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This case study is based on the experience of Fonkoze, a microinsurance project co-financed by the Swiss Agency for Development and Cooperation (SDC). It forms part of a series of thematic case studies of SDC's Employment + Income Network.

Standing Firm With Clients When Disaster Hits: Fonkoze's Catastrophe Microinsurance Programme

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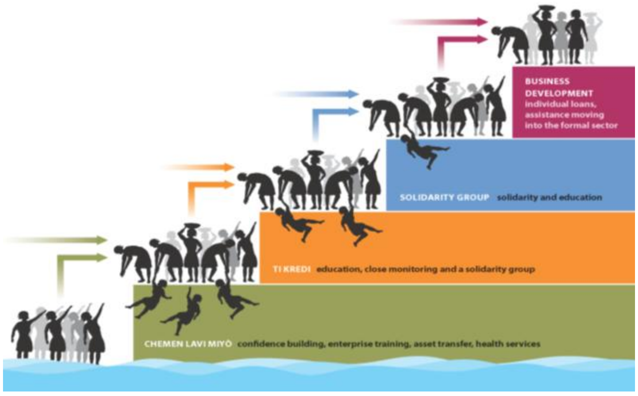
1. Protecting homes and business assets of Haiti's poor through microinsurance

Plagued by tropical storms, floods and even earthquakes that have killed hundreds of thousands of people and left even more destitute, Haiti has a long history with Mother Nature. Every few years, the country is struck by one or more serious natural disasters. Haiti's poor, already so vulnerable, struggle to cope with houses destroyed, business assets washed away and the challenges of getting back on their feet following these disasters.

Picture: Fonkoze's Branch Network

Fonkoze, Haiti's largest microfinance institution, believes strongly that there is a "staircase out of poverty", but it is a difficult one to climb. Fonkoze accompanies its female clients during two years with a programme that provides financial and non-financial services. It comprises training in literacy, business and life skills during 4 steps in which clients start to receive small loans. Besides, Fonkoze offers savings products, currency exchange and direct deposit services.



Picture: Staircase Out of Poverty

However, it is predictable that uncontrollable events, such as hurricanes, death in the family, thefts, fire, will set a poor person back because there are so few protections against the risks they face. For every step forward, there is at least one step back. Thus, Fonkoze realized even before the 2010 earthquake that its members needed tools, like insurance, to safeguard against devastating risks and to maintain their livelihoods. Starting after four consecutive hurricanes in 2008 and continuing after the earthquake in 2010, Fonkoze worked with a network of private-sector and institutional partners to establish an insurance mechanism that provides coverage from disasters at a price affordable to our clients.

The result was the creation of a (re)insurance company (the Microinsurance Catastrophe Risk Organisation or *MiCRO*) to insure the risks of the world's most vulnerable and the rollout of *Kore W*, Fonkoze's catastrophe insurance product for its clients in Haiti.

2. Understanding MiCRO and Kore W

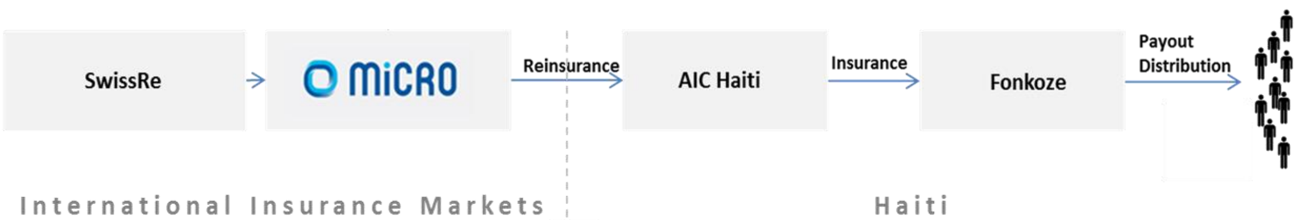
MiCRO, which employs an innovative hybrid insurance solution to reduce the cost of coverage to vulnerable people in high-risk regions, is a multi-organization public private partnership between Fonkoze; Mercy Corps; Swiss Re; Caribbean Risk Managers Ltd; Guy Carpenter and Company LLC; Alternative Insurance Company (AIC); the UK Department for International Development (DFID); the Swiss Agency for Development and Cooperation (SDC); and the Caribbean Development Bank (CDB).
The first component of the product is a *commercially reinsured "parametric" contract* where payments are automatically triggered if objective thresholds are exceeded for rainfall, wind speed or seismic activity at any Fonkoze location through Haiti. MiCRO purchases this coverage from Swiss Re on behalf of Fonkoze. The second component is *coverage* that MiCRO itself provides to Fonkoze *for the "basis risk"* – that is, the difference between the coverage provided by the parametric payout and the actual losses incurred by the insured under the *Kore W* programme criteria.

