Microfinance and Disaster Management

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Microfinance Institutions and Disaster Relief

> **The timing for MFIs to enter a disaster-affected zone is 'yesterday' with preparedness products, 'an hour after' the disaster with basic relief and 'a week later' with livelihood support.**
>
> *(BWDA, an MFI in Tamil Nadu, India that operates in the Tsunami-affected areas)*

In any natural disaster those most affected are the poor, many of whom are active or potential clients of microfinance institutions (MFIs). The emergency and relief stages that follow a natural disaster require various agents to provide or coordinate logistics and resources to support affected people. It has been observed that where an MFI was already operating in a disaster-affected area, it was invariably called upon as first responder until relief agencies and government organisations entered the scene.

SHOULD MFIs GET INVOLVED IN DISASTER RELIEF EFFORTS?

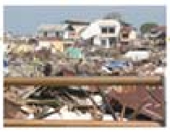
Yes! It is recommended that MFIs become an integral part of the disaster relief process. However, relief efforts for MFIs should not involve distribution of blankets, medicines and food throughout the emergency period, or operating camps for internally displaced persons. MFIs, by design, are not specialised to provide such types of relief.

LESSONS FROM TSUNAMI-AFFECTED AREAS OF INDONESIA, SRI LANKA AND INDIA:

- Go early, even during the emergency stage.
- Provide immediate relief that is only within the MFI's financial and human resource capacity.
- Open access to savings and allow accrual of savings.
- Respect, listen and dialogue with relief agents to foster coordination and partnerships.
- Take caution when providing grants: do not provide large amounts for long periods and, if possible, provide grants through a third party.
- Avoid mixing grants with loan products in the same contract.
- Link cash grants with access to loans, savings, insurance, and leasing.
- Slowly start providing regular loan products immediately after the relief stage for select clients on a limited basis, and gain pace.

Source: FDC research conducted in Feb–Mar, 2006





The major role for MFIs in disaster response involves facilitating coordination among various players such as relief agencies and the government, to help avoid market distortions and provide financial services other than just loans. Indeed, loan products are least demanded in the first few weeks following a natural disaster.

It is important for MFIs to recognise their financial and human capacity limitations to provide relief services. For example, if they lack liquid funds to provide basic needs but have adequate numbers of staff, they can provide moral support and mobilise food and water from the local non-affected public (see example below from Sareeram, Sri Lanka).

WHAT CAN BE DONE BY MFIs DURING THE DISASTER RELIEF STAGE?

MFIs can contribute the most during relief stages in the following areas:

- locating affected people;
- linking affected people with relief efforts;
- arranging for transportation to safer areas;
- using MFI communication lines to inform head offices of the situation;
- transmitting public health messages;
- coordinating with relief agencies and providing information about the area;
- organising MFI group members for community relief efforts such as clearing of debris;
- helping with damage assessment and design for relief and reconstruction plans.

Example:

Sareeram, an MFI in Batticaloa, Sri Lanka operates in the conflict-affected North East Province. When the Boxing Day Tsunami affected the area, Sareeram was the first to bring relief since it had good vehicles and officers on duty. Relief agencies and government agencies were not present before the Tsunami. Therefore, it took 2–3 days for them to arrive with relief supplies. Sareeram helped move affected people to temporary camps set up by local organisations. It helped collect food and water and distributed these for the first week. Later, it stopped providing basic needs but collaborated with relief agencies to compile a list of affected people. It conducted several participatory rapid appraisals to identify their immediate needs. It provided female staff to approach women and thus ensure trust for collection of confidential information. It then passed the information to government officials to facilitate the release of relief supplies.

WHY SHOULD MFIs GET INVOLVED DURING THE DISASTER RELIEF STAGE?

To re-establish relations with their clients.

Microfinance is based on long-term relationships. The relief stage after a natural disaster offers a chance to establish new relationships while renewing the existing ones, by being there for the clients, listening to them and linking them with relief agencies.



To help affected people to cope by releasing savings and facilitating money transfers.

This is especially important in areas that are frequently affected by disasters, where donor fatigue may limit the flow of funds for relief and livelihood restoration.

To help relief agencies with logistics and information.

In most places, MFI officers have comprehensive information about a village and its inhabitants. MFIs can be useful information partners to help relief agencies provide immediate assistance to affected households, since they are familiar with their clients and can quickly identify those most in need of relief.

To facilitate smooth transition from relief to recovery.

MFIs can engage with relief agencies in designing well-planned interventions for reconstruction while relief efforts are under way, so that transition from relief to reconstruction is rapid and efficient. Often, relief stages tend to be protracted because no long-term developments are initiated.

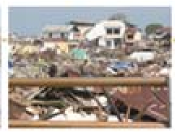
Relief agencies realise that livelihoods need to be restored before they can leave, and finance is important for this. Those agencies that lack MFIs to partner with, and/or microfinance expertise among their staff, tend to initiate programs that become unsustainable, leading to more harm than good for the affected people and MFIs in the long run. Such efforts include mixing grants with loans and the provision of highly subsidised loans with lax repayment requirements. It is to be noted that grants and loans play complementary roles in restoring livelihoods. But when the same organisations deliver grants and loans under the same contract, clients receive mixed signals and this affects repayment discipline. Concessionary loans can have serious negative consequences and undermine fragile financial systems for the poor.

After the February 2000 floods in Mozambique, MFIs were very involved in relief programs and actively participated in all coordination meetings. They partnered with relief agencies to provide cash grants to entrepreneurs to restart businesses. They were also able to convince many relief agencies not to start their own revolving loan funds.

To avoid market distortions.

MFIs can work with relief agencies to minimise market distortions and use resources effectively. Staying out during the relief stage can create damage that will be hard to fix later. For example, in Sri Lanka, the wages for ‘Cash for Work’ (CFW) were fixed at Rs.400 a day while it was Rs.100 a day pre-Tsunami (Rs.100 = 1US$). This created inflation and also shortage of labour for livelihood activities such as microenterprises and farming. CFW activities overlapped with the agriculture season and labour could not be obtained on time since wages for farm labour were only half those for CFW. Consequently, some large farmers obtained bank loans and imported harvesters. Following withdrawal of the CFW program, the labourers were left unemployed, since the farms that engaged them before are now mechanised. These landless labourers now need to start new





livelihoods and require capital from the MFIs. They require non-financial services since they need to be trained to become entrepreneurs. A better design of the CFW by a relief team *and* MFI staff could have minimised the distortions.

As a result, the NGOs in Batticaloa and Ampara in Sri Lanka have established a consortium to scrutinise any future interventions in the area by new relief agencies.

As well, linkages between relief agencies and MFIs could have helped CFW beneficiaries to accumulate savings in a safe place, enabling them to obtain loans during the recovery stage.

WHAT CAN BE GAINED FROM ENGAGING IN DISASTER RELIEF EFFORTS?

Help track grant inflows and assess the need for financial services besides loans.

The assessments will also help MFIs to make better estimates of their need for liquidity to cope with the situation.

For example, BWDA in Tamil Nadu, India entered Tsunami-affected areas immediately to provide basic needs, sensitise their clients regarding grants and keep track of the grants that their clients received so the agency could offer them suitable financial products. BWDA also conducted periodic assessments from the third week after the Tsunami, to assess client needs and to time release of their savings and loans products. The assessments helped them identify demand for emergency loans, which they then provided to long-term, well-performing clients a month after the Tsunami. They also found demand for loans at normal terms and conditions emerging four months after the Tsunami. BWDA was able to slowly increase its loan portfolio and also record good repayment.

Capture savings from cash transfers.

Research in Aceh showed that 40% of those who engaged in CFW saved over 20% of their payments and spent the money on buying jewels and goats or invested in rotating savings and credit associations. Some also used CFW to repay old debts to moneylenders. MFIs that managed to partner with relief agencies and link grants with financial products such as savings were able to increase their business after the relief stage. For example, two MFIs in Sri Lanka (Sareeram and Alqueresh) could double the minimum savings requirements without any problem when they realised the huge inflow of grants and savings among the people both during and immediately after the relief stage.

Develop the microfinance business.

