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The Evolution of Specialized Rating for MFIs

Todd Farrington

A decade ago the specialized rating of microfinance institutions (MFIs) was hardly more than an idea. But the concept grew, and in the past five years has gained increasing attention from a wide variety of market participants. Why has specialized rating for microfinance come to be? How has it developed to where it is today? How might it evolve in the future?

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Microinsurance in Latin America

Nidia Hidalgo Celarié and Pedro Valdéz

Microinsurance reduces the exposure of low-income groups to risks that could entail significant material losses, providing a more complete protection than other instruments (such as microcredit or microsavings[1]) or other protection strategies (such as solidarity assistance among community members). As an instrument for fighting poverty, microinsurance combines technical and economic features of traditional insurance with social features.

However, despite its potential for reducing the vulnerability of low-income people, microinsurance has only become an important issue in the last few years. Moreover, it has received comparatively little attention in Latin America, compared to countries such as India, South Africa, Bangladesh, Uganda, and the Philippines where multiple microinsurance initiatives are being developed.

This article provides an overview of microinsurance in Latin America and it explains its role as an alternative for reducing the vulnerability of low-income people.

Models of Microinsurance Provision

Microinsurance services are typically provided by community-based organizations or mutual insurers, microfinance institutions (MFIs), commercial insurers, or public institutions. Chart I shows the advantages and disadvantages of each one of these groups in performing the tasks involved in providing microinsurance. Due to the obstacles faced by each organization in performing optimally all tasks on their own, insurance provision models are most often based on partnerships between different actors. These alli-

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The simple answer to the first question is that investors with money in play in microfinance wanted more information about the risks they face and the effectiveness of their investments. Theoretically, the goal of specialized rating was to create an enabling market mechanism that would reduce information asymmetries, help bring perceived risks in line with actual risks, and increase capital flows to the emerging microfinance sector. Given that ratings had proved useful to describe some aspects of investment risk in financial companies in developed markets, their adaptation and application to microfinance seemed a logical step. But the differences between microfinance and commercial banking have made the necessary adaptation more than superficial. Behind these differences lie the answers to how specialized rating has become what it is today, and where it might be headed in the future.

Origins

The term "rating" is usually used as shorthand for credit rating. In this sense, a rating can be of an issuer (the company itself) or of an issue (the debt security). An issuer rating is an opinion of capacity and willingness to meet financial commitments. A rating of an issue is an opinion of the creditworthiness of the specific financial obligation[1]. Specialized rating for microfinance most closely resembles the former, although it goes beyond mere payment capacity to capture aspects of institutional performance particular to microfinance.

Corporate credit rating had its origins in the first rail-bond ratings of John Moody, who started Moody's Investors Service in 1900. Today, a credit rating is both necessary for access to capital and a key determinant of the price of funding for many companies in developed capital markets. In most countries credit ratings have weight for regulators as well as for the capital markets, and banking supervisors often require them to determine such things as deposit insurance and minimum capital requirements.

The idea of creating a specialized rating agency for MFIs emerged in 1996[2] as a result of the pilot study for MicroRate. Eighteen of the early MicroRate ratings were funded by an Inter-American Development Bank project (Standards of Performance for Microfinance Institutions). While Moody's has grown into a multi-million-dollar-a-year international company, MicroRate and those who followed, such as Planet Rating, Microfinanza or M-CRIL, struggle to define their niche in a sector that is still part economic development and part financial intermediation. This is mainly because demand for specialized microfinance ratings, both from the capital market side and the regulatory side, is unclear at best: access to, and the price of funding for MFIs is not determined by a rating, nor do banking regulators uniformly require specialized ratings for MFIs in their systems. At least one of these elements of demand must be in place for specialized rating of microfinance institutions to flourish as a viable industry.

Commercial raters, or nationally recognized statistical rating organizations (NRSROs), are recognized by the United States Securities and Exchange Commission as exactly that – statistical organizations. On the basis of static pool analysis of rated companies they make correlations between letter-grade expressions of probability of default (a rating) and actual defaults over time.

Timely, consistently defined and objectively presented financial and portfolio performance indicators for MFIs, to say nothing of static pools of rated companies and historical default rates, simply did not exist in the mid-1990s. For the sector as a whole, inconsistent definitions of key performance measures made it difficult even to know what kind of performance benchmarks should be expected of a well-managed MFI. Given this lack of basic industry data, the first step toward a rational and coherent approach to specialized rating for MFIs was to describe what was out there, to quantify best practice, and to benchmark industry leaders.

