Policy and Regulatory Issues and Challenges in Microinsurance: A Philippine Case*

GILBERTO M. LLANTO**

ABSTRACT
When poor households face catastrophic events, they do not have any means for risk protection. Access to formal risk protection schemes such as insurance may be a more effective means to minimize the poor households' losses but traditional mainstream insurance has bypassed informal workers and poor households. To fill the gap, microfinance institutions (MFIs) have developed informal "insurance" schemes while the more enterprising MFIs have established licensed mutual benefit associations. Still, others have partnered with commercial insurers to provide insurance to their member-clients. This paper discusses the need for an appropriate regulatory framework for microinsurance and provides specific recommendations to address the emerging challenges in this segment of the financial markets.

MOTIVATION FOR MICROINSURANCE
Sudden and unexpected shocks such as severe illness, injury, death of a family member, and manmade or natural disasters impair the poor households' cash flow and income-earning abilities and drive them deeper into poverty. However, they

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do not have adequate protection to deal with such catastrophic events. A study by Churchill (2006) observed that informal risk-coping measures are oftentimes insufficient for the desired risk protection as they tend to cover only a small portion of the loss, thus failing to shield poor households and informal workers against a series of perils. Moreover, there are no indigenous mutual support schemes that could be formed in anticipation of future risks (Balkenhol and Churchill 2002). It is common for poor households to make direct spot payment to the health provider, e.g., doctor, when they currently need it but not to form mutual support schemes in anticipation of a future health problem.

Access to formal risk protection schemes such as insurance may be a more effective means to minimize the poor households’ losses but traditional mainstream insurance has bypassed informal workers and poor households. High transaction costs and the perception that poor households and informal workers do not have the cash flow to remit regular premium payments have led traditional insurers to ignore the potential of this client base. For those poor households and informal workers, an insurance market is virtually absent in the formal sense. The gap is filled by various attempts to provide informal insurance to poor households and informal workers. Various studies (Brown and Churchill 2000; Brown et al. 2000; Churchill 2002; Brown and Finkelstein 2004; Almazan 2005; Churchill et al. 2005, among others) have called attention to this phenomenon. The importance of this phenomenon underscores the necessity of examining it more closely because of its implications to the well-being of poor households and the stability of the insurance industry.

This paper provides a preliminary overview of an emerging “microinsurance industry” that has risen to meet the challenges described above and discusses some policy and regulatory issues that the government has to consider, as well as directions for future research or study.

Microfinance institutions (MFIs) have recently recognized that their low-income clients (the poor households and informal workers) need not only loans but also other financial services such as insurance. MFI borrowers could stop loan repayment temporarily or permanently depending on the effects of ill health, accidents, or death on the household, creating deleterious effects on the loan portfolio and ultimately on the profitability of the lending institution. To protect themselves while at the same time provide some form of risk protection to vulnerable low-income clients, MFIs have devised informal “microinsurance” schemes such as inhouse mutual aid or benefit funds, “credit life insurance,” and other similar schemes.

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1 Such as credit unions and credit-granting nongovernmental organizations (NGOs).
Microinsurance is generally for individuals who are ignored by traditional commercial and social insurance schemes, typically from low-income households, who work in the informal economy, have irregular cash flows (Churchill 2006), and have seasonal fluctuations in earning capacity. Microinsurance schemes would generally focus on life and health insurance because death risks and illness are the major risks faced by poor households. Microinsurance schemes offered by MFIs and mutual benefit associations are a risk-pooling strategy that enables poor or low-income households to cope with larger risks, e.g., death and health risks. In Churchill’s fine explanation: “participating in a risk pool is a more efficient means of accessing protection than if households try to protect themselves independently” (Churchill 2006:14).

**UNDERSTANDING THE RISKS FACED BY LOW-INCOME HOUSEHOLDS**

Low-income households 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. Households that possess risk-coping mechanisms such as educational and retirement plans can deal with predictable risks. In contrast, unpredictable risks, which are associated with illness, injury, death of a family member (especially, the learning head of household), natural and manmade calamities, and others, could also substantially erode the net worth of low-income households. Their impact could be more devastating because they are largely unpredictable and low-income households do not have access to instruments that can help them deal with those risks. The unpredictability of those risks underscores the great need of the poor for some form of insurance and this is where informal schemes are finding their niche.