The presence of an MFI during times of need creates loyalty to the institution, helping to retain old clients and also gain new ones. LEAD, a cooperative in Trichy, India, enlisted 4070 new shareholders by partnering with a relief agency that provided CFW programs. The amount of share capital collected from these new members was about Rs.233/new member. As of March 2006, they additionally hold a savings balance of about Rs.40/member. More than 1600 of the new shareholders opted to obtain a loan from the cooperative.



A WORD OF CAUTION

Do not contemplate starting a new MFI during the relief stage. Established MFIs are better equipped to deal with the effects of a disaster if they have been in operation for some time, gained a good track record and possess local information and a client base.

In locations with no established MFIs it may be better to involve relief agencies with expertise in relief and microfinance. Such agencies include NGOs such as World Vision, Mercy Corps, World Relief, CARE, Save the Children, and Caritas. Microfinance experts in these agencies should be fielded along with relief staff and be involved in designing relief and livelihood restoration projects that will minimise market distortions.

This brief was written in May 2006 by Dr. Geetha Nagarajan, Research Coordinator, Capacity-Building for Microfinance Institutions for Post Tsunami Reconstruction, Foundation for Development Cooperation, Brisbane, Australia. *The author acknowledges all the sources in Sri Lanka, Indonesia and India that contributed to this brief.*

SUGGESTED READING

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The Role of Microfinance in Livelihood Restoration following a Natural Disaster

About 80 per cent of the tsunami-affected households lost their main source of income, and 90 per cent of those households had productive assets destroyed or damaged.
(ILO, 2005 - Rapid Livelihood Assessment Survey, Sri Lanka, February 2005).

Over 100,000 microentrepreneurs lost their livelihoods in Aceh.
(Badan Rehabilitasi dan Rekonstruksi (BRR) report, December 2005)

WHAT ARE LIVELIHOODS?

A **livelihood** is a means of support, something that provides income to live on, especially paid work to secure the necessities of life.

Livelihood activities are economic activities that people know, own and undertake to earn income today and into the future.

A **sustainable** livelihood is one which can cope with, and recover from, stresses and shocks and maintain or enhance its assets and capabilities while not undermining the existing resource base (University of Sussex, used by DFID and the World Bank).

WHAT ACTIVITIES FACILITATE LIVELIHOODS?

Livelihood activities undertaken by people are shaped by their knowledge, inherent capabilities, and assets. These activities are enhanced by five basic assets with linkages to each other: natural, social, human, physical and **financial** capital.

These assets change over time and differ among households and communities. Access to them is vital for livelihood sustainability and resilience/restoration after a shock.

HOW IS MICROFINANCE RELATED TO LIVELIHOODS?

The **livelihoods approach** helps the poor to improve their livelihoods by strengthening these five basic assets, and comprises broad and interrelated programs and policies. Microfinance is an important component.

The livelihoods approach includes:

- giving people salaried jobs and other opportunities to earn income,
- providing loans, savings and other financial services,
- providing training in job and business skills,
- developing institutions, alliances and networks to advance economic interests,
- promoting policy and social changes that improve people's livelihood prospects.



WHO ARE THE MAJOR PLAYERS IN LIVELIHOOD RESTORATION?

The major players involved in livelihood restoration include:

- *Relief agencies* that focus on the initial stages of disaster response.
- *Development agencies* that provide assistance during reconstruction stages to restore livelihoods and to prepare for and mitigate future disasters.
- Some of the above organisations engage in both disaster relief and long-term development.

MFIs are invariably drawn into livelihood restoration from the earliest stages following a natural disaster, if they were present in the affected community before the disaster event. They seek to work closely with relief agencies for a smooth and quick transition from relief to reconstruction.

WHAT ARE COMMON LIVELIHOOD INTERVENTIONS IN THE WAKE OF A NATURAL DISASTER?

The major instruments used by relief agencies for restoring livelihoods include:

- grants (cash and in-kind);
- cash-for-work (CFW);
- distribution of tools and equipment to replace damaged and lost assets;
- distribution of tools and equipment to diversify into disaster-resistant livelihood activities.

Some relief agencies have provided a combination of grants and loans to facilitate a smooth transition from relief to reconstruction. Many of them have opted to partner with MFIs and local self-help groups (SHGs) to provide grants and loans.

The above instruments *directly* help disaster-affected people. In addition, *indirect* strategies such as facilitating coordination among various players, collection of information required for recovery and reconstruction, and restoration of markets and infrastructure, also help with livelihood restoration.

The major instruments used by development agencies for restoring livelihoods include:

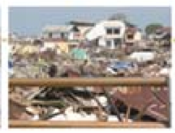
- job and business training;
- business development services;
- financial services, including savings, credit and sometimes leasing finance.

Development agencies typically attempt market-based interventions to facilitate revival of livelihoods.

In relation to livelihood restoration following a natural disaster, **subsequent briefs** in this series discuss the following subjects in more detail:

- Grants and Loans
- Cash for Work
- Savings
- Lease Financing
- Microinsurance





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Grants and Loans in Livelihood Restoration following a Natural Disaster

Despite concerns from some segments of the microfinance community, grants are often provided to microentrepreneurs following a natural disaster. The challenge for relief agencies and microfinance providers is to design these interventions in such a way that they contribute positively to restoration of livelihoods, without creating dependency or undermining efforts to provide market-based financial services on a sustainable basis over the long term.

Large-scale natural disasters affect microfinance clients by:

- causing severe damage to productive assets,
- disrupting local markets for their products and services.

In the absence of adequate savings or insurance, people affected by a natural disaster may use emergency loans for immediate consumption needs rather than to restart livelihood activities. Many disaster-affected people may also have outstanding debts. Supplying new loans in these situations may further destabilise their economic condition. Therefore, grants are often necessary to help people re-acquire assets required for income generation. Many relief agencies provide both in-kind and cash grants to help replace lost assets and to help with restoration of livelihoods. Grants to microentrepreneurs are indeed recommended as a core strategy in immediate post-disaster situations compared to microcredit (de Klerk, 2004; Parker and Pearse, 2001).

It is not uncommon for microfinance institutions (MFIs) to be asked to provide cash grants to their disaster-affected clients, to help them restore their livelihoods. However, many MFIs fear that the provision of grants will undermine their image as a reputable financial service provider and that it may negatively impact loan repayment discipline.

This brief focuses on grants made to microentrepreneurs, since they are the main client group of MFIs. It provides guidelines for microgrants and examines some of the effects of combined grant-and-loan products on MFIs and their clients. The overarching recommendation is that there must be deliberate and close ***coordination between relief agencies and MFIs*** to ensure effective interaction between grant and loan products.

Example:

NO COORDINATION BETWEEN RELIEF AGENCIES AND MFIs

In the wake of the Asian Tsunami, numerous relief agencies provided relatively large grants in the form of fishing boats, nets and cash. Recent evaluations of such grant programs showed that they were not very effective in creating sustainable livelihoods since they were poorly targeted,



long-running and not coordinated with microfinance organisations (Cosgrave, 2005). Cash grants and loans were available concurrently. This sent mixed signals to clients and resulted in low repayment rates, low client satisfaction and eventually loss of credit lines for many people.

For example, in Tsunami-affected Andaman and Nicobar Islands of India, SEEDS India and Cap Solidarités (France) found that communities where grants were ongoing showed less interest in credit programs compared to those areas where grants were phased out. Indeed, when an NGO started distributing grants almost one year after the Tsunami, microcredit clients openly questioned why they should repay loans when free money was available for many.

The MFI clients subsequently began delaying repayments and this severely affected the viability of the MFI. It became necessary to re-educate clients on repayment policies of the MFI (AIDMI, 2005).

Had the relief agency collaborated with the microfinance provider, it may have been possible to apply the grants to good effect without undermining the long-term provision of micro-loans.

Example:

GOOD COORDINATION BETWEEN RELIEF AGENCIES AND MFIs

On the other hand, when relief agencies and MFIs work in close coordination, sequencing loans to follow grants can be an effective strategy.