Describing the industry in comparable terms in order to infer performance and risk parameters was a necessary first step in the specialized rating of MFIs. Initially written with investors and funders in mind, MFIs found MicroRate reports useful for comparing their performance to that of their peers and for helping them to assess their management. Although the early ratings may have accelerated the development of MFIs and helped shape the industry, initially they had little impact on funding flows.

Mainstream Versus Specialized Ratings

It was apparent that the emerging approach to rating was answering a question more inclusive than simply a company's willingness and ability to meet its financial obligations, and that mainstream rating differed substantially from specialized microfinance rating.

Although by 2000 all reports included an explicit judgment on creditworthiness, there was considerable pressure to assign letter grades. Others did so from the outset, but it was not until 2003 that MicroRate offered a "performance rating" expressed in a 10-grade Greek-letter scale. Other specialized raters use a more traditional rating scale to grade MFI performance.[3] The most important difference between

[1] Credit ratings can be short or long term, in local currency or dollars, in comparison to a pool of domestic peers or on the basis of international comparisons.

[2] ACCION International had adapted the CAMEL approach to the analysis of financial institutions in evaluating their affiliate MFIs in the early 1990s. One of the trial runs was the Fundación Ecuatoriana de Desarollo in 1993 with Carlos Castello, Bob Christen and Michael Chu. The approach was a diagnostic internal to ACCION; the idea of creating a specialized rating agency (oriented toward investors) only emerged later with the creation of MicroRate.

[3] The use of a Greek letter scale, as opposed to the traditional Latin, helps indicate at first glance that a microfinance performance rating is something other than a traditional rating of counterparty credit risk. See www.microrate.com for scale and definitions. Other specialized raters use grades and definitions implying more direct comparability to those of mainstream raters beginning with their first ratings: A+ to E in the case of Planet Rating (www.planetrating.org); and AAA to E in the case of Microfinanza (www.microfinanzarating.com) and ACCION (www.accion.org).

mainstream and specialized raters is that while commercial ratings focus primarily on creditworthiness, specialized ratings place much more weight on analyzing microfinance performance (see table 1)

To illustrate the difference between an institutional credit rating and a performance rating, imagine a microfinance company with a large capital base and lots of liquidity. Creditors need have no fears, but that same company may well do a lousy job making and recovering microloans. The result is a high credit rating and an unacceptable microfinance performance rating. However, the results are more often the other way around; that is, excellent loan portfolios and polished methodologies, but a somewhat shaky financial position (usually too small a capital base due to fast, leveraged growth). In those cases the credit rating sets a ceiling on the performance rating.[4]

The end users of mainstream and specialized ratings also differ. Socially responsible investors, while naturally concerned with the likelihood that an MFI can fulfill its contractual obligations, also want answers to questions such as: "how good is this MFI at providing microfinance services?" and "if we lend money to this MFI, will it be effectively used?" These questions are currently answered by a performance rating. On the other hand, local investors and regulators need to compare the MFI to their alternative portfolio investments or to other financial institutions under their supervision, respectively. As the funding structure of MFIs evolves and socially responsible and local investors continue to play an increasingly important role, both products will have to adjust.[5]

As in any other dynamic industry, products are constantly being adapted to satisfy client's needs. As a result, two distinct performance-rating styles are beginning to emerge. On the one hand, some raters emphasize judgment based on knowledge of the risks particular to microfinance, with descriptive detail deliberately kept to the minimum necessary to substantiate that judgment. Another approach to specialized microfinance ratings focuses more on the requirements of development agencies, with their greater appetite for descriptive detail. It will be interesting to see which type of rating report the market eventually settles on: crisp, analytical reports written for analysts who must make quick decisions, or reports that are more descriptive.

Trends in MFI Ratings in Latin America

The 2001 launch by the IDB and the Consultative Group to Assist the Poorest (IDB/CGAP) of a subsidy fund (the Rating Fund) had significant influence over the direction of the emerging "industry" of specialized microfinance raters. In the absence of clear capital market or regulatory utility for specialized microfinance ratings, the Rating Fund intervention was intended to stimulate demand by underwriting a portion of their cost to the MFI.