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), and political (civil war) or economic (oil crisis) risks. Figure 1 maps these risks in terms of the degree of uncertainty and relative loss or cost.

The more unpredictable the risk, the more devastating it is for low-income households. Poor households would have to use available meager savings, liqui-

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2 From hereon, the terms “informal sector” and “poor households” will be lumped together into one term, that is, “low-income clients,” for parsimony.
date scarce household assets, e.g., small equipment used for microenterprise activities, or get high-cost loans to cope with the catastrophic event.

Research by McCord shows how low-income households rank the risks they face. Top ranked are health risks followed successively by (a) death of a breadwinner, (b) death of family members, (c) accidents and natural disasters, (d) loan repayment problems, and (e) risks against access to education. In this regard, many poor households without insurance feel vulnerable to catastrophic events that may wipe out their hard-earned assets, including the main earners in the family. 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 1 lists the ways by which low-income Philippine households cope with the negative outcomes of risk events. The list is not meant to be exhaustive.

Households with marketable assets, savings, and access to loans may have better coping capacity compared to poor households, which obviously would have very limited ability to manage risks and absorb the negative outcome of risk events. Figure 2 traces the impacts of a risky event on and the expected responses of the poor.

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 but such need does not automatically lead to demand. The affordability of insurance, measured by the insurance premium, the burden of making regular premium payments when cash flows are irregular and earnings are meager, and problems about physical accessibility of the insurance provider, which increase transaction costs, may dampen the demand for insurance. Low-income households may also mistrust formal insurance providers given some reported cases of failure to indemnify clients who have experienced losses. 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 or, at worst, do not even trust.

Table 1. Coping mechanisms of low-income households

<table>
<thead>
<tr>
<th>Coping Mechanism</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Informal, on the spot action</td>
<td>Raise money when idiosyncratic risks occur (through support from relatives, loans from moneylenders, sale of livestock, etc.)</td>
</tr>
<tr>
<td>Indigenous Social Protection Schemes</td>
<td>Prepayment aimed at covering common risks or needs such as the <em>paluwagan</em></td>
</tr>
<tr>
<td>Institutional Insurance Schemes</td>
<td>Social protection organized by the state such as the Social Security System, Government Service Insurance System, and PhilHealth, and commercial insurers, if households are able to access them</td>
</tr>
<tr>
<td>Microinsurance Schemes</td>
<td>Schemes developed by MFIs, mutual benefit associations (MBAs), or cooperatives</td>
</tr>
</tbody>
</table>

* Cohen and Churchill (2006) note that insurance may have a negative image in a community, especially if certain individuals who have had access to conventional insurance have a negative experience, e.g., claims processing delay, rejected claims, and lapsed policies.
To sum it up, factors affecting the demand for microinsurance include perception of and attitude toward insurance, risk management substitutes (product-demand match), affordability (premiums, income level), and institutional rigidities (high transaction costs, accessibility).

We now turn to the supply-side factors affecting insurance provision to low-income households.

The lack of good infrastructure in areas where most of the low-income households can be found increases the costs to collect premium payments, file and process claims, register and renew membership, keep members informed, and recruit new members. The transaction costs associated with insurance delivery to low-income households are large indeed, e.g., 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 2 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.

In sum, traditional commercial insurers could but would not offer insurance services to the poor due to existing barriers to entry such as high transaction cost, costs related to asymmetric information and uncertainty, actuarial difficulties, aggregate risks, and lack of information. The regulatory environment is also an important contextual variable, which defines the framework and boundaries for providing insurance. This is an issue the paper discusses below. A restrictive regulatory environment may constrain efforts to provide insurance to low-income households. A huge capital requirement needed to put up an insurance entity may induce insurance firms to target the big rather than the small clients to compensate

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Figure 2. Risky event and expected responses by low-income households