In tsunami-affected areas of Sri Lanka, a parent NGO relief organisation, Womens' Development Federation (WDF), worked with its MFI partner Janasakthi Bank to provide MFI clients with small cash grants, which were followed up with a loan. In Hambantota, Tangalle and Siribopura WDF provided funds to Janasakthi banking units to reconstruct damaged units and extend micro-credit for income-generating activities. In May 2005 clients received loans averaging \$150 (LKR 15,000) from Janasakthi and a one-time cash grant of \$50 (LKR 5000) from WDF to re-start their businesses. By October 2005 observers noted that many clients were running their businesses well and were starting to expand and demand new loans (World Bank, Sri Lanka, December 2005).

Similarly, on the southwestern coast of Sri Lanka a USAID funded project provided small in-kind grants through its relief partners for purchase of items such as cooking pots and other essential materials. Subsequently MFI partners arranged loans averaging US\$150 for clients to buy inputs to run their microenterprises (USAID, 2005).

The success of these 'Trickle Up' programs, that provide very small grants to those that the MFIs identify as potential clients then later give grantees access to regular microfinance products through MFIs, has now been demonstrated. Trickle Up grants are appropriate for the extreme poor, women, refugees, immigrants, people living with HIV/AIDS, people living with disabilities and those affected by disasters. Many Trickle Up programs provide partner MFIs with grants that they can use to reach people that do not initially qualify for their



own programs. With help from such grants entrepreneurs can 'graduate' and qualify for the partner-agency savings and loans program, provided they have managed their business properly and contributed to their personal savings. Trickle Up has implemented some of these programs in Sri Lanka in tsunami-affected areas (Palanisamy, 2005).

Another example of coordinated distribution of cash grants using MFIs is a case from CARE Mozambique (Nagarajan, 2001). After the floods of February 2000, CARE provided one-off cash grants of average US$100 each to around 2000 families, including clients of two MFIs—Fundo de Crédito Comunitário (FCC) and Caixa Comunitária de Crédito e Poupanca (CCCP).

The MFIs approached their clients and informed them of the grants from CARE. The grants were disbursed by CARE staff. To those grant recipients that also had active loans, the MFIs offered the option of applying the grant to repay their outstanding loan balance, so they could maintain their credit line and immediately qualify for a new loan. The MFIs then provided new loans to those that had repaid their old debts. Alternatively, clients could receive the entire cash grant and reschedule the repayment of their loans over a period of time decided by the MFIs. New loans, however, were not made available until the restructured loans were repaid.

Repayment effected through the grants helped the MFIs to avoid cash-flow problems, immediately service their clients, and protect their credibility. Resumption of the loan cycle quickly helped to revive the MFI's business and, as a result, the incomes at the end of the year were not significantly different from the previous year (Nagarajan, 2001).

This approach was effective due to several factors:

Co-ordination among agencies.

CARE, FCC and CCCP worked well together, enabling an effective design and delivery of the product, and helping to avoid duplication of grants to the same recipients.

Small grant size.

There were many small grants rather than a few large grants, thus spreading their positive impact and minimising the potential for inequitable distribution.

Implicit link between grant and loans.

Although implicit, the cash grant was tied to the repayment of loans. Therefore, it was perceived less as a handout and more as a mechanism to help them continue as clients of the MFI.

Good timing.

The grants were made after the emergency stage, when markets began to emerge. Therefore, people could resume their economic activities using either the grants or new loans received after repaying previous loans.

Other assistance.

Other forms of assistance, such as building materials, food and clothing, were provided by other relief organisations. This meant that the cash grant was available to re-start economic activities. In the absence of this other assistance, the cash grants could have been diverted for consumption



purposes and the MFIs could have experienced repayment problems.

Good communication.

Frequent contact with clients and clear communication by the MFI staff before grants were disbursed was effective. The staff informed the returning clients of the possibility of a grant from an external agency that could be used to repay outstanding debt, making them immediately eligible for a larger loan to restart their business.

Immediate resumption of regular loan cycles.

The MFI avoided a liquidity squeeze because clients kept up loan repayments and helped FCC and CCCP to disburse regular loans. Client desertion was low.

Example:

BAD COORDINATION BETWEEN RELIEF AGENCIES AND MFIs

One relief agency initiated a loan-cum-grant package in partnership with a local bank, to restore livelihoods among the affected populations and to ease them from relief to recovery phase using market-based principles. The agency designed the package after conducting PRA exercises among potential recipients in June 2005.

The PRA analysis helped identify activities to support the introduction of the package and also to fix the terms of operation: total size of the package not to exceed $1000 per recipient, grant to loan ratio of 60:40; one-year loans to be repaid in monthly instalments with an annual interest of 18%. The package was provided through groups, with no collateral required except for group guarantees. Both men and women were eligible. The groups can comprise members of the same gender or can be mixed.

The relief agency provided the grants but selected a local financial institution to provide the loan component. Prior to the tsunami the financial institution typically served a broad clientele and the non performing loans were about 30–40% of its portfolio.

The loan-cum-grant program went into operation in July 2005. Members of the relief agency frequently visited the villagers and made them aware that the agency had provided the package. During their visits they monitored use of the grant component, and were gratified to observe that the majority of package recipients purchased assets to restart their livelihoods and many were operating a micro-business. While men often purchased fishing nets, small motors, transport vehicles and boats, women obtained inventories to run petty trade and to repair sewing machines etc.

An evaluation of the loan component in March 2005 showed that repayment rates were around 60%. But analysts found very little evidence of deposits at the financial institutions where the loans originated. These institutions now refuse to make follow-up loans to the package beneficiaries.

The relief agency attempted to coordinate and partner with a financial institution to make the grants and loans, but problems remained. It was a large package, and grants were used for replacing high-value assets. The grant portion of the package exceeded the loan portion. The chosen partner bank was inexperienced in making



micro-loans and maintained a poor portfolio prior to the tsunami. Members of the relief agency visiting the targeted areas inadvertently implied that the package was a grant, even though part of it was a loan. Also, failure to secure the title of the boats as collateral led to the sale of assets suitable for generating incomes.

Example:

WHAT IF SEPARATE RELIEF AND MFI AGENCIES ARE NOT AVAILABLE FOR COORDINATION?

Often many multi-service organisations providing both relief and MFI services are found to operate in disaster-affected areas. In such cases the best practice to prevent mixed signals to clients has been to use separate operational units and specialised staff to provide required services. For example, The American Refugee Committee (ARC) that operates in many conflict and disaster-affected areas provides small initial grants to refugees and IDPs in camps then later inducts recipients into regular microfinance programs. ARC operates grants separate from the MFI by using staff dedicated solely to either relief or microfinance activities, separate office spaces and individual names for the programs. They also operate in a two-step manner where loans 'follow' grants. ARC monitors grantees to determine if they have asset growth at the end of the grant period, whether a viable on-going business has been created/re-started, and whether the business is able to tap into sustainable financial services such as savings and loans after the grant period ends.

ARC learned that sequencing grants and loans encourage investment in productive assets. The agency is now attempting to provide these services in drought-affected regions of Africa and in the parts of northern Sri Lanka affected by conflicts and the tsunami (ARC, 2005, Nourse, 2004; and Nourse in an Interview with FDC researcher, 2006).

GUIDELINES FOR MFIs INVOLVED WITH CASH GRANTS FOR LIVELIHOOD RESTORATION

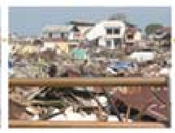
Grants are not suitable for all disaster situations.

Grants are less appropriate in places with frequent disaster events, areas with serious delinquency problems and regions where markets cannot return to normal for a long time, thus restricting recommencement of economic activities.

Wherever possible, provide grants through a relief partner and loans through the MFI.

Do not provide grants and loans through the same organisation unless there is no alternative. However, if there are no relief partners for the MFI, the MFI should at least separate staff and offices providing grants from those providing loans. Transitioning staff from grant makers to loan providers and vice-versa will only harm the MFI in terms of poor repayments for the loan portfolio.





Be transparent with the criteria for selection of grant beneficiaries.

The criteria for distribution of grants should be made clear to avoid conflicts within the community.

