately by 0.35%, totaling to 4.5 million policies by the end of 2004. The number of policies in-force has been on an uptrend since 2000 as seen in Table A.3.

Table A.3: Life Insurance In-Force (2000-2004)

	Policies		Insurance In-force	
Year	**Number**	**% Increase**	**In trillion pesos**	**% Change**
2004	4,566,925	0.35	1.878	-8.74
2003	4,551,012	4.10	2.049	25.78
2002	4,371,761	6.39	1.629	8.53
2001	4,109,111	10.80	1.501	43.36
2000	3,708,532	2.16	1.047	3.15

Source: Insurance Comission

Ordinary insurance accounted for the largest portion of the total insurance in-force policies, averaging at 78.82% in 2000-2004, followed by group insurance and industrial insurance with 21.14% and 0.04% shares, respectively.

The number of new life insurance policies has been falling since 2000. Despite a 0.71% decrease in the number of new life insurance policies in 2004, the sum assured for new business registered a growth of 42.06%, while premiums from new business was 13.70% higher than the 2003 level. The growth momentum was partly due to the higher coverage from the group new business, which negated the decline in ordinary business coverage (Table A.4).

Table A.4: New Business Generated (2000-2004)

	Policies		Annual Premium		Sum Assured	
Year	**Number**	**% Change**	**In billion pesos**	**% Change**	**In billion pesos**	**% Change**
2004	336,360	-0.71	14.44	13.70	223.94	42.06
2003	338,756	-7.08	12.70	11.21	157.64	-4.73
2002	364,569	-13.79	11.42	45.66	165.46	-7.06
2001	422,901	-7.49	7.84	15.98	178.02	4.82
2000	457,148	-11.17	6.76	22.02	169.83	14.89

Source: Insurance Commission

By type of policy, whole life insurance dominated the market with 61.56% of the total new policies sold in 2004. Far behind are term insurance and endowment with 5.04% and 33.4% shares, respectively (Table A.5).

Table A.5: Distribution of New Business by Type of Policy (2000-2004)

	Whole Life		Term		Endowment		TOTAL	
Year	**Policies**	**PhP B**	**Policies**	**PhP B**	**Policies**	**PhP B**	**Policies**	**PhP B**
2004	207,051	72.18	16,970	129.92	112,339	21.84	336,360	223.94
2003	199,761	75.70	20239.00	57.04	118,756	24.90	338,756	157.64
2002	214,722	83.88	22,877	51.37	126,970	30.21	364,569	165.46
2001	247,152	90.01	26,803	62.82	148,946	25.19	422,901	178.02
2000	253,398	92.14	40,112	53.71	163,638	23.98	457,148	169.83

Source: Insurance Commission

A total of 545,872 policies or an equivalent of PhP628.64 billion sum assured of policies have been terminated in 2004. Of these, 46.98% were lapsed policies, followed by expiries and surrenders at 24.08% and 15.07%, respectively (Table A.6).

Table A.6: Terminated Insurance Policies and Sum Assured (As of December 31, 2004

	Number of Policies						
Type of Policy	**Death**	**Maturity**	**Surrender**	**Lapsation**	**Expiry**	**Others**	**TOTAL**
Ordinary	9,388	16,662	82,251	255,387	129,164	29,615	522,467
Group	18,981	-	17	1,053	2,248	24	22,323
Industrial	-	1,024	5	-	53	-	1,082
TOTAL	**28,369**	**17,686**	**82,273**	**256,440**	**131,465**	**29,639**	**545,872**

	Sum Assured (in billion pesos)						
Type of Policy	**Death**	**Maturity**	**Surrender**	**Lapsation**	**Expiry**	**Others**	**TOTAL**
Ordinary	2.12	0.57	18.63	62.27	304.69	15.13	403.41
Group	3.34	3.53	0.78	37.13	129.28	51.15	225.21
Industrial	-	0.01	-	-	-	-	0.01
TOTAL	**5.46**	**4.11**	**19.41**	**99.40**	**433.97**	**66.28**	**628.63**