<table>
<thead>
<tr>
<th>Risk Event</th>
<th>Consequences of Shocks</th>
<th>Selected Responses</th>
<th>Secondary Shock Impacts</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Income loss</td>
<td>Draw on formal and informal schemes</td>
<td>Reallocated household resources</td>
</tr>
<tr>
<td></td>
<td>Asset loss</td>
<td>Use savings</td>
<td>Depleted assets and financial reserves</td>
</tr>
<tr>
<td></td>
<td>Need for lump sum of cash</td>
<td>Borrow from informal or informal sources</td>
<td>Indebtedness – claim on future income flow</td>
</tr>
<tr>
<td>---</td>
<td></td>
<td>Sell assets</td>
<td>Loss of income</td>
</tr>
<tr>
<td>---</td>
<td></td>
<td></td>
<td>Loss of access to financial markets</td>
</tr>
<tr>
<td>---</td>
<td></td>
<td></td>
<td>Untreated health problems</td>
</tr>
</tbody>
</table>

Source: Cohen and Sebstad (2003).
Table 2. Insurance risks and mitigation measures

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

Source: McCord (n.d.)

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 profit potential of this uninsured segment of the population. However, many of 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 microinsurance, many informal microinsurance schemes have emerged, operating without an insurance license.

**ADDRESSING THE DEMAND-SUPPLY GAP THROUGH MICROINSURANCE**

Formal and commercial insurance have excluded low-income households 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. This is because the traditional insurance products have been designed with the middle- and high-income classes 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 microinsurance schemes have emerged.

Indigenous social protection schemes such as paluwagan (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 microinsurance, low-income households may have a useful coping instrument to meet the risks of illness, death, and other unpredictable risks. Thus, the potential of microinsurance emerges in situations of vulnerability and poverty of low-income households.

Microinsurance schemes as developed by MFIs, MBAs, and other grassroots-type organizations are quite unlike mainstream commercial insurance that may grant a comprehensive insurance cover or even pay for extensive income replacement benefits. Typical microinsurance 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 suitable life and health insurance products. MFIs and other types of organizations catering to low-income households generally charge affordable premiums, whose collection depends on the cash flows of low-income households, e.g., adjusted to irregular cash flows over a period of time.

An important element of microinsurance schemes is the appropriateness of the delivery mechanisms that make them accessible to low-income households. Table 3 shows some delivery models of microinsurance. These models offer ways to lower the transaction costs and address the problem of asymmetric information in the provision of insurance to the poor.

According to Churchill, the preferred model for low-income insurance provision is the “partner-agent” model. Established commercial insurers use MFIs, cooperatives, and other local institutions as distribution channels. Although experiencing significant problems, mutual insurance schemes are another option. Notwithstanding the somewhat negative impression of the mutuality model, it is gaining ground in the Philippines through licensed organizations called mutual benefit associations because of their ability to respond to local insurance needs and provide affordable premiums and lower distribution costs—in addition to the fact that they are member-owned.

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6 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 often corrupt governance resulting in repeated decapitalization of the premiums and reserves, reduced contributions, and termination of services from the provider; (4) inadequate accounting systems enabling mismanagement and abuse; and (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 (McCord n.d.)
<table>
<thead>
<tr>
<th>Institutional Options</th>
<th>Description</th>
<th>Advantages</th>
<th>Challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partner-Agent Model</td>
<td>An established insurance company works with a distribution channel, e.g., MFI, that actively serves low-income clients.</td>
<td>Insurer is able to reach a market it cannot reach on its own.</td>
<td>There is a need for adequately trained staff to explain insurance in ways the illiterate poor can understand. The distribution channel must still be licensed as an agent.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>MFI can provide members with better services at lower risk.</td>
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</tr>
<tr>
<td></td>
<td></td>
<td>The poor get valuable protection that otherwise would not be accessible to them.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Most regulatory complications are eliminated.</td>
<td></td>
</tr>
<tr>
<td>Mutuality Model</td>
<td>Savings and credit cooperatives or credit unions offer loan protection insurance.</td>
<td>Helps monitor moral hazard.</td>
<td>The provider must have sufficient technical and financial capacity to provide the service.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Reduces transactions cost.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Remains responsive to clients' needs and interest.</td>
<td></td>
</tr>
<tr>
<td>Direct Sales Model</td>
<td>Insurance companies directly serve low-income clients through individual agents on salary or commission basis.</td>
<td>Helps overcome control problems in the partner-agent and mutual models.</td>
<td>There may be high transaction costs in trying to serve a market unknown to traditional insurance provider.</td>
</tr>
<tr>
<td>Community-based Model</td>
<td>Nonprofit schemes that have voluntary membership.</td>
<td>Reaches not only the poor but also more of the poorest.</td>
<td>This model may face problems of sustainability and protection of member premiums, if not appropriately regulated.</td>
</tr>
<tr>
<td></td>
<td>Policyholders prepay premiums into a fund and are entitled to specified benefits.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Technical assistance and general oversight are given by a network support organization.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
PHILIPPINE MICROINSURANCE