For example, many MFIs only include those that microcredit cannot serve at that time. These may comprise active and non-active clients that are temporarily displaced and severely affected.

Some MFIs let local communities help identify the beneficiaries to receive the grants and this advice may lead them to widows, the very poor and those that lost the most assets.

The final choice of beneficiaries in most cases, however, is determined by the fund size and magnitude of the disaster.

Provide grants only for a very short time.

As a rule of thumb, grants should be phased out once markets begin to revive and ceased once the markets begin to function regularly.

Grants should be one-off, and there should be a 'graduation' process to market-based mechanisms such as microcredit.

Accompany grants with advice that this is a one-time intervention. This information should be provided prior to disbursement of grant. Do not simultaneously provide grants and loans to the same individual client.

Require beneficiary participation for asset replacements.

Some agencies in tsunami-affected areas insisted that the recipient make a cash contribution of at least 5–10 per cent of the grant value, to ensure that the entrepreneur remained committed to the proposed economic activity, and had not simply dreamt it up in response to grant availability. In highly affected areas, where funds are not available due to total loss of assets and incomes, some agencies require clients to contribute their labour to rebuild community assets.

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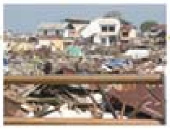

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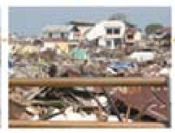


Microfinance and Cash-for-Work in Livelihood Restoration following a Natural Disaster

As a general recommendation, MFIs should not be *directly* involved with Cash-for-Work (CFW), since community-related activities invoking logistical issues that are beyond their specialisation may often be involved. Also, the transfers made through such CFW activities may often be considered as grants and safety-net measures—sending a mixed signal to the clients about the seriousness of the MFI as a reputable financial service provider.

However, there are ways in which MFIs can be *indirectly* involved with CFW activities. Broad guidelines include the following:

Build consensus with CFW providers to avoid market distortions.

MFIs and CFW providers need to discuss how to set fair market wages to avoid inflated wages. CFW should involve short-term interventions that do not overlap with seasonal livelihood activities such as agriculture, and that can be phased out when markets begin to emerge.

For example, in Sri Lanka, the wages for CFW were fixed at Rs.400 a day, compared with Rs.100 a day pre-Tsunami (Rs.100 = US$1). CFW activities included clearing debris, laying roads and de-silting ponds. This created inflation and also shortage of labour for livelihood activities such as microenterprises and farming.

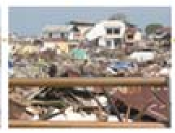
CFW activities overlapped with the agriculture season and labour could not be obtained on time,since wages for farm labour were only half those for CFW. Therefore, some large farmers got bank loans and imported harvesters. Now that the CFW is over, the labourers are unemployed since the farms that engaged them before are now mechanised. These landless labourers now need to start new livelihoods and require capital from the MFIs. They also require non-financial services, since they need to be trained to become entrepreneurs. A better design of the CFW by a relief team and MFIs could have minimised the distortions and linked the CFW beneficiaries with savings that could have helped them later to obtain loans (Aheeyar, 2006).

Link with CFW providers and their beneficiaries to supply required financial services.

Cash transfers through CFW were provided in excess in many places. Some MFIs decided to capture the savings made from such cash transfers. One cooperative in India, LEAD in Trichy, collaborated with the relief organisation Save the Children to capture the savings.

While Save the Children implemented CFW programs in LEAD operational areas, LEAD convinced the CFW beneficiaries to buy shares in the cooperative. After buying 3 shares they became eligible for loans worth 3–5 times the share value at a low interest rate (about 8% below market rate) from the cooperative.





By the end of the CFW in June of 2005 it was reported that 1400 new members were added due to this effort—about 235 of them took loans using the shares as collateral, and repayments were reported at 95%. The total savings at the cooperative also increased due to new members.

World Vision in Sri Lanka noticed surplus incomes due to cash transfers made to affected households. In order to capture the excess it adopted a policy of compulsory saving of a minimum of 25% of the CFW salary in a savings account into a local bank where it locked for 3 months. This applied to all CFW projects of 2 weeks duration or longer.

For example, in the southern region of Sri Lanka beneficiaries selected National Savings Bank (NSB), since this bank has village-level branches at post offices. They needed only Rs.200 (US$2) to start a savings account compared with Rs.500 at Peoples Bank; NSB also provided the highest interest rate for a savings account.

A CFW supervisor/monitor collected passbooks from beneficiaries once a week while collecting the CFW attendance sheet. The passbooks were returned to beneficiaries after the cash was deposited. The bank opened new savings accounts for many beneficiaries.

Many relief agencies in Sri Lanka and India, and some in Aceh, used banks and MFIs to pay their CFW and cash-grant beneficiaries. Some MFIs, such as SANASA in Sri Lanka, requested a commission of 5% of the cash grant to cover their administration costs.

Some MFIs in Sri Lanka also encouraged the beneficiaries to deposit some portion of their grants into MFI accounts, to provide for the beneficiaries' future needs and help them to access new loans (Aheeyar, 2006).

Design responses that are gender-equitable

Many donors provided CFW and also gifts of boats and nets to restore livelihoods. These activities were found to be more beneficial to men than to women.

MSSRF, an NGO in Chennai, India conducted a participatory rural appraisal (PRA) in the internally displaced person (IDP) camps and found that women required livelihood diversification since many were reluctant to depend entirely on fishing.

Therefore, women received training in poultry keeping, mushroom cultivation and drying and canning small fish that cannot be sold in the market. The women were new to such livelihood activities. They were also provided with seed capital as grants to start off the business and were formed into self-help groups (SHGs) in April–May 2005.

The women requested access to reliable financial services and were linked to the nearby branch of the State Bank of India.

The bank, through its microfinance wing, helped the SHGs to save for 6 months and then provided them with small loans for working capital in November–December 2005.

Some women's groups also obtained loans to buy small used trucks to transport fish to markets. The local public transportation was unreliable and unavailable during early hours of the day when the fresh catch needed to be sold.

The bank issued a group loan for 3 years to purchase the truck at a reduced interest rate. MSSRF helped buy a used truck, calling on member savings together with a standing guarantee to the bank. The women now rent out the truck to nearby communities and they also pay a user fee to their group to help pay back the loan every month. The women are trained by MSSRF to keep books for both the revolving fund and the truck rentals. When interviewed, they indicated their satisfaction with the arrangement and noted that they would have spent all the grants if the bank had not offered them a place to save and access to loans in the future.

This brief was written in May 2006 by Dr. Geetha Nagarajan, Research Coordinator, Capacity-Building for Microfinance Institutions for Post Tsunami Reconstruction, Foundation for Development Cooperation, Brisbane, Australia. The author acknowledges all the sources in Sri Lanka, Indonesia and India that contributed to this brief.

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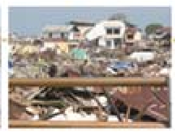

Microleasing in Livelihood Restoration following a Natural Disaster

Microleasing, for its self-collateralising attribute and ability to help accumulate productive assets, is now considered a viable option to loans for quickly replacing productive assets lost by the poor in major disasters. In many ways, microleasing can provide a win–win proposition to collateral-poor clients and liquidity-strapped financial institutions, as well as to donors and policy makers concerned about market distortions and creation of grant mentality. Leasing is also permissible under Sharia Law, which may be practiced in some Islamic countries.

INTRODUCTION

In a simple leasing arrangement the lessor (leasing company or a MFI) rents the equipment/asset to the lessee (client) for a fee payable in instalments. The lessor retains the title of the asset so that the asset cannot be sold/mortgaged/pawned. As a result, no tangible collateral except a steady cash flow projection is required for approval of leasing contracts. The term of a lease may stretch up to 70% of the estimated useful life of the asset. In this way, should a leased asset need to be recovered due to delinquency, value of the lease is not depreciated beyond the resale value of the asset. A standard lease agreement consists of a promissory note and an acceptance receipt evidencing that the asset has been received. At the end of the lease, the client/lessee has an option of buying the asset from the lessor at a previously agreed-upon residual price.