As of today, the Rating Fund has funded around one hundred ratings in Latin America and the Caribbean, the vast majority of which have been performance assessments by special-

Table 1. Differences Between Mainstream and Specialized Ratings

Mainstream Raters	• More emphasis on credit risk and solvency. • Benchmarking against the banking sector. • Main areas covered: capital adequacy; profitability; operational efficiency; liquidity risk; foreign exchange risk; credit management, organizational management and ownership; market position; projected cash flows. • Qualitative vs. Quantitative information: S&P 50-50; Fitch Ratings 50-50*
Specialized Raters	• More emphasis on portfolio structure and quality and operational risk and efficiency. • Benchmarking against other MFIs. • MicroRate analyzes five areas of MFI performance and risk: microfinance operations; portfolio quality; management and organization; governance and strategic positioning; and financial performance**. Qualitative vs. Quantitative information: 70-30* • Planet Rating methodology looks at: governance and decision making (20%); information and system (12%), risk management (12%); activities and services (25%); funding and liquidity (7%); and efficiency and profitability (24%). Qualitative vs. Quantitative information: 60-40* • Microfinanza covers: external context; governance and operational structure; financial products; assets structure and quality; financial structure; operational and financial results; strategic objectives and financial needs. Qualitative vs. Quantitative information: 50-50*

* As self-reported to the Rating Fund. www.ratingfund.org; ** MicroRate takes into account operational, financial and market risks in microfinance companies, and uses these functional areas as an organizing framework

[4] In fact, a mapping of MicroRate ratings to mainstream ratings of MIFs shows a strong positive correlation.

[5] Socially responsible investment does not necessarily mean "below market rate." Donations and subsidized credits made up less than 1 percent of the funding of MFIs rated by MicroRate as of 12/04.

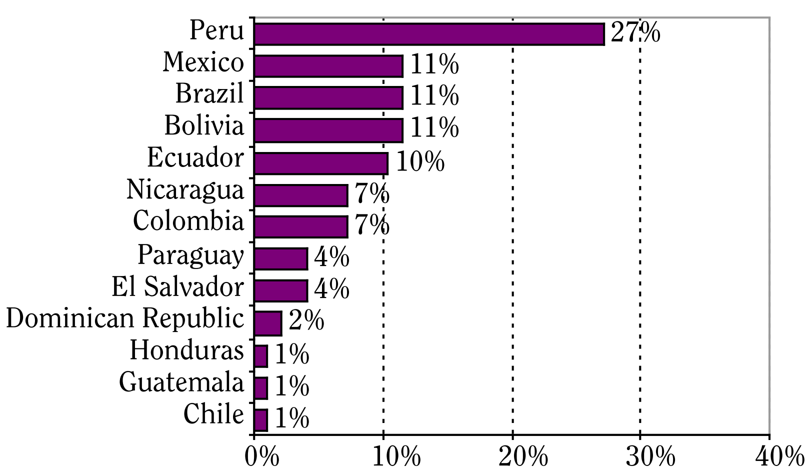
ized raters, while less than 10 percent have been institutional credit ratings. As seen in figure 1, ratings have concentrated in the Andean countries, where the microfinance industry is more highly developed, in addition to Brazil and Mexico.

Some interesting trends are emerging in the use of specialized ratings. We now see some commercial banks relying on them for the initial screening of potential MFI clients. Several investment funds use them as an indispensable tool in their investment process to complement their own due diligence and assure the reports reduce the duration of their whole investment process.[6] Some MFIs that have required mainstream ratings (to go to the bond market) have continued to commission specialized ratings as well, which shows that the differentiation of products is beginning to be more widely understood by market players.

However, challenges remain despite these promising results. The problems of conflict of interest that plague the mainstream rating sector[7] have been quick to appear in parts of the microfinance ratings industry, damaging the image of specialized raters. These conflicts involve the failure of some of them to remain independent, objective and credible, characteristics that are very important for a rater. *Independence* refers to economic and political independence with no conflicts of interest in the market. *Objectivity* implies a rigorous and transparently defined methodology as well as risk-based analysis. *Credibility* means demonstrating historical validity and a consistent correlation with other risk indicators, as well as having internal procedures to prevent the misuse of information.