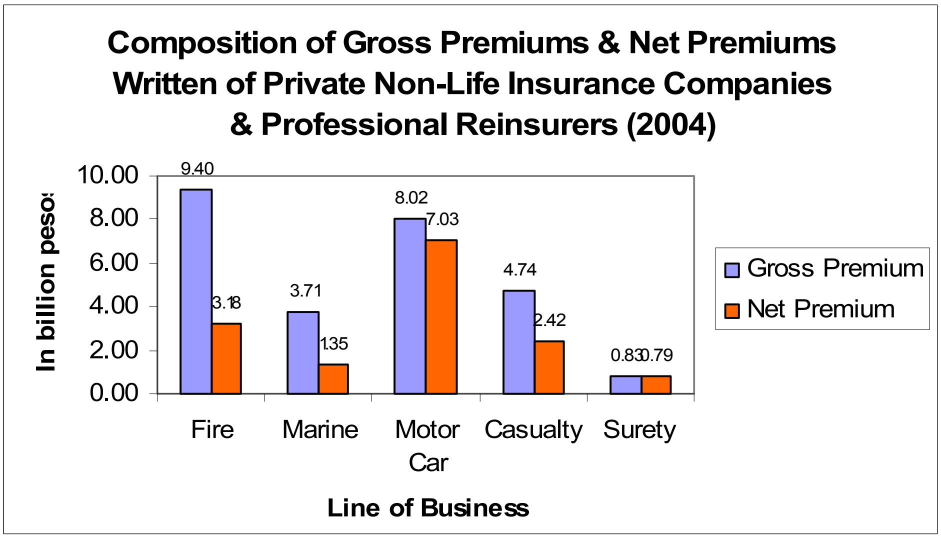
Source: Insurance Commission

Non-life Insurance

From PhP25.53 billion in 2003 to PhP26.70 billion in 2004, gross premiums of non-life insurers picked up slightly by 4.58%. Fire maintained its dominance, accounting for 35.21% of the total gross premiums for the said year. Behind it is motorcar (30.04%), followed by casualty, marine and surety ship business with a combined share of 34.75%.

In terms of net premiums written, motorcar business has consistently been the top grosser in the market for years now. The retention ratio (ratio of net premiums to gross premiums) in 2004 was 59.74% compared to 57.23% posted in 2003.

The total premiums earned increased by 10.16% over the 2003 level with all lines recording growth in premiums earned.