MICROLEASING IN DISASTER RELIEF

Most microfinance clients are unable to provide collateral to financial institutions to access debt finance and purchase assets required to restart their livelihoods. In such situations, the self-collateralising nature of leased assets allows collateral-poor clients to obtain the assets while allowing the leasing institution to repossess the asset in case of default so that it can be sold and the investment in the leased asset recovered.

In addition, microfinance institutions may face liquidity shortfalls in the wake of a disaster, thus limiting their ability to make the many unsecured loans required to replace assets lost in the disaster. The loans made for asset purchases also require larger amounts, grace periods and medium-term duration that do not fit the standard loan products offered by many small and new MFIs. Also, MFI experiences in Bangladesh with new loans made for asset replacement after a disaster have shown that three consecutive new loans are required to replace lost assets in order for the client to



generate adequate income to service these loans.

Leasing usually incurs lower transaction costs compared to collateral-based term loans, due to lower costs in developing and enforcing contracts in areas where asset registries and judicial systems for contract enforcement are poorly developed. These features make leasing attractive to the lessor and especially to the impoverished lessee.

EMERGING LESSONS

Leasing facilitates client screening in times of distress

Leasing ensures that a price is paid for obtaining a productive asset that can be purchased over time and also should be maintained by the client for the period of the lease. Lease arrangements could have helped minimise the number of the client sales arising from excessive supply of free boats and assets in Tsunami-affected areas of Sri Lanka. One NGO in Batticaloa distributed free canoes that did not meet the fishermen's requirements to restore their livelihood. Since the boats were free, many affected households obtained them even if they could not be used, then sold them at 75% of the original price within a week of their distribution. The money received by beneficiaries through re-sale was not sufficient to restart livelihood activities. In consultation with the fishermen, a leasing arrangement in which the clients had to pay for the asset and hold it for the period of the lease could have been designed for boats. This could have helped identify the clients who were serious about their livelihood revival.

Down payments can help reduce the lessor's risks since the lessor assumes all of client's business risk

For example, CARE, India offers microleasing through 'The Rickshaw Bank Project' in Chennai, India. Rickshaws are small motorised/non-motorised tricycles used for transporting people. The owner of the Rickshaw Bank receives venture capital from CARE India to manufacture 200 rickshaws and issue them under a lease-to-own arrangement. The Rickshaw Bank partly leases the vehicle and partly issues it as an in-kind loan to be repaid in cash with interest. Each rickshaw costs about US$200. The client need to pay about 5% of the cost of the rickshaw as down payment and the rest in small sums of approximately Rs25 ($0.50) every day for 15 months. At the end of the daily payments in 15 months, the ownership of the asset is transferred to the client. Repayments have been high and no sale of rickshaws was reported (Source: CARE, India, 2006)[1]. CECAM, a cooperative in Madagascar that provides sewing machines, requires a down payment of 25% of asset value for a lease term of 4 months. The client pays the remaining 75% of the price in instalments tailored to client cash flows, with an annual interest of 30%. The asset title is transferred to the client upon full repayment (Boss and Henderson, 2000, page 10).

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[1] Information was provided by Dev Prakash, CARE, India during the interview by Geetha Nagarajan, March 12, 2006.

Choice of long-term credit-worthy microfinance clients helps reduce risks if down payments are not possible

Grameen Bank has offered microleases in Bangladesh since 1992. In 2002–03 the average lease amount was equivalent to US$364 and total outstanding lease portfolio was US$22 million. Lessees are selected among existing microfinance clients with additional sources of income. No down payment is required from the lessee and a 20% flat interest rate is charged. Flexible repayments include allowing lessees to repay the entire amount if they wish.

Microleasing provides an option for the poor to diversify livelihoods

CARE India designed a lease-to-own product to help diversify income-generating activities of fishermen affected by the Tsunami. Diversification of income-generating activities is an effective risk-/vulnerability-reduction strategy. The product was introduced one year after the Tsunami in order to support sustainable livelihood activities and reduce the dependence on subsidies and grants of those affected by the Tsunami. As a result, many fishermen who till then had been unsuccessful in accessing funds for diversification reportedly moved to the transport business.

Microleasing can help provide grants without creating market distortions and help create productive assets

In Banda Aceh, Indonesia, the World Vision (WV) Livelihood Team developed a leasing product to assist motorised becak drivers who lost their livelihood as a result of the Tsunami. The program involves the drivers, the motorcycle dealer and World Vision. World Vision provides 50% of the purchase price of the becak to the dealer on the condition that the dealer finances the second 50% of the purchase price with the driver under a lease agreement. The monthly payments at prevailing market rates (18%/yr) are structured over 18 months to make the payments manageable for the driver. In this scheme, the drivers need to set aside Rp17,000 (USD1.80) a day from their daily income to repay the loan and own the becak. WV community facilitators undertake a background check at the becak registry in Banda Aceh to ensure the beneficiaries were becak operators prior to the Tsunami. As part of the qualification process the beneficiary drivers must agree to the conditions of the program. Once this has been completed the dealer is contacted and they determine whether they are eligible for dealer financing. After that the driver beneficiaries are able to receive the new becak. From September to December 2005 World Vision assisted 21 becak drivers in Aceh and Meulaboh to regain their livelihoods under this program. Through this scheme—namely equal portions of grant and loan under a lease arrangement along with active participation from the community—WV hopes to provide an economic boost to Tsunami-affected communities.

Not all MFIs can and should provide microleasing, especially after disasters

Human capital requirements are higher for leasing operations than for standardised loan operations, and specialised staff is



difficult to hire in a short time frame after a huge disaster. Leasing contracts are also more suitable for individual (versus group) transactions that are common among MFIs. Also, not all assets required by typical microfinance clients can be leased by the MFI and this may limit reaching scale to minimise costs.

Liquidity-constrained MFIs may not be suitable for microleasing

Many MFIs that are liquidity-constrained will be unable to purchase assets to lease to their clients. They may prefer to make small loans compared to leasing, even if benefits of leasing may be higher than from loans. In such cases, trade financing from manufacturers and dealers to MFIs, and partnerships with them, can help offer microleases.

Microleasing is appropriately provided through partnerships between MFIs with leasing companies, dealers and manufacturers

It is feasible for MFIs inexperienced in providing microleases to provide venture capital type financing to specialised leasing companies with a requirement to provide necessary services to its clients. The case of CARE India that provided a venture-capital loan to the Rickshaw Bank to provide microleases is one good example, while another is the case of microleasing through becak dealers in Banda Aceh.

Microleasing is less suitable for remote areas

Existence of secondary markets for resale of re-possessed assets and repair/maintenance services highly facilitate leasing operations, but these are scarce in remote areas

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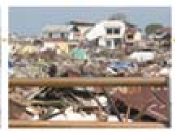


Savings for Risk Mitigation and Crisis Recovery

Emerging Lessons:

- **Many MFIs promote savings through mandatory and sometimes voluntary schemes, to help the poor accumulate cash resources and help reduce vulnerability to crises;**
- **Not all MFI clients seek to withdraw their savings in the immediate aftermath of a disaster.**
- **The poor are more likely to withdraw savings to meet personal emergencies such as sickness, accidents and death than to cope with major disasters that affect many people.**
- **In areas frequently affected by disasters, personal savings are generally used for disaster preparation and during late recovery stages, rather than for coping during the relief stage;**
- **Demand exists for deposit services even during relief and early recovery stages;**
- **Not all MFIs can offer flexible 'on-demand' savings products.**

Cash savings help the poor prepare for, cope with, and recover from crises including natural disasters. Cash deposits made in financial institutions may reduce a person's vulnerability to disaster-related crises in a number of ways:

Physical assets converted to safer, liquid savings

Exposure to losses can be reduced if a person can maintain his/her excess income or precautionary savings at a financial institution rather than in physical assets that may, for example, be indivisible, not easily liquidated, or stolen.

Savings used to invest in risk-reducing measures

An MFI client may be able to accumulate sufficient savings to invest in risk-reducing measures such as water-harvesting devices in drought-prone areas, purchasing a boat in flood-prone areas, improving housing structures in earthquake and typhoon-prone areas, and others.