This is complicated by the fact that the demand side has two dimensions: the MFIs who actually pay for a service based on perceived utility, and the investors and regulators. Given this, for the Rating Fund to have a positive long-run effect the investors and regulators must be satisfied that the specialized raters "walk the walk" ***and*** "talk the talk" - that is, behave like the mainstream rating companies while being willing and able to accurately assess performance and risk in MFIs. Most investors would probably think that raters are not "walking the walk" if they violate one of the three abovementioned conditions. Since some specialized raters have these conflicts, many investors have become skeptical of "specialized raters" as a group, weakening that element of demand.

Figure 1: Percentage of MFI ratings of the IDB/CGAP Rating Fund, by country



Source: The Rating Fund database. www.ratingfund.org.

On the other hand, the participation of mainstream raters in the MFI market is still incipient. It is mostly seen in the few MFI bond issues and in those countries like Peru or Bolivia where ratings are required by regulators. For these raters, the MFI market is risky in terms of reputation, and so far seems not to be profitable. Moreover, the ability of mainstream raters to fall back on their core business (in other sectors) when the mood changes could undermine their commitment to MFI rating.

Finally, it is clear that specialized rating for microfinance is not yet a viable industry. Without subsidies from the Rating Fund, demand for ratings would contract dramatically. We are still a long way from the day when MFIs will pay the full cost of a rating because it has become an essential tool in their funding efforts.

A Look to the Future

Ratings for MFIs have come a long way in the last decade. However, they will only become an essential tool for MFIs when they become a necessary condition for access to funding and contribute to the price of that funding, and when financial regulators demand specialized MFI ratings, as is the case in mainstream rating markets. There will only be demand from the MFIs themselves when there is demand from the market in which they operate. Given the nature of microfinance, that market will most probably always demand an opinion of MFI performance ***as a microfinance company***; that is, its ability to reach its market niche effectively and efficiently using microfinance credit technologies. But regardless of their degree of social responsibility, investors and regulators will only be satisfied if those ratings are produced by independent, credible, and objective rating agencies.

What would this industry look like? First it must be competitive, but barriers to entry will probably be high in terms of minimum capital,

[6] BlueOrchard and MicroVest, among others.

[7] This issue was very well portrayed in a recent article: "Credit-rating agencies. Who rates the raters?" The Economist. March 23rd, 2005.

legal status and market acceptance. "Specialized" would probably mean that the rating agency does not rate companies in other sectors (e.g. insurance, investment funds). It would certainly mean that they would not also provide consulting services or financing. The dimensions of the microfinance industry (the size of the individual companies and the size of transactions) would argue that margins on ratings will never be large. It will also be interesting to see if mainstream raters are committed enough to stay in the MFI market.

As a true market emerges, standards and quality will be selected for by investors and banking supervisors, and the predictive content of MFI ratings will be continuously put to the test. As specialized credit ratings become accepted by local authorities,[8] those that focus on the additional risks of decentralized operations will become increasingly useful to regulators due to the Basel II guidelines emphasizing operational risk.

Today the market for specialized rating is very small mainly because the microfinance industry itself is still so small. But the present surge in demand for ratings (MicroRate provided 28 ratings in the first half of 2005 compared to 37 in all of 2004) can only be explained if ratings have become a useful instrument for accessing funding. The prevalence of repeat ratings is another indication that this is the case: Of the 28 ratings undertaken during the first semester of 2005, 19 involved MFIs that had been rated before.

Specialized rating as a tool that helps direct funding flows is taking off. The market is busy sorting out which raters it finds credible. In the future, we are likely to see conventional credit ratings and specialized performance ratings move closer to each other until they finally merge[9].

[8] MicroRate is in the final stages of approval as a legally recognized international rating agency by the banking superintendency of Peru.

[9] Todd Farrington is the General Manager for Latin America at MicroRate.

Microinsurance...

(continued from page 1)

ances allow them to join resources and skills, pool risks and provide better services. There are three basic models of microinsurance provision.

The first is the *full service model*, under which a single company undertakes all the tasks, from product design, sales, and colleting premiums, to reviewing claims, handling payments and even providing reinsurance. The insurance organization takes on all the insurance-related risk and deals directly with the policyholders. Commercial insurers and certain MFIs are examples of organizations that use the full service model. In some cases, a third-party service provider may also be involved. For instance, in the case of health insurance, a third party may provide medical services. In specific cases where the insurer and service provider are the same entity, the model is known as a *provider model*.