It will be important to stress the inadequacy of information and data problems weighing down a precise discussion of the situation of microinsurance in the country. What this paper has is anecdotal evidence of demand situations in the emerging “industry” that is mainly derived from a few surveys done by some providers of microinsurance and interviews done by the author. For example, a large NGO, the Center for Agriculture and Rural Development, conducted a survey of potential clientele in Bicol region to establish a database for decisionmaking. The findings of the surveys manifest different demand conditions, which reflect varying local characteristics and nuances. Studies by the Microinsurance Centre indicate that the Philippines is only one of a few countries that provide microinsurance. A recent survey by the Risk Management Solutions, Inc. (RIMANSI), a local organization, revealed that around 17 grassroots organizations composed of 12 cooperatives, 3 NGOs/MFIs, and 2 transport associations, have been offering informal microinsurance. The membership base does not go beyond 3,000 individuals, on the average, with the majority of those providers having assets of less than P300,000.

In contrast, the mainstream insurance industry deals with the formal sector and 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) 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 microinsurance include the members or clients of the microfinance institutions themselves or the broader low-income community, including the vulnerable households. 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-risk groups such as older persons or those with pre-existing conditions (Wipf et al. 2006:153). Limited survey data show that Philippine microfinance institutions that are trying to develop microinsurance schemes have a basic understanding of customer needs and preferences, and they develop appropriate delivery mechanisms to reach their target clientele. What is doubtful, however, is whether they have appropriate risk management techniques or not to ensure sustainable services.

The target clientele mostly come from the informal sector, which represents roughly half to three-fourths of the Philippine economy’s labor force. The micro and small enterprises, constituting the majority 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 microentrepreneurs 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 cannot provide, therefore, the social protection needed by poor households.

While the economic growth has slowly recovered in the past few years, a substantial number of workers and establishments continue to be classified as informal. The vulnerability of many low-income households and informal worker underscores the need for some form of social protection that is better than the present informal social protection schemes currently existing. This is the situation of low-income clients to which MFIs have responded—first, with microcredits and, recently, with microinsurance schemes.

The survey data show that low-income households are convinced of the need for risk protection and that they are quite willing to make regular but affordable premium contributions. Several surveys and focus group discussions conducted by RIMANSI show that 70 to 90 percent 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 microinsurance program will not be assailed by high dropout rates and inadequate levels of premium contributions (see Box 1).

In the Philippines, a number of MFIs have started to provide informal microinsurance schemes to low-income households. They have grassroots information about their clients that is crucial in developing appropriate products and delivery mechanisms. They also have built an infrastructure and have 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. They either have partnered with an established commercial insurance provider or have tried to develop and deliver their own ‘microinsurance’ products. Under a partner-agent model with established commercial insurance firms as providers, MFIs with stable credit portfolios, strong data-tracking abili-
ties, 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 face severe constraints. Many of the pioneering attempts to provide microinsurance have been closely linked to microfinance programs and MFIs. In the words of Paul Siegel, 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 microinsurance. For one, MFIs lack the resources required to quantify and manage insurance risk. Many MFIs (cooperatives and NGOs) are small and lack efficient management information systems and management expertise. They are also ill equipped to perform many of the activities required to achieve long-term profitability and client satisfaction in the insurance market. Only per-

**Box 1. Conditions for microinsurance success**

The limited empirical evidence on microinsurance experience suggests 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

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: Siegel et al. (2001).

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7 Social Protection Unit, Human Development Network, World Bank.
haps a few MFIs have access to historical experience of the client base that can provide a reasonable actuarial analysis. MFIs may also have limited liquid reserves, 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.

The MFIs’ core competence lies in microfinance operations that may be undermined by more complex insurance products that would create huge risks for them. It will not be prudent for these MFIs to mix insurance with microloans in their array of financial services for the poor.