Savings used to replace lost or damaged assets

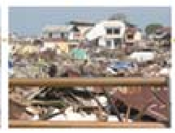
Savings can play a substantial role immediately following a natural disaster, allowing people to replace income-generating assets. Savings can also serve as a deposit towards securing finance to replace larger assets in the post-disaster reconstruction phase.

In India, household savings are found to be significantly larger in places frequently affected by natural disasters by comparison with other areas. The poor consider precautionary savings as insurance to cope with crises (Nagarajan and Brown, 2000).

WHAT SAVINGS PRODUCTS ARE USEFUL FOR RISK MITIGATION?

MFIs may offer various types of savings mechanisms and products. Savings may be mandatory or voluntary, and may be held as demand deposits, contractual deposits for special purposes such as funerals, fixed-term





deposits, illiquid group deposits that allow access to emergency loans, and group emergency funds that help cover delinquent loans.

In general, MFIs that collect mandatory deposits only allow for a small and fixed amount of cash to be deposited. These funds are usually only available for withdrawal when the member leaves the program. Even if these funds are available following a natural disaster, this type of savings product is not observed to help cope with crises, since the amount accumulated in members' accounts is usually very small.

Studies now show that appropriate savings strategies for disaster management for the poor comprise both highly liquid accounts that allow frequent, small deposits and withdrawals and time-bound accounts that allow people to save for specific objectives.

Savings have proven more effective in disaster management when used in combination with other financial products such as loans, insurance, leasing, remittances/money transfers and pawn services (Rutherford 2000).

CAN ALL MFIs PROVIDE DEPOSIT SERVICES?

While mandatory deposits are relatively easy to manage, more flexible savings products involve significant management and cost implications—and not many MFIs have the requisite capacity. Also, most countries only allow licensed banks (including MFIs that have obtained a license) to mobilise voluntary deposits from the public.

The criteria determining that an MFI qualifies for provision of deposit services include the following (CGAP 2005):

- appropriate governance, ownership and institutional structure;
- strong management of credit, liquidity and interest rate risks;
- sound internal controls;
- financial capacity to withstand external shocks (inflation and devaluation);
- adequate capital;
- regulatory framework and supervision focused on depositor safely;
- commitment to expanding access.

CAN MFI CLIENTS SAVE EVEN AFTER A MAJOR DISASTER?

Yes! The poor can save soon after a disaster both in financial and non-financial forms. Whether or not savings are deposited with MFIs depends on clients' trust of the MFI, transaction costs and accessibility.

MFIs operating in Tsunami-affected areas of Sri Lanka reported larger total savings balances in March 2005 compared with March 2004. They also recorded larger total savings balances in December 2005 compared with December 2004 (field research by FDC team, March 2006). An assessment in Batticoloa district showed that around 35% of cash grants and cash-for-work (CFW) payments received by beneficiaries were saved in MFIs (Aheeyar, 2006).

The above trends can be explained by the availability of cash grants, CFW, and subsidised loans in the aftermath of the Tsunami. Most MFIs experienced significant growth in their membership base, and some MFIs also increased the minimum savings required for membership. As a result, many MFIs in Sri Lanka experienced an increase in total savings in 2005 despite the Tsunami.

Similar trends were also observed in Aceh, Indonesia. Mercy Corps implemented a CFW program in Tsunami-affected areas that benefited nearly 18,000 participants and disbursed over US$4.5 million in direct payments. The program began on 7 January 2005 and was gradually phased out by 31 July 2005 in favour of other programs aimed at building livelihoods and more sustainable sources of income. Exit surveys of CFW participants showed that 29% of households had deposited cash savings and 26% of households had purchased gold in lieu of cash savings.

HOW CAN MFIs CAPTURE SAVINGS AFTER A DISASTER?

There are opportunities for MFIs to capture savings by partnering with relief agencies and offering low-cost savings products. Numerous relief agencies in Sri Lanka and India, and some in Aceh, used banks and MFIs to pay their CFW and cash-grant beneficiaries (see Brief 4: Microfinance and Cash-for-Work in Livelihood Restoration following a Natural Disaster).

WHAT ARE THE ISSUES FOR MFIs TO CONSIDER FOR PARTNERSHIPS WITH RELIEF AGENCIES?

MFIs need to negotiate the following with relief agencies to provide payment services efficiently:

- commission rate for payment services;
- security arrangement for cash delivery;
- time schedule of cash payments;
- mechanisms for cash withdrawal;
- service charges for withdrawals;
- minimum savings balance for account holders.

This brief was written in May 2006 by Dr. Geetha Nagarajan, Research Coordinator, Capacity-Building for Microfinance Institutions for Post Tsunami Reconstruction, Foundation for Development Cooperation, Brisbane, Australia. The author acknowledges all the sources in Sri Lanka, Indonesia and India that contributed to this brief.

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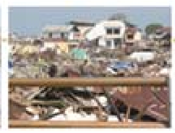
SUGGESTED WEBSITES

- Savings Resource Center at Microfinance Gateway: www.microfinancegateway.com/resource_centers/savings?PHPSESSID=76c188bc1d47733cb281a52d0797604a

- Product Development for Savings: www.microsave-africa.com





Microinsurance for Risk Mitigation and Crisis Recovery

While only 5% of the population was aware of insurance before the 2001 earthquake in Gujarat, India, some 67% were aware of it afterwards.
(AIDMI, 2005)

This brief focuses only on current microinsurance products designed to protect poor microentrepreneurs in the event of massive disasters by covering damage to assets used for income generation—such as livestock and property—and disruption to their livelihoods.

Microinsurance intends to offer the poor protection against specific risks in return for payment of regular premiums proportionate to the likelihood and cost of the risk involved. A growing body of literature on microinsurance highlights design and implementation challenges, but provides some successful pilots in developing countries along with valuable lessons for MFIs that intend to provide microinsurance services to their clients. The available information, however, only provides guidelines to design and implement life, loan and health insurance that protect the poor from personal calamities (for further information refer to other readings suggested at the end of the brief).

Microinsurance, when available at affordable prices, is now recognised as an important financial service providing some protection to the poor in the event of personal and natural disasters. A recent study of microinsurance in Bangladesh shows that health, life and loan insurance are now functioning and covering about one third of the poor. But disaster and livestock insurance are virtually unavailable, and the only institution providing them covers about 4% of MFI clients (Ahmed et al., 2005). While it is important to cover asset and livelihood losses in the wake of a major disaster, many microinsurance experts point to the inability of current microinsurance products to cover such losses from these events (McCord and Cohen, 2005)[1]. Information on such microinsurance programs is sketchy due to poor documentation and monitoring, and lack of evaluations to learn lessons. As a result, it remains unclear whether microinsurance is either feasible or effective in the event natural disasters such as highly destructive tsunamis and hurricanes.

[1] Evidence from Tsunami-affected areas of Sri Lanka shows that the majority of the poor lost about 70% of the physical assets used for their livelihoods. Several lost assets such as houses/work space, livestock, boats, and other equipments such as sewing machines. There was also severe disruption to conducting their livelihood activities due to displacement, lack of markets and loss of assets. The poor cope with losses by selling their remaining assets, using savings or borrowing, and accessing grants/public funds. Availability of insurance could have been another useful tool to help the poor in managing disasters.



A. LIVESTOCK INSURANCE

Requiring insurance when financing livestock through bank loans is a practice in several countries, including India. The Grameen Bank in Bangladesh started such a program in the mid-1990s, offering it only to its borrowers via its insurance wing. Grameen's experience, however, showed that the costs of insuring livestock during rainy months have been prohibitively high, due in part to limited staff skills and the inability to pool risks and achieve volume. This has been especially challenging for semi-formal institutions such as cooperatives, credit unions, NBFIs, and MFIs that function in rural areas.