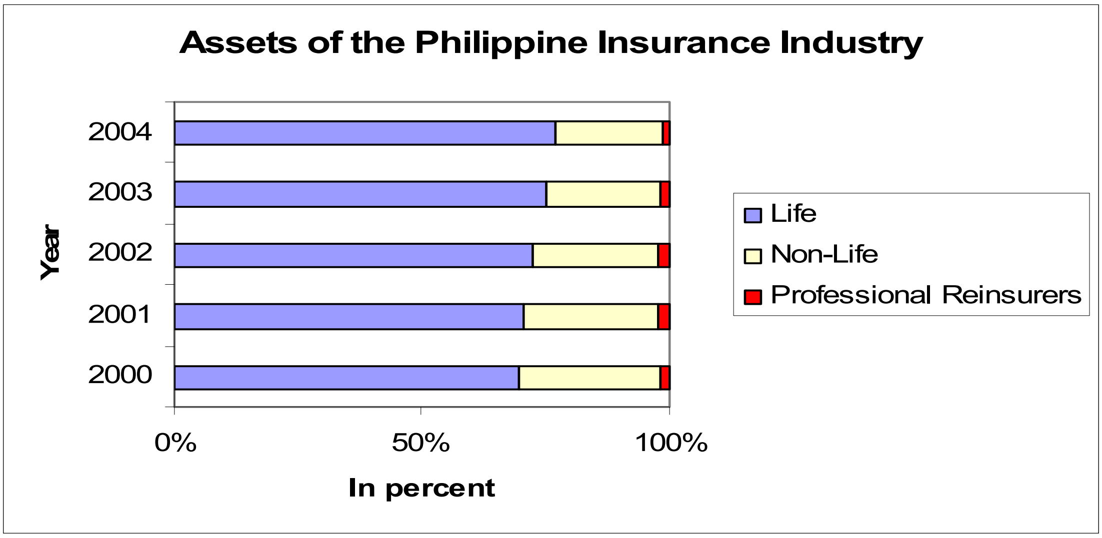


Source: Insurance Commission

Size of assets and net worth of the industry

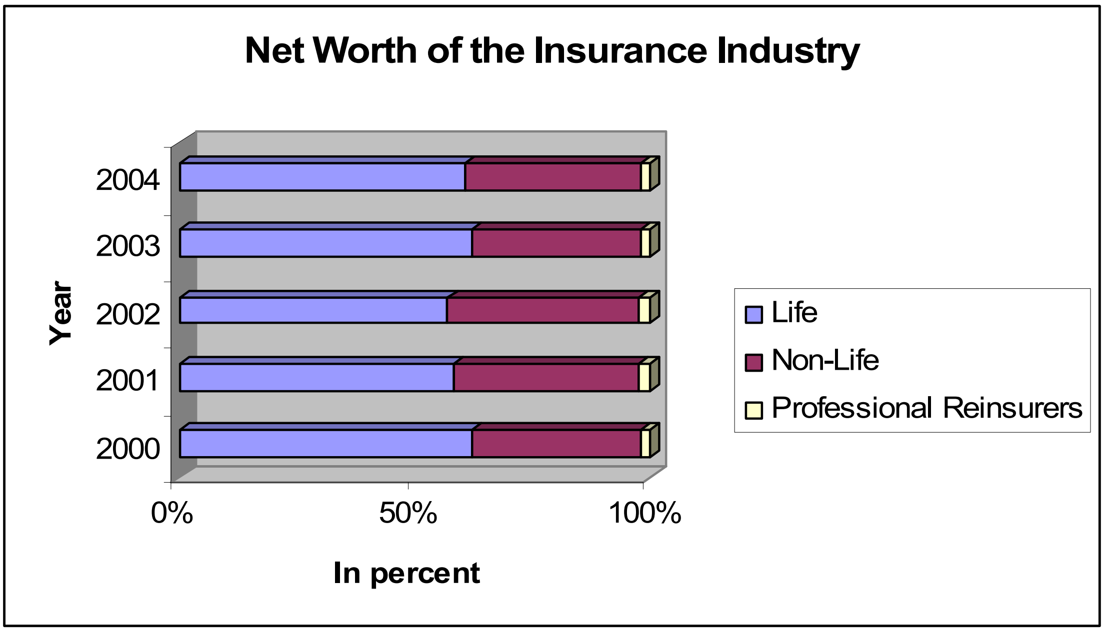
The total assets of the insurance industry expanded by 12.03% to reach PhP311.02 billion in 2004 from PhP277.62 billion in 2003. The life sector took up the largest share in the total assets (77.18% in 2004), while the non-life sector accounted for 21.30%.

Accounting for 41.41%, bonds comprised the major component of the total assets in 2004, followed by stock and cash deposits with 19.85% and 7.68% shares, respectively.



Source: Insurance Commission

The total invested assets of the insurance industry recorded a moderate growth of 10.98% to attain PhP226.54 billion in 2004 from PhP204.12 billion in 2003. In fact, the industry's investments have been growing since 2000. Of this, 85.01% was accounted for by the life sector and 14.99% by the non-life sector.



Source: Insurance Commission

The total net worth of the industry in 2004 was 2.56% higher than PhP92.07 billion in 2003. Roughly 60% of the total net worth of the industry has been accounted for by the life sector in 2000-2004, while the non-life sector and professional re-insurers took up the remaining 37.52% and 2.48%, respectively.

The Top Ten Insurance Companies

Both life and non-life insurance companies have been ranked by the Insurance Commission in terms of net income, premium income, net worth, assets, investments-at-cost, and paid-up capital. The following is a list of life insurance companies that have been top rankers in all categories in 2004:

Top Life Insurance Companies in 2004:

1. Philippine American Life & Gen. Ins. Co., Inc.
2. Sun Life of Canada (Phils.) Co.
3. Manufacturers Life Insurance Co., (Phils.) Inc.
4. Ayala Life Assurance, Inc.
5. Great Pacific Life Assurance Corp.

The following is a list of non-life insurance companies that have been consistent top rankers in at least 5 categories:

Top Non-life Insurance Companies in 2004:

1. Malayan Insurance Company, Inc.
2. Philam Insurance Company, Inc.
3. BPI/MS Insurance Corporation (FEB Mitsui Marine)
4. Pioneer and Insurance Surety Corporation
5. Standard Insurance Company, Inc.

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End Notes

[1] MicroSave-Africa, Microinsurance Centre

[2] James R. Garven is the Frank S. Groner Memorial Chair of Finance and Professor of Finance and Insurance at Baylor University’s Hankamer School of Business

[3] Rajeev Ahuja is a Senior Fellow at the Indian Council for Research on International Economic Relations (ICRIER). Johannes Jutting is a Senior Economist at OECD Development Centre.

[4] Craig Churchill, Social Finance Programme, ILO

[5] Among these include: 1. often inadequate membership volumes to spread the risk, leaving them vulnerable to shocks sometimes as limited as one member’s care, 2. insurance risks are left with the members of the mutuals instead of with a professional, financially sound organization thus yielding an inability to properly manage the risk, 3. incapable and indeed often corrupt governance resulting in repeated de-capitalization of the premiums and reserves, reduced contributions and termination of services from the provider, 4. inadequate accounting systems enabling mismanagement and abuse, 5. skewed incentive structure where (for health insurance, for example) the incentives encourage clinics to put the emphasis on expensive curative services and excessive medications in order to improve earnings and leave any incentive for efficient and preventive care to the mutual membership that has very limited capacity to provide these (Michael J. McCord)

[6] Social Protection Unit, Human Development Network, The World Bank

[7] See for example, the discussion by Wiedmaster-Pfister and Chatterjee in the volume edited by Craig (2006).

[8] W. Jean Kwon."Toward Free Trade in Services: Emerging Insurance Markets in Asia", (undated)