This is not to say that the partner-agent model is the only viable delivery model for microinsurance but it may be very risky for MFIs to be direct providers of the service. The success of a delivery model or of an organization seeking to be a microinsurance provider would depend on a variety of factors that this paper would not be able to discuss in detail. Suffice it to say that there are other delivery models for microinsurance, which should be monitored and studied by the insurance regulator in order to ensure the protection of low-income policyholders.

As presently structured, the microinsurance schemes developed by Philippine MFIs have several limitations. The risk covered is not comprehensive, that is, only a few limited forms of risk is covered, which are perceived to seriously affect low-income households, e.g., death of a family member and illness. At first blush, one may erroneously conclude that this shows a limited understanding of the insurance needs of the target clientele. A closer scrutiny reveals that the inadequacy may arise from the absence of a large enough client base, the lack of technical and management expertise, the inability to develop appropriate products, and the inadequate financial resources of the microfinance institution. The survey conducted by RIMANSI indicated that their so-called “microinsurance” programs are not operated according to sound actuarial principles. This may be because of the small, organization-specific client base, which does not allow for risk diversification. What looks disturbing is the fact that those informal “microinsurance” products continue to be provided despite actuarial weaknesses and the obvious lack of financial capacity of the providers.

Thus, MFIs offer informal microinsurance schemes with a limited scope of operation in terms of area, being mostly implemented over a narrow geographic area and focus and being mostly community based in many instances. This situation gives rise to covariant risks. Thus, MFIs should be able to operate in areas beyond their original boundaries or strive for a large outreach in order to widen the risk pool.

Often, microinsurance providers cannot charge high enough premiums 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.

The mutual benefit associations (MBAs) are the usual formal vehicles of microinsurance programs. MBAs are formal providers because they are registered and regulated by the Insurance Commission in contrast to many grassroots organizations, including MFIs that offer “microinsurance” products, which are neither sanctioned nor regulated by the Insurance Commission. Table 4 presents the differences between MBAs and commercial insurance companies. In 2004, 18 MBAs were registered with the Insurance Commission and had accumulated as-

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Mutual Benefit Association (MBA)</th>
<th>Commercial Insurance Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policymaking Body</td>
<td>Board of Trustees composed of members of the MBA who know the needs of their co-members</td>
<td>Board of Directors composed of private individuals who have invested in the company</td>
</tr>
<tr>
<td>Orientation</td>
<td>Service to the members</td>
<td>For profit, stock company</td>
</tr>
<tr>
<td>Contributions/Premiums</td>
<td>Paid contributions stay with the association for mutual benefit of members</td>
<td>Paid contributions are used to generate more profits for the company and the individual shareholders.</td>
</tr>
<tr>
<td></td>
<td>Level contributions, level benefits</td>
<td></td>
</tr>
<tr>
<td>Catastrophic Claim</td>
<td>Has to shell out a lot of funds but bankruptcy can be avoided through reinsurance facilities</td>
<td></td>
</tr>
<tr>
<td>Payment of Claims</td>
<td>Can be done as early as 2 to 3 days from the time of notification but no longer than 1 week from date of claim</td>
<td>Most insurance companies can settle claims within one month from date of claim</td>
</tr>
<tr>
<td></td>
<td>Simplified documentation</td>
<td>Several documents are required, which vary from one insurance company to another</td>
</tr>
<tr>
<td>Coverage</td>
<td>All legal dependents of the members are covered</td>
<td>Only the policyholder with option to cover family members but with additional premium</td>
</tr>
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MBAs can work well with the commercial insurance companies through reinsurance treaties.

Source: Adapted from Abellera (2005).
sets 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 microinsurance 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.

Many smaller MBAs are looking up to the successful experience of CARD MBA in developing appropriate products for members and delivering them through cost-effective means. The experience of CARD MBA shows that microinsurance can be sustainable largely if there is a wide and functioning microinsurance distribution channels, low overhead expense, and an effective premium collection mechanism.