Therefore, MFIs in some countries are now attempting to provide livestock insurance to their clients by partnering with specialised insurance firms that have the ability and skills to design and manage insurance contracts. For example SHEPARD, an MFI operating with SHGs in rural India, offers group-based livestock insurance in partnership with a local insurance agency. The product covers accidental and natural death of cattle financed by a loan. The member pays 4% of the animal's value as a premium, of which 2.25% goes to the insurance partner. The insurance product is voluntary for clients. The number of policyholders rose from 126 in 2000 to 302 in 2002, but fell to 85 in 2003. The product's sustainability has been difficult to assess since the organisation does not measure the costs associated with insurance delivery (Churchill and Ramm, 2004). BASIX, an NBFI in India, has been offering livestock insurance to its borrowers since October 2002. It partners with Royal Sundaram Alliance General Insurance Company Ltd. to offer livestock insurance products. As of March 2004, BASIX had insured livestock for a value of US$99,534 through this company. However, neither scheme has been exposed to any major disaster. Therefore, one cannot ascertain the robustness of the product as an aid during major disasters.

There are several challenges to managing livestock-insurance projects when the trigger mechanism to settle claims is not very transparent. To increase transparency and reduce the time required to settle claims, index-based schemes for livestock insurance (based on concepts of index-based schemes for crop insurance) are now being considered for pilot projects. Here, weather predictions are used to gauge the severity of damages. The World Bank is now piloting an index-based livestock insurance product in Mongolia in winter blizzard affected areas. The insurance is expected to enhance the financial security of livestock-owning households by reducing the impact of livestock deaths due to the blizzards. It is still early to gather lessons on the viability and effectiveness of the product, which needs to be monitored for results and replication.

B. ASSET/PROPERTY INSURANCE

La Equidad in Colombia developed a comprehensive property insurance product for microenterprises in 1996 to cover for La Nina disaster losses. The insurance was offered through a network of cooperatives and credit unions around Colombia, with 300



policies sold in the first year. However, sales of these policies were suspended the following year, due to a financial crisis in Colombia that led to the collapse of most of the cooperatives La Equidad was using to distribute the product. However, other policies of La Equidad are still in place. Typically, the assets insured by La Equidad ranged in value from US$200 to US$6,000 (Churchill and Ramm, 2004). The example shows that the product introduced in response to a natural disaster was not able to withstand another type of major disaster –the financial crises that affected many people in large areas. This raises concerns regarding the effectiveness of the product in the event of another natural disaster.

Recent research in India showed that poor households, on average, lose close to US$15 every year of their assets due to fires and floods (annual per capita income in India is about US$420). In the past five years there have been several initiatives to extend microinsurance products to cover asset losses due to natural disasters. For example, the Gujarat State Disaster Management Authority (GSDMA), India, formed after the devastating earthquake of January 2001, has been actively engaged in the rehabilitation or reconstruction of houses damaged or destroyed by the earthquake. Under this agency, beneficiaries receiving grants for reconstruction must purchase a policy from the compulsory housing insurance scheme to protect their investments and prepare for future events. The GSDMA acts as an intermediary between beneficiaries and insurance companies, grouping individual policies and passing on to insurers the compulsory premium from each individual's final reconstruction grant (AIDMI, 2005).

Caritas India has now designed an insurance product to help the poor that have lost their livelihood equipment and have not received any compensation. Under this scheme self-help groups (SHGs) are formed and four families are made joint owners of livelihood assets—with an agreement. They are registered with the Fisheries Department. Twenty-five per cent of the total cost on the assets is to be repaid in 36 installments through SHGs to the Village Development Council to form revolving funds. Boats and engines are required to be insured along with the lives of the crew, and premiums are paid by the joint owners of the boat through self-help groups. Men in many villages have come forward to get insured under the group insurance scheme of LIC called Janashree Bima Yojana. The pilot scheme needs careful scrutiny, since jointly held assets insured can create multiple layers of misuse of insurance. The requirement for loan repayments to be channeled into a community fund may also create problems since such revolving funds appear to record very low repayment rates and seldom revolve more than once (see FDC Brief # 4 on Loans and Grants in the Wake of Disasters, 2006).

The 'Swayam' micro credit Tsunami recovery program of SEEDS India and Cap Solidarités (France) operating in the Andaman and Nicobar Islands both include compulsory insurance for all assets distributed through the program. While Swayam supports the first year's premiums, further premiums must be paid by the beneficiaries. The



program works with a partner insurance company and provides training for beneficiaries on the importance of insurance for disaster reduction (AIDMI, 2005). The success of a microinsurance program depends heavily on diversification, volume and renewal of clients. The program needs to be studied for renewals when clients are responsible for paying the full premiums.

In another initiative, CARE, India has fostered partnerships between its selected MFI partners and the private insurance company Royal Sundaram, to provide a packaged microinsurance that covers the following: loss of household assets valued up to US$25, accidental death (including Tsunami-caused death) and health insurance to cover hospitalisation up to US$125. To receive the package, MFI clients pay all the premiums (about US$2.50 per year) to the private insurers. The private insurer pays a 15% commission to the MFIs for bringing the clients. The product was rolled out in March of 2006 in the Tsunami-affected areas in the states of Tamil Nadu and Andhra Pradesh and 1200 clients have received it to date (source: Interview of CARE, India by FDC researcher, March 2006).

Micro-insurance products pilot-tested to protect assets of the poor show that providing group microinsurance to MFI clients through established insurance firms can help with claim settlement and also reduce the transaction costs and keep premiums at affordable rates. But MFIs need to be aware that asset insurance is relatively more complex and difficult to provide compared with life insurance.

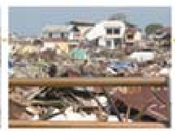
Verifying claims for asset losses is often a challenge, due to lack of reliable methods to determine the value of the assets and simple and swift mechanisms for evaluation of the loss, especially after the calamity. Several insurers also exclude many disasters, even if they sell the product as a disaster-protection plan for assets. It is imperative for MFIs and their clients to be educated on the coverage and exclusion clauses to avoid disappointment and misunderstanding regarding the usefulness of the product.

It is also to be noted that several programs are mandatory in order for the program to reach scale and reduce costs. For compulsory schemes to be successful, however, policy-level support is needed.

I was in Colombo for a workshop in March 2005 organised by the Sri Lanka Tourism Board and the World Tourism Organisation where microfinance was discussed for reviving micro and small tourism businesses. Representatives from several Regional Chambers of Commerce and SME associations volunteered that even in cases where they had insured their assets, the insurance companies were not settling the claims on the pretext that only in cases where an earthquake was covered specifically in the insurance policy would they consider the case and indicated cover under natural disasters was not sufficient enough. Further some insurers went another step further and said that since the earthquake was not in Sri Lanka and the damage was caused by flooding due to an earthquake elsewhere, even earthquake coverage could not be considered. Since we have moved ahead from the basic justification for the need for insurance, it is important that such bottlenecks are discussed and highlighted to take the industry in the direction needed to help cover natural disasters.

Shivendra Sharma, PlaNet Finance India, Speakers Corner, June 2005, www.microLINKS.org.





C. LIVELIHOOD AND WORK SECURITY INSURANCE

Many poor households lose their livelihoods in the wake of a major disaster. A livelihood protection or work security insurance can help to compensate for income losses due to livelihood disruptions after a major disaster. This can be especially useful in places with frequent and predictable disasters.

SEWA in India has developed a work security insurance to protect incomes of its clients who lose work and assets due to illness, widowhood, accidents, fires, communal riots, floods and other such natural and human-made calamities. The insurance is provided in collaboration with a national insurance company, Life Insurance Corporation of India. By 2005, about 32,000 members were covered. Members pay an annual individual premium of Rs.60 (US$1.50) for comprehensive coverage of losses worth Rs.50,000 (US$1100). The microinsurance product is provided through SEWA Insurance, an intermediary between the SEWA clients and the formal insurance companies such as LIC.

One of the major lessons learned at SEWA included the importance of speed in claims processing—essential for avoiding client disillusionment with both the insurance product and the MFI. Also, collaboration with major insurance firms was essential to reduce costs (see SEWA website, http://www.sewa.org/services/work.asp). However, the product is not yet tested for a major disaster affecting most of the insured clients.

D. ISLAMIC INSURANCE

In Islamic countries, to comply with Shariah laws, a new form of insurance called *takaful* is emerging—examples include Malaysia and Sudan. It is a slight variation of mutual insurance and is based on mutuality, cooperation, shared responsibility and joint indemnity. Policyholders cooperate among themselves for their common good. Losses are divided and liabilities are spread according to a community pooling system (Patel, 2004).