Both the parametric and the basis risk coverage have overall limits for the policy and sublimits for rain, wind and seismic damage. Whenever there is a rain, wind or earthquake event, Swiss Re pays out rather quickly according to the pre-established criteria. Fonkoze receives the payout regardless of the extent of actual damage to clients' homes or business assets. Meanwhile, Fonkoze accepts claims from its clients, evaluates these and pays out indemnities to accepted claims. If the amount paid to clients exceeds the amount received from the parametric policy, Fonkoze submits a *basis risk claim* to MiCRO. When the claim is accepted by the committee, MiCRO pays out 85% of the amount, by drawing on funds within its "Haiti cell", which is further backed by a Multi-Donor Trust Fund (MDTF) managed by CDB and financed by CDB and DFID.

«All I was able to save from my home were my youngest children and their birth certificates… Thank you, Kore W… Kore W is needed everywhere in Haiti.» Lovana Hermilus

SDC has been involved from the outset – first by assisting Fonkoze to purchase additional shares in the Haiti cell, then by helping with capacity building and by partially covering the Year 2 debt. Now SDC is helping MiCRO to expand the catastrophe microinsurance product to other countries in Central America and the Caribbean.

Fonkoze's implementation of catastrophe insurance through its programme, *Kore W,* was designed to be affordable, effective and comprehensible for the extremely poor clients that Fonkoze serves. The cost of the insurance to clients with 6-month loans is 3% of the loan value, paid at the time of disbursement. The average loan size is about USD 250, but can range between USD 70 and 1'250. Clients pay around 45 – 55% of the premium that Fonkoze pays to MiCRO. Fonkoze pays a portion of the premium because of the benefits it derives from the policy – clearly it helps to protect the portfolio against costly defaults. The remainder is subsidized by the IFC. This subsidy is not expected to continue long-



Picture: Flow of Insurance Benefits from International Markets to Haitian Micro-Entrepreneurs term. However, it is needed momentarily because the taxes on the insurance premium are a whopping 18.5%. Fonkoze is working to be relieved from paying these taxes, which would make the subsidy unnecessary.

3. Benefits to Policyholders

In the case of Haiti, rain constitutes the biggest risk to our clients. Many of their homes are covered with a thatched roof and a dirt floor with one or two rooms. Thus, the two biggest threats are water entering the home, washing away the merchandise that is stored at home and damages to the walls or roof. The damage to the homes is one problem, however the loss of their productive means leaves these people temporarily without work and without income. This leads sometimes to negative coping strategies, where immediate insurance payouts play a crucial role in rehabilitation.

The indemnity assessment by the Centre chief considers two factors: The severity of damages to client's home, merchandise or business premises (*high-level* of damage is prerequisite for a payout) and the interruption to income generating activities. If eligible to an indemnity payment, the client will receive following benefits:

- Cancellation of the balance remaining on their loan
- A cash payout of approximately USD 58 to assist with emergency needs
- Pre-approval for a new loan to recapita-lize their business when they are ready

«I had such a rapid response to the damage from the Kore W insurance that I had signed with Fonkoze to receive. Kore W eliminated my old debt, gave me a new loan, and a cash stipend was put into my bank account.» Guerda Pierre

As an example, Guerda Pierre was one of the victims after Hurricane Sandy did its damage to Haiti in late October 2012. The home she shares with her three children and mother was completely flooded and all her merchandise was destroyed. In addition, the plantain trees and beans in her garden were wrecked. Guerda had paid USD 5.30 for her insurance policy with Fonkoze when she received her 6-month loan of USD 176. That is 3% of her loan value paid one-time at the start of the loan for 8 months of coverage. Following the storm she received a cash payment of about USD 58, the cancellation of her debt with Fonkoze and a new loan. As you can imagine, she and many others like her quickly became big fans of the insurance programme!

Nevertheless, the beneficiaries still use other forms to cope with the damage: many reduced their spending, sold off (productive) assets, depleted savings or received money from other sources such as family and friends, money lenders, or other financial institutions. This could lead to over-indebtedness. Beneficiaries used their payout as follows:

Did *you* use your payout to…	Pay off de*bt?*	*Work* less?	Fix or buy new things?	Save or invest in your business?
Yes	54%	29%	26%	69%
No	46%	63%	71%	31%
Don't know	0%	9%	3%	0%

The survey in 2011 showed that the insurance truly helped the poor to get back on their feet, especially the loan forgiveness was very appreciated. 97% of clients who received a payout and 90% of clients who did not receive a payout indicated the insurance product was a "good addition" to Fonkoze. 58% of beneficiaries also perceived the pricing as fair. This view changes significantly with those, who did not receive payouts: only 40% agreed with the price whereas 60% considered the premium too expensive or were not sure.

4. Fonkoze's Evolving Role and Adapting Process

Many of the normal tasks of administering an insurance policy fall on Fonkoze's shoulders. For instance, Fonkoze is responsible for explaining the programme and its cost to clients, enrolling and renewing clients, collecting premiums (accomplished at the same time a loan is disbursed), receiving and assessing claims, managing all data and making the cash payments, cancelling the existing balance of victim's loans and disbursing new ones. These functions were, for the most part, new to the institution and did require some new staff – specifically an insurance manager and 7 staff who were responsible for training clients as they renewed their loans and ensuring they enrolled in the programme. It also increased the work load of other staff.

In addition, the programme leveraged Fonkoze's existing network and infrastructure to apply a unique model of determining who qualifies for benefits following a disaster event. Clients meet with their Solidarity Groups (five clients who know and trust one another) twice a month with six to ten other groups in "Centres". A Centre is an association of women committed to bringing their families out of poverty by strengthening their businesses and educating one another. Each Centre elects a client to serve as "Centre Chief." Immediately after a disaster occurs, Centre Chiefs are charged with visiting all of the members of their respective Centres to assess losses. They are paid a small amount for these assessments. The Centre then meets and, using the findings of the Centre Chief, a trained Fonkoze staff member facilitates a discussion of the losses to determine those who are eligible under the *Kore W* criteria. Losses are selectively audited and disputes are resolved by trained Fonkoze staff.

«Eight of us from the same centre in Okoto lost all our merchandise and in many cases part of our homes in the last storms. If not for Kore W, we would still be sitting with our hands under our chins. I was able to start my commerce again in less than 1 month.» Josette Lazarre

5. Localise weaknesses to improve the catastrophe microinsurance

First Year - Evaluation

Fonkoze began enrolling clients in January of 2011 – one year after the earthquake. Similar to many years in the past, 2011 brought devastating floods to certain parts of the country, wiping out marketplaces, inundating merchandise and destroying homes. In 2011, however, Fonkoze clients were able to turn to *Kore W* to get back on their feet following the disasters.

The first event came in late May – 7 days of devastating rains settled over Southern Haiti. Immediately the *policy paid out USD 1,05 million* based on the amount of rain that had fallen in a 5-day period as measured by a NASA satellite. In total, 5'822 clients were assessed, and *3'815 were accepted and paid* for a total of almost exactly *USD 1,05 million*. The parametric policy seemed to be working. Other events during the year, such as tropical storm Emily and hurricane Irene, caused some damages. *Between January 2011 and February 2012* a total of *6'794 clients* directly benefited from the insurance coverage by receiving both a cash payout and the elimination of their debt on the day of the event.

Policy year	**2011-2012**
Number of Clients Insured	58'737
Total Premium Amount by Clients	718'341 USD
Price of Insurance Policy (parametric and basic risk coverage, incl. taxes and fees)	1,45M USD
Number of Accepted Claims	6'794
Total Cost Of Cash Payouts & Loan Balance Elimination	1,9M USD

From February through May 2012, Fonkoze began to take a closer look at both the achievements and shortcomings of *Kore W's* first year in order to make positive changes. Clients and staff have been interviewed, focus groups conducted, statistics analysed and the internal operations evaluated. The evaluation concluded that:

1. *Dropout rates were at the lowest in history,* especially in branches where clients received pay-outs.
2. *Damages* in 2011 were *caused primarily by rain* and led to the *loss of merchandise more than housing*. This led to a new focus on rolling out a *Disaster Risk Reduction plan* that will specifically focus on reducing merchandise losses caused by flooding rains.
3. The *time* between event and payout was *too long* in 2011. Although MiCRO made its payouts to Fonkoze very quickly, it took the Insurance Department *too long to evaluate all the claims – 45 days on average*. This meant that clients had to turn to other coping mechanisms.

4. Overall, *client understanding and client satisfaction* were high for the first year.
5. Both clients and staff alike logged some *complaints about the meetings when damage evaluation information is collected*. Some clients feel their claims were unfairly rejected, while some staff feels the decisions have cause jealousy among clients.
6. Clients and branch staff share similar suggestions for making *changes to the product* including premiums that vary by regional risk, no-claims refunds and premium payments that are split over a period of time.

Thus, as with every innovation, *Kore W* had its challenges to overcome. However, the insurance product was a success so far. Tens of thousands of clients took the first steps to protect themselves by participating in *Kore W.*

Client Suggestions

1. Extend coverage to include crops and livestock
2. Include vehicle accidents
3. Lower the premium or allow monthly payments
4. Reward clients with no claims
5. Charge clients more in riskier areas
6. Rely on the Centre Chief reports rather than seeking consensus in