These models have not been very successful in reaching lower-income groups in an efficient and effective manner. Traditionally, commercial

Chart 1. Strengths and Weaknesses in Microinsurance Provision by Type of Organization

Tasks	Mutual Insurers	Community-based Groups	MFIs	Mutual Insurer Networks	Social Insurance	Commercial Insurers
Product Sales	+	+	+	_	_	_
Premium Collection, Claim Review and Payment	+	+	+	_	_	_
Product Design	_	_	_	_	+	+
Pooling Risk[2]	_	_	_	+	+	+

Note: + Advantages; - Disadvantages. Source: Based on Loewe, M. 2002. The Third Way in Social Protection. Group-Based Schemes and the Potential of Micro-insurance. Seminar on Social Protection for the Poor in Asia and Latin America, Asian Development Bank, Manila, 21 to 25 October.

[1] Brown, W. and C. Churchill. 1999. Providing Insurance to Low-Income Households Part I: A Primer on Insurance Principles and Products. Microenterprise Best Practices, U.S. Agency for International Development. Washington, D.C.

[2] Insurance provision is based on a risk-sharing mechanism that pools a large number of individuals who share the losses resulting from any risk.

insurers have not covered low-income households because of the high administrative and transaction costs involved in reaching these customers, particularly those in remote areas, and their lack of familiarity with the demand profile. When attempting to reach these customers they must often deal with issues of adverse selection and moral hazard, as well as a lack of actuarial information for setting premiums. MFIs face additional hurdles to offering microinsurance products to their clients, including a lack of technical knowledge regarding insurance products, burdensome regulatory requirements, highly concentrated portfolios, and lack of reinsurance vehicles.

The second model is the *community group-based model*, under which policyholders own the insurance company and select a group from among themselves to manage the scheme.[3] This group is responsible for all insurance-related tasks, and may subcontract external service providers to supply specific services. Insurers in a community group-based model are typically mutual insurers, cooperatives, community-based organizations, and credit unions. The Colombian group *La Equidad*[4] is an example of this type of model. This participatory model has the advantage of reducing moral hazard problems. In addition, proximity to its clients allows them to fashion a microinsurance product that more easily meets their client's needs. Nevertheless, the absence of reinsurance mechanisms and the geographic concentration of risk could potentially lead to the failure of the scheme in the case of catastrophic events or large-scale claims. Finally, a sizeable investment may be required, along with long-term training and technical assistance to establish a sound administrative structure.

The third type of microinsurance provision scheme is the *partner-agent model*, under which an insurer enters into a contract with an agent who markets its products. The most popular partener-agent model used to serve low-income households is the *MFI-insurer partnership*. In this type of partnership, the microfinance institution serves as a sales agent for a commercial insurer. Four parties are involved: the insurer, the agent (the MFI), the policyholders, and, if applicable, the external service provider. The MFI and the insurer work together to design a product for low-income clients, and both entities negotiate the rate offered to the customer. The MFI handles marketing, premium collection, and other customer services. It also participates in claim reviews and issues payments on claims. In return, the MFI receives a commission. The insurer absorbs all the risks, sets the final rate, pays the claims, and monitors that all legal requirements are being met. An example of this model can be found in Mexico where ALSOL Chiapas (a microfinance institution) acts as the agent and Zurich-Vida acts as the insurer.

This model is most effective when each party performs the tasks it is best at, thereby maximizing operational efficiency. It has advantages for both the MFI and the insurer.[5] The advantages for the MFI are that it enables it to offer customers a new product for reducing their vulnerability, while increasing the protection for its own portfolio, and generating additional revenues from sales commission. In addition, the MFI will not need to invest its own resources in developing a new operational structure, training personnel, and complying with legal reserve or capital requirements, investment restrictions, or other regulations. Finally, this model provides the MFI an opportunity to learn about the insurance business in a relatively riskless manner. For the insurer, working with an MFI means that it can gain access to new markets, obtaining information on potential customers through the MFI's records. It can also reduce its transaction costs by operating through the MFI's organizational structure and using its infrastructure. Finally, it may learn new skills from the MFI´s work with low-income households. Despite these advantages, insurers have not expressed a great deal of interest in entering the "micro" market, and, when they have, they grapple with the challenge of adapting the terms of microinsurance to the needs of low-income people.[6]

Microinsurance in Latin America

Given the importance of adapting insurance products to the needs of low-income people, studies should be undertaken to determine the size and nature of the demand prior to launching a product. Studies of this kind have been conducted with micro-entrepreneurs and low-income people in Mexico, Bolivia and Colombia. The results are discussed below.