The first *takaful* company, the Islamic Insurance Company, was established in Sudan in 1979. There are now more than 50 *takaful* companies worldwide and their insurance premiums represent 0.02 percent of world insurance premiums. *Takaful* is used primarily to cover trade-related losses in large businesses.

Studies now show that demand also exists for micro-*takaful* products among the poor. Islamic laws also allow linkages between cooperatives and *takaful* companies (but not cooperatives and commercial insurance companies) to help with increased outreach to the socially excluded poor. However, the outreach of micro-*takaful* is limited by a lack of trained personnel, little awareness regarding this type of insurance among the poor, insurers, and re-insurers, and a lack of appropriate regulations.

Micro-*takaful* schemes are now available for providing health insurance. The Agricultural Mutual Fund, established in Lebanon in 1997, provides health insurance for the rural poor. Premiums are kept down since health costs are low in Lebanon and the program



receives large government subsidies. But the scheme may need to raise premiums if the government withdraws or reduces its subsidies. There is also a need for wider coverage beyond rural areas, for technical assistance, and for reinsurance to help achieve sustainability. As a result, it has been difficult to tailor the product to also provide asset insurance. Also, it has been difficult to provide the product without subsidisation.

E. DESIGNING MICROINSURANCE PRODUCTS FOR NATURAL DISASTERS

Well designed microinsurance products to protect clients in the wake of natural disasters are contextual and require the providers to listen to the clients. It is important for microinsurers to understand the risks their clients face, how they face them now, and what they still need to maintain financial stability and move towards growth. Conducting appropriate research, using a structured product-development process, and partnering with a reputable insurer can best ensure success for microinsurance products (Cohen and McCord, 2005).

Steps in product design

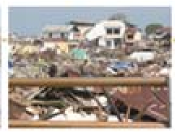
For example, in 2003 Opportunity International (OI) and its affiliate microfinance institutions developed seven microinsurance products covering risks such as illness, death, and property damage. To ensure that these microinsurance products meet the needs of clients, OI conducts ongoing, intensive market research and product refinement.

The client-driven design process proceeds in five stages. First, staff members from OI's Technical Services Division conduct initial visits to the participating MFI to determine controlling conditions such as current business practice and overall vision and values. Second, the products are designed and priced, and internal policy and procedures are formulated. Third, manuals and training materials are created. Fourth, pilot-testing of the product is carried out. Fifth, a nationwide rollout is carried out. Then frequent monitoring and market surveys are required to learn lessons for ongoing refinement and redesign of the product.

The market research and product design stage proceeds in a series of detailed steps to ensure that client preferences are incorporated into new microinsurance products. Market research consists of focus groups to determine the kinds of events that force entrepreneurs to divert working capital from their businesses. For events that are predictable and thus not insurable, information obtained through the focus groups can be used to design suitable credit or deposit products.

For insurable events, parameters such as cost and frequency are clarified, and the information is used to design a qualitative questionnaire focusing on product pricing and delivery details. The output from this questionnaire guides product design. Only after product specifications are developed in-house does the OI partner approach local insurance companies for quotations. This ensures that the product is designed to meet the needs of clients rather than insurers. OI





has found that while the types of product needed (e.g., life, property) are often already available, details such as instalment plans and payment frequency must be tailored to OI's clientele. However, insurers are often willing to negotiate on such points because microinsurance gives them access to individual clients in largely untapped markets. These new markets provide growth opportunities and diversification away from the commercial clients on which insurers in developing countries are often heavily dependent.

The last stage of this client-driven design process is additional market research using both qualitative and quantitative methodologies, in order to refine products as necessary. OI states that some of the best results have come, not in the initial product design stage but rather when products have needed redesigning. This was the case with CETZAM, an OI partner in Zambia. CETZAM staff members were puzzled when their new funeral benefits policy, which initial surveys had predicted would be very popular, failed to meet expectations. Using a client-driven redesign process, they discovered that pre-launch marketing, delivery systems, and certain product features made the policy less attractive to customers in one particular area of the country. These findings allowed staff to modify the product and its marketing, resulting in greatly increased sales.

Premiums

The premiums for the product should reflect the costs of providing the product and indemnities due to losses incurred. Often, however, such actuarially based premiums are not affordable by the poor. Also, they may not be able to pay in lump sums. This may lead to low renewal of contracts.

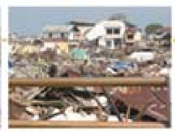
A major issue in developing microinsurance products immediately after a disaster involves lack of databases to help with proper actuarial calculations that form the basis for pricing of products. Indeed, SEWA in India took four years to build up a database for calculating premiums. The data were collected by grassroots-level women through the filing of receipts provided to the insured woman and her family members.

Also, many clients find it difficult to pay their premiums in a lump sum. In order to ease premium payments by poor clients, SEWA devised a method to link them to a savings plan. SEWA promotes insurance products through an integrated approach, *sankalit abhigam*, that combines savings, credit and insurance through *Swashrayee* Mandals. Members can save for their insurance premium through small monthly instalments in *Swashrayee* Mandals. At the end of the year when the policy is due for renewal or when new policies are to be purchased, the full premium amount is withdrawn from the account. Members who were not able to contribute the full amount are still insured and the balance of their premium is treated as a loan from the Mandal.

Coverage

The extent of coverage may range from protection against a small portion of the loss incurred as the result of the disaster to near complete coverage of losses. It depends on the scale, diversification and experience, the ability to cross-subsidise between many





insurance products, retention levels and effective partnerships.

Delivery method

Microinsurance schemes can follow various delivery methods. For example, for asset insurance, the most frequent model in India is where the insurance agency provides the insurance product and the insurance delivery institution/organisation (workers union, MFI or NGO) takes up the activity of sales and servicing the clients. Examples include BASIX—India and the recent pilot by CARE—India in Tsunami-affected areas. Alternatively, an organisation such as a MFI can act as an intermediary between the target population and one of the insurance companies. SEWA is an example of such a scheme. The choice depends on the ability and willingness of the MFI to handle both microinsurance sales and regular financial activities.

F. EFFECTIVENESS OF MICROINSURANCE FOR NATURAL DISASTERS

Growing evidence on microinsurance products to protect the poor against natural calamities shows that it can only be effective and efficient if the following items are addressed:

- Large and diversified outreach
- Low transaction costs and premiums
- Renewal rate of insured clients around 75% (lower drop outs; higher retention)
- Good appraisals of assets owned/rented/leased by the poor to help with their livelihoods
- Good data to help fix the premiums
- Good baseline information on livelihood activities and crisis-coping mechanisms of the poor
- Established insurance and reinsurance firms for partnership
- Client awareness and appreciation for insurance products
- Political and donor will to support insurance products rather than quickly intervene after the disaster with grants and cheap loans
- Realisation that some heavy losses affecting many people are non-insurable without heavy subsidisation
- Not all MFIs can/should offer microinsurance products. Demand and supply constraints should be well addressed before launching the service

While it is important to develop insurance products to protect the poor after a major disaster, it has been extremely challenging to design good products at an affordable price and quickly settle claims after the disaster. Also, it has been challenging to create demand for the products in areas that are rarely affected by disasters that cause massive damage. Subsidisation at the product design stage and premiums paid by clients have also become essential in many cases. It has been difficult to design a comprehensive product that can protect the poor from both personal and all types of natural disasters. As a result, a few pilot cases that may demonstrate success may suffer if scaled up and replicated in other places.



At present, a cautious approach is essential in advocating microinsurance as a major tool for natural disaster management of the poor. It can, however, be considered as one of the tools along with other microfinance products such as savings, loans, leasing and remittances to help in disaster management. At best, well tested life and some health insurance products are available to cover loss of life of the income earner and illness during times of disaster.

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USEFUL WEBSITES FOR INFORMATION ON MICROINSURANCE

- www.microinsurancecentre.org
- www.microfinancegateway.org/section/resourcecenters/microinsurance/
- www.proventionconsortium.org