**REGULATORY ENVIRONMENT FOR MICROINSURANCE**

Insurance rules and regulations are designed to ensure the stability of the financial system, to promote good governance, and to guarantee the efficient and

<table>
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<th>Box 2. The CARD MBA experience</th>
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<tr>
<td>The following lists the key success factors in CARD MBA:</td>
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<tr>
<td>Large Membership Base</td>
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<td>✦ At least 8,000 members</td>
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<td>✦ Compulsory life insurance and retirement coverage to prevent adverse selection</td>
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<td>✦ Clients well distributed throughout the archipelago to minimize co-variant risk</td>
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<td>Affordable Contributions and Effective Collection Mechanism</td>
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<td>✦ Level contributions, level benefits</td>
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<tr>
<td>Low Administrative Cost</td>
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<td>✦ Less than 20 percent on administration and marketing</td>
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<tr>
<td>✦ Can be done by pairing up with an MFI</td>
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<tr>
<td>Sound Technical/Actuarial Basis</td>
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<td>✦ MIS to track members’ history and to gather data for periodic actuarial analysis</td>
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<td>Professionally Managed</td>
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<td>✦ For the development of products designed to meet members’ needs</td>
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<td>✦ For proper implementation of the rules and regulations of the association</td>
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<td>Effective Information, Education, Campaign Strategies</td>
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<td>✦ A very good understanding of microinsurance leads to its wide acceptance among members and strong willingness to pay.</td>
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<tr>
<td>Safe and Sound Investment Policies</td>
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<td>✦ Sense of protection of members’ individual interest in the association</td>
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<tr>
<td>Adequate Reinsurance</td>
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<tr>
<td>✦ Depends on the size of the MBA and products</td>
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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 insuring public. Wiedmaster-Pfister and Chatterjee (2006) enumerate at least three different ways to do this:

✦ Protecting policyholders in general by ensuring solvency of the insurers, 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.

These are broadly stated approaches to insurance regulation. What is slowly being realized by various stakeholders in the emerging microinsurance industry is that the application to microinsurance should take into account the peculiarities and nuances of this industry. In other words, there may be no case for a straightforward application of traditional insurance rules and regulations to a little understood industry such as microinsurance, which is currently in an evolutionary stage.

Traditional insurance is a mature industry and there are 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’ that is accessible mostly to the nonpoor. The supply of commercial insurance to low-income households in the informal sector seems constrained by high transactions cost and the irregular cash flows of this sector. However, there may be regulatory practices or rules that may be overly restrictive so as to constrain potential providers of microinsurance. High minimum capital requirements, licensing, and investment restriction, which have often been designed for providers catering to the higher-income markets, may not be appropriate for providers that are providing microinsurance products to low-income customers.

The evolving insurance product called ‘microinsurance’ tries to address the existing gap in risk management capacity of households, particularly poor households. The providers of microinsurance are not the typical commercial insurance providers but are mostly community-based or grassroots-type organizations. In
their formal form, they are the MBAs. The application of existing rules and regulations that have been developed for commercial insurance does not appear to be straightforward if imposed on nontraditional providers such as the MBAs.

A general issue is the lack of understanding of microinsurance among various players, stakeholders, and the regulatory authority. Since microinsurance is an evolving industry, there is yet no acceptable definition of what microinsurance is, its characteristics and features, both from the 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 microinsurance.

There is a dearth of information on the appropriate regulation for microinsurance. Is it the same as the typical insurance product but differentiated only by the size of insurance given and the type of client (poor clients) being served? Or is microinsurance as it evolves a different product hence merits a different treatment? There is little or no single authoritative information on microinsurance regulation because the subject of microinsurance 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 microinsurance but slowly, research is being undertaken to establish an appropriate regulatory framework for microinsurance.

The regulatory authorities are still grappling with the issue as there is insufficient understanding or knowledge on what microinsurance is. Insufficient understanding may bring about a regulatory environment that is not conducive for microinsurance, which might stifle innovation and the flow of microinsurance 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 microinsurance services to low-income households in the informal sector and ensuring the viability of the institutional providers in particular and the insurance system in general.

