

Cover against poverty

Microinsurance to cover climate risks

Photo: Dirk Reinhard



| Dirk Reinhard

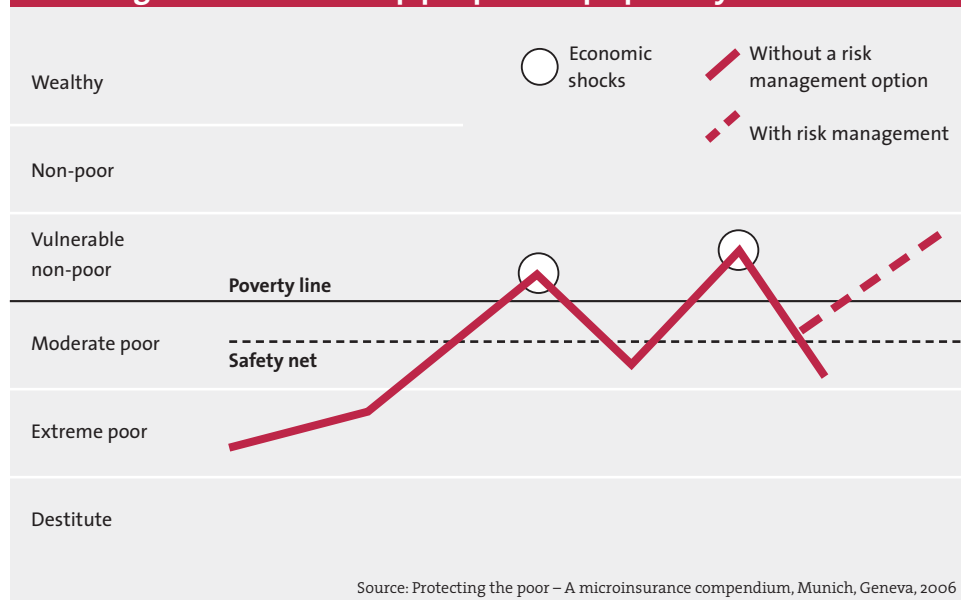
Loans and insurance can be a considerable help to people on low and irregular incomes. They enable many families to build up a livelihood and protect themselves from financial hardship. However, in the past they have been in short supply for those who will be most affected by climate change, the poorest of the poor.

Since the Grameen Bank first introduced microcredits in Bangladesh in the late 1970s, schemes of this kind have been an effective means of helping people to improve their financial situation and of fighting poverty. It is estimated that over half a billion people now take advantage of microcredits and other microfinance products. Such products help

them to establish a living and escape poverty – an increasingly urgent problem as the world's population continues to grow. This model for helping people to help themselves achieved international distinction when Professor Yunus, founder of the Grameen Bank, was awarded the Nobel Peace Prize in 2006.

Microinsurance is an important addition to the range of microfinance products. It is normally tailored to the major risks to which the people of a particular region are exposed. De-

Cover against risks can help people escape poverty



Knife salesman in Mumbai, India. Hundreds of thousands of people in developing and emerging countries earn a living from micro-businesses. Their livelihood is on the line when natural catastrophes and other events cause economic crises. Microinsurance can be the solution.

spite a significant increase in the number of schemes and insureds in the last few years, it remains relatively low key. Nevertheless, even the most rudimentary of financial services are still beyond the reach of many in the developing world. Surveys carried out in late 2006 by the Microinsurance Centre, a US consultancy firm, found that fewer than 3% of the poor in the world's 100 poorest countries had access to insurance products, i.e. less than 80 million people.

This figure is far from adequate, particularly in view of the increasing risks posed by climate change. The UNDP's 2007 report on human development explicitly states that little or no insurance cover, low incomes and negligible to non-existent financial reserves often spell disaster for poorer families when extreme weather strikes.

| Demand for new natural catastrophe covers

Studies carried out by the CGAP Working Group on Microinsurance – a network of microinsurance experts – on behalf of the International Labour Organization (ILO) show that low-income households regard the incapaci-

ty of the family breadwinner as the biggest risk they face. Ill health and death are the main causes. However, even if breadwinners are not directly affected, they may still find themselves unable to earn money if, for example, they are cut off from their workplace by floods. A natural catastrophe therefore constitutes one of the greatest risks they encounter.