Focus groups held with women clients of MFIs in the Mexican state of Veracruz found that the key risks that they face are, in order of importance, death of a family member, serious illness, and accidents.[7] The women interviewed expressed their willingness to purchase microinsurance to

[3] On some occasions professionals have been hired to handle the scheme. Case studies conducted by The Americas Association of Cooperative/Mutual Insurance Societies in Colombia and the Dominican Republic, showed that hiring professionals who share the values of community-based groups has led to efficient management.

[4] *La Equidad* provides micro life insurance and multirisk microinsurance (theft, fire, earthquake, loss of income, machinery breakdown, etc.), which it has offered under a full service model. However, difficulties in collecting premiums, a lack of incentives for the sales force (because of the low profitability of low-premium insurance), and other factors, have led it consider forging a partnership with MFIs for marketing its products.

[5] Brown, W.; C. Green and G. Lindquist. 2000. A Cautionary Note for Microfinance Institutions and Donors Considering Developing Microinsurance Products. Microenterprise Best Practices, USAID, Washington, D.C.

[6] For example, low-income women in the state of Veracruz, Mexico, prefer weekly or bi-weekly premium payments, while insurance companies require an annual or monthly payment.

[7] Hidalgo Celarié, N. 2004. Para asegurar a las personas de bajos ingresos: el microseguro en México. Ensayo predoctoral, CIESTAAM, Universidad Autónoma Chapingo, México.

protect against the risk of death or serious illness of a family member. They price that they are willing to pay for this service is up to US$0.50 a week per insurance. A nationwide study conducted with MFI clients in Bolivia concluded that, according to their perception, the risks to which they and their family members are exposed to are, in order of importance, illness, accidents, theft, assault and robbery, and death.[8] Those interviewed expressed their interest in purchasing the following types of insurance: health, accident, house theft, theft at work, and death. The average annual payment that those interviewed would be able to make to purchase these products was a maximum of US$35. An exploratory study of low-income microentrepreneurs conducted in Colombia found that the main risks they face are, in order of importance, serious illness, theft, death, property damage, education, fire, natural disasters and death.[9] Out of all of these, the microentrepreneurs said they were willing to protect themselves against theft, illness, and fire, by paying no more than US$2 to US$4 a month.

In spite of evidence illustrating a demand for a broader variety of microinsurance services, the most common microinsurance products in Latin America are currently debtor and life insurance. These products are relatively less complex for insurance companies and, as seen in the cases illustrated in chart 2, they tend to be offered under the partner-agent model.

The provision of other types of microinsurance, such as health insurance, is less common given the lack of interest on the part of insurers in providing highly complex products to the "micro" market. Non-government organizations (NGOs), community groups, and government agencies have been more involved in providing health insurance, whether individually under a provider model or by through government-NGO or government-community groups' partnerships. A few examples of this are *Serviperú*, a cooperative organization in Peru; the *Fondo Comunitario de Salud* of the municipality of Tupiza in Bolivia, which resulted from an initiative by the local community, the municipality, and the Tupiza health district; and the Popular Health Insurance (*Seguro Popular de Salud*) offered by the Mexican government. In Bolivia, *Adriática Seguros y Reaseguros S.A.* offers micro health insurance to workers and household employees (i.e. maids) under a full service model in which pre-qualified physicians and clinics provide medical services. The benefits cover outpatient and in-patient care, accidental death, and personal injury.

Chart 2. Micro Life Insurance Schemes in Latin America

Features	ALSOL Chiapas and Zurich Vida	BancoSol and Zurich Boliviana Seguros Personales S.A.	Affiliated Cooperatives FENACOAC[10] and COLUMNA
Country	Mexico	Bolivia	Guatemala
Scheme Starting Date	2001	2004	1970 (as FENACOAC)
Type of Microinsurance	Life insurance (mandatory)	Life insurance (voluntary)	Life insurance (mandatory for co-op members and voluntary for others)
Provision Model	Partner-Agent	Partner-Agent	Partner-Agent
Number of Policyholders	Approximately 3,000 low-income women	Approximately 4,900	Approximately 54,000 policyholders under the microinsurance scheme
Premium	US$0.18 a week per customer	US$0.99 a month per customer	US$7.80 to US$39 annually
Benefits	In the case of death, any unpaid portion remaining on the loan is paid, in addition to US$885.	a) US$300 to US$15,000 for accidental death and death by other causes (cap based on average balance on savings accounts) b) US$300 to US$700 for burial (cap based on average balance on savings accounts) c) US$50 for each child (a maximum of 4 children). If policyholders do not have any children, US$200 will be awarded to the surviving spouse.	US$1,235 to US$ 6,173 in the case of death by natural causes, and an additional amount to cover accidental death and disability. In the case of death, any unpaid portion remaining on the loan is paid.

Source: Own source based on fieldwork; Herrera, Carlos and Bernardo Miranda. 2004. COLUMNA Guatemala. CGAP Working Group on Microinsurance, Good and Bad Practices, Case Study No. 5.; and Schulze (2004).

[8] Schulze, Erick. 2004. Servicios de microseguros a los usuarios de IMFs. Centro Internacional de Apoyo a las Innovaciones Financieras (Centro AFIN), La Paz, Bolivia, 2004.

[9] Latin-American Forum on Microenterprise. Workshop on New Microfinance Products. At: http://www.iadb.org/sds/doc/MicCHigueras.pdf

[10] Federación Nacional de Cooperativas de Ahorro y Crédito

Challenges and Opportunities for Implementing Microinsurance Schemes

Traditional insurance provision models face numerous obstacles to reach low-income households. In order to become more efficient and effective at providing microinsurance, the MFI partner-agent model makes it possible to combine the know-how and skills of MFIs in the low-income market with those of commercial insurers in the provision of insurance products (an entirely different business from savings and loans). By working with the MFI's customers, organizational structure, and infrastructure, this model allows for reduced transaction costs and adverse selection problems, thereby lowering the risk taken on by the MFIs. Although there is little experience in the region with the provision of more complex insurance products through partner-agent models, it is recommended that the potential of these partnerships continue to be explored as a way to expand the range of insurance products offered to low-income households. There are four key challenges to the success of these schemes in Latin America:

- **Bringing the insurance sector closer to MFIs so that they may jointly design and operate products that meet the needs of MFI customers.** Although MFIs are interested in offering their customers new products, the insurance sector is reluctant to become involved in these schemes. Marketing and awareness-raising activities about the "micro" market and the successful experiences of MFIs with this market segment are an important step in attracting insurers to this scheme.
- **Promoting a culture of insurance among the low-income people.** In Latin America, insurance is considered a luxury item, and low-income persons are not familiar with it. Thus, it is key that microinsurance schemes should also provide detailed information on the service and include strong marketing campaigns.
- **Fostering collaboration among actors to promote economically viable microinsurance schemes.** Donors and governments can support these schemes by providing technical assistance as well as by funding feasibility studies and operating expenses during the start-up phases of microinsurance schemes. MFI networks could play a role when the product requires economies of scale and a large number of policyholders to be economically viable. Finally, Governments may also subsidize insurance premiums for extremely poor groups; and may act as a reinsurer of last resort.
- **Designing a microinsurance-friendly regulatory framework.** Some countries have regulations that prevent MFIs from selling insurance and prevent cooperatives from participating in insurance schemes.[11] A flexible regulatory framework that allows these actors to participate is key to enable the emergence of innovative microinsurance schemes[12].

In Future Issues...

How do MFIs Best Themselves

The Risk of Microfinance and Basel II

[11] In Mexico, community-based savings and loan institutions cannot be insurers or agents. In Bolivia, only authorized insurance brokers or agents can apply and receive commissions for selling collective insurance, and only financial entities can conduct mass marketing of insurance to individuals.

[12] Nidia Hidalgo and Pedro Valdez are independent consultants at PlaNet Finance Mexico.

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The Micro, Small and Medium Enterprise Division manages the IDB's microenterprise projects with the private sector and provides training, disseminates best practices, and develops policies and strategies to guide Bank country operations and promote the growth of the microenterprise sector in Latin America and the Caribbean.

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