There exists some similarity between microfinance and microinsurance. In both instances, some form of financial intermediation occurs. In the case of microfinance, MFIs take in savings deposits that are then used for their lending operations. In the case of microinsurance, the insurer collects insurance premiums and/or contributions that are then used for payment of some future insurance

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8 See, for example, the discussion by Wiedmaster-Pfister and Chatterjee in the volume edited by Churchill (2006).
benefits and claims of insured clients. However, there may be differences in the regulatory treatment of these two types of finance products. The provision of microinsurance products and services requires a different kind of approach and discipline compared to microfinance. Running an insurance business entails different technical and management competencies particularly in the understanding and management of risks and in the design of nontraditional microinsurance 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 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 prudential guidelines, 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 types of insurers: (1) life insurance provider; (2) nonlife insurance provider; (3) composite insurance provider; and (4) mutual benefit associations. Past regulations required no less than PhP50 million capitalization for a life insurance entity. For nonlife insurers, capitalization should also not be less than PhP50 million. To provide both life and nonlife insurance, capitalization requirement is doubled and should not be less than PhP100 million.

The minimum capital requirement for new insurance and reinsurance companies has recently been increased⁹. Life or nonlife insurance companies are required to have a minimum capitalization of PhP1.0 billion, of which at least 50 percent 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 50 percent 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 have the financial resources to sustain their operations. Critics of this requirement point to its implication to low-income clients. They claim that while the goal of financial sustainability to be attained through large capitalization requirements may be laudable, this will create the incentive for commercial insurance providers to focus their operations on the middle- and high-income brackets in order to recover their huge financial investments at the soonest possible time but at the expense of the low-income clients.

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

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

At present, commercial insurers tend to shy away from the lower income market. Their limited understanding of this market has stifled their ability to

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⁹ Required during the incumbency of former Insurance Commissioner Evangeline Escobillo. Mr. Eduardo Malinis has since then replaced Ms. Escobillo and, recently, Mr. Malinis has been quoted by the newspapers as saying that the requirement for an increase in capitalization may not be appropriate at this time and that there may be a need to review this mandate by the Insurance Commission.
design applicable products for the poor. Moreover, large insurance companies find the microinsurance sector financially unattractive and costly as they have to deal with small insurance policies and 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 have collaborated with a large local insurance company 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 inhouse microinsurance, 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 tend to create and maintain a separate staff of licensed insurance agents or brokers within their respective organizations in order to service the insurance demand of thousands of small clients. This may turn out to be costly and organizationally cumbersome for the MFIs concerned.

Allowing MFIs (cooperatives and NGOs) to be microinsurance providers may create unnecessary risks both for those MFIs and their respective clientele. Significant problems may arise when one combines microfinance operations with the delivery of microinsurance. Microfinance and microinsurance 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 microinsurance insurance delivery organizations. Recognizing the unique members-only ownership structure of MBAs, the Code provides special provisions to govern the registration and operation of MBAs that are separate and distinct from the general provisions governing insur-
ance entities. As a matter of fact, MBAs are classified differently from “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 nonstock, nonprofit organization organized to benefit its members.

Aside from the required guaranty fund, there are prudential requirements that are imposed on MBAs by the Insurance Code, namely:

✦ At least 10 percent of total assets shall always be maintained in the Guaranty Fund;
✦ At least 50 percent of members’ contributions shall be set aside as reserve requirement;
✦ Liabilities shall not be more than 80 percent of the MBA’s non-risk assets; and
✦ 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 MBAs from PhP10,000 to PhP12.5 million for currently operating MBAs. For new MBAs, the guaranty fund shall not be lower than 25 percent of the minimum paid up capital of new insurance companies or PhP125 million.

In addition, the Cooperative Code authorizes cooperatives to organize cooperative 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 cooperative 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 licensing of MBAs provides opportunities for extending insurance coverage to poor households and the informal sector in general. In practice, the Insurance Commission has not really taken much cognizance of these small microinsurance providers until lately when it realized the potential of those MBAs. The Insurance Commission has since then adopted an attitude of regulatory forbearance toward the MBAs with the understanding that those MBAs must build management, technical expertise, and financial muscle. The problem with most MBAs is that they have remained small and inadequately capitalized. The increase in required guaranty fund is a first step for financial strengthening. The Insurance Commission tends to devote its supervisory resources to the larger, first tier insurance companies for obvious reasons. In view of limitations in supervisory resources, this seems to be the practical approach. In this regard, there is scope for motivating the MBAs and cooperative insurance societies to develop the capacity for self-regulation and to require them to adhere to certain performance standards (yet to be developed) and covenants in order to ensure consumer protection.

MBAs and cooperative insurance societies have the greatest potential to be the main vehicles for the delivery of formal microinsurance services because they have the distinct advantage of knowing their market and understanding the insurance needs of the poor. They can develop more responsive insurance products and premium payment mechanisms customized to the irregular cash flows of the informal sector and poor households. However, they have to acquire financial strength, develop technical and management expertise, and be adequately supervised.

Given the pressure to meet the demand by the informal sector for microinsurance services, MFIs (particularly cooperatives and NGOs) have designed informal microinsurance schemes that seem to be outside the ambit of the regulation and supervision of the Insurance Commission. Without effective regulation and supervision, there are risks of fraud, mismanagement, unsound financial practices, and failures. While ostensibly the informal microinsurance 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 relaxed licensing and capitalization requirements for MBAs and cooperative insurance societies, there seems to be no compulsion or incentive among small informal microinsurance providers to become formal and be placed under Insurance Commission regulation and supervision. Policymakers 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 microinsurance products may be defeated by the instability and financial weaknesses of the informal "microinsurance pro-
viders.” It is not just a matter of providing the poor with access to finance and microinsurance services but also an issue of ensuring consumer protection through the stability and financial adequacy of the those providers.

CONCLUDING REMARKS AND RECOMMENDATIONS
Traditional commercial insurance markets have bypassed the poor but microinsurance appears to be an emerging market that tries to meet the demand of poor households for risk protection. MFIs have developed informal microinsurance schemes for their members but recently, some of the larger MFIs have organized licensed MBAs to provide formal insurance products to the poor. Other MFIs have opted to partner with commercial insurers to provide similar products. What is observed in the Philippine microinsurance market are various attempts to use formal and informal schemes to develop risk management instruments for the poor. 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.

There is a need for a greater understanding of what microinsurance is and the implications of providing microinsurance schemes through different delivery mechanisms, e.g., MBA. The current tendency of MFIs (cooperatives and NGOs) to undertake microinsurance programs should be thoroughly examined in view of their lack of institutional competence and financial capacity to provide microinsurance products. The experience of a successful MBA, the CARD MBA, to provide viable microinsurance services seems to indicate a path for other MBAs that are seeking to expand or strengthen their microinsurance operations. CARD MBA was able to show that it is possible to provide viable microinsurance schemes provided the following 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. It will be useful to study more closely this reportedly successful experience as well as to examine other approaches for delivering microinsurance. A deeper study of the different delivery models has to be undertaken for the benefit of would-be providers of microinsurance and the regulatory authorities as well.

It is important to review the regulatory issues facing microinsurance in order to develop a regulatory environment that is supportive of microinsurance operations. There is a need for a regulatory environment that would be conducive to protecting holders of microinsurance policies and developing insurance markets that cater to low-income households. The question that needs to be raised is whether the regulatory framework in the country is conducive or not to protecting policyholders and developing insurance markets that include the low-income segments of the population (Wiedmaier-Pfister and Chatterjee 2006).
An inclusive microinsurance operation will enlarge the risk pool and thus will address the adverse selection problem and covariate risks but this could also mean higher transaction costs and voluntary exclusion by wealthier participants in the risk pool. Churchill (2006) asks whether inclusion is feasible for market-based microinsurance. 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 microinsurance 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 and dedicated entity that provides microinsurance. Insurance products are not the same as the typical microloan products of MFIs. Policyholders must be protected from the insolvency of an MFI that does not have institutional competence and sufficient financial capacity to act as insurer.

At the end of the day, perhaps the most pressing question to answer is whether microinsurance will strengthen household risk management capacity or not and whether access to microinsurance improves their level of welfare or not. 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:

✦ Documentation of existing microinsurance 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 microinsurance schemes. There is a need for a good database on this emerging industry.

✦ Review of the current regulatory environment, identification of barriers to sound microinsurance, and formulation and adoption of appropriate rules and regulations and guidelines for the safe and sound operation of institutions providing microinsurance and for the protection of policyholders.

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

✦ Review of the technical capacity and capability of the Insurance Commission to effectively supervise and monitor the operations of microinsurance providers.

✦ Strengthening of MBAs and cooperative insurance societies with regard to management, technical skills, and financial capacity to perform their functions as microinsurance providers.
Information and education campaign among low-income households on the need for risk protection through such schemes as microinsurance.

REFERENCES