In essence, microinsurance is no different from other forms of insurance: losses suffered by individuals are borne by the community of insureds as a whole. The only difference is that the customers have not had access to financial instruments before. There is great need for information and awareness programmes. Many people in the regions concerned cannot read or write. Frequently, they are "insurance illiterate", believing that insurance works like a lottery. Policies therefore have to be simple and easy-to follow, with no complicated exclusions. Premium collection also has to be very flexible to ensure cover does not lapse if payments fall into arrears because the insured's income is irregular. In the absence of a suitable financial infrastructure, new sales channels will have to be established. At the same time, however, in view of the low premiums, administration will have to be highly efficient to ensure costs are kept under control. Future technological advances such as mobile data acquisition systems will play an important role in this.

Microinsurance developments follow two distinct paths, depending on the risks to be insured. The one aims to make social security systems (such as health insurance) accessible to the poor. The other aims to develop profitable products that target the low-income segment of the market. The distinctions are blurred. Given the enormous threat posed by natural catastrophes, microinsurance should be complemented by specially developed catastrophe bonds or weather derivatives and tailored reinsurance so that schemes are not put at risk by extreme events.

| Sustainable economic development

Numerous needs analyses have shown that the potential buyers of microinsurance are not the poorest of the poor, for whom other solutions are needed. Microinsurance caters more for people currently in the process of freeing themselves from poverty, for example after they have obtained a microcredit to help them set up in business. The Indian insurance regulator estimates the number of potential microinsurance customers in that country alone to be around a quarter of a billion. Without suitable cover they would probably be plunged back into poverty at the first economic setback (see chart).



Nothing will grow any more on this land in Burkina Faso. The poorest of the poor will not be able to afford microinsurance to cover increasing crop failures. Those primarily responsible for climate change should help to find solutions to insure the poor.

Case studies by microinsurance experts have also shown that the poor are more than ready to pay for cover if they believe the money is well spent. After all, in the long term they will “pay” a lot more if they do not have suitable cover. For example, if they have to sell their livestock to pay a medical bill or if their tools of trade are destroyed.

Insurance is just one of many instruments that help the poor manage the risks they face. Savings, loans and traditional mutual assistance options within the village or family soon reach their limits if losses follow one

another in rapid succession. Moreover, the precautionary and preventive concept of insurance and the detailed risk evaluation it involves offer enormous potential for preventing losses and the human suffering they bring.

Unlike state support or emergency external aid, insurance is a more reliable means of helping people find their own way out of crises. The past has shown that emergency aid is very much dependent on the region concerned and media reaction to the disaster; those affected cannot really rely on it. Moreover, people do not like having to accept charity.

| Cooperation with the insurance industry

Help is also needed from the insurance industry if microinsurance is to achieve a major breakthrough. Since many insurers are reluctant to assume the financial and administrative burdens involved, and most do not have access to the people concerned, aid organisations, local NGOs, government representatives and insurance industry will have to jointly take the initiative and work more closely with one another. The supervisory authorities need to create the right legal framework to facilitate the development of microinsurance.

However, developing appropriate microinsurance covers will be a lengthy process if adequate resources are not available. The Bill & Melinda Gates Foundation recently emerged as a major sponsor. The foundation will provide funding in the order of €16m over the next few years in support of the Microinsurance Agency set up by microfinance network Opportunity International. Its aim is that, by 2012, more than 20 million people will have microinsurance cover. The Gates Foundation is providing €20m in support of the Microinsurance Innovation Facility. This is backed by the CGAP Working Group on Microinsurance and provides start-up capital

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for innovative microinsurance projects, technical expertise and research.

Commercial insurers are also taking a growing interest. Swiss Re, Munich Re and primary insurers like Allianz, Zurich Financial Services and Axa are starting to explore this potential growth market. US insurer AIG already has over 1.5 million customers in Uganda and has established a joint venture with India's TATA insurance company which is expected to have more than 100,000 customers by 2008 and as many as a million by 2012.

In the face of this demand, other companies are waiting in the wings. Microinsurance doubtless also has huge potential to offer people in developing countries cover against weather-related extremes and catastrophes. The current discussion hinges on whether premiums should be paid only by those concerned. Another potential source of finance would be to establish climate funds to which those primarily responsible for climate change would contribute. The issue has already found its way onto the agenda of the international climate forums and is set to be an even bigger talking point in the future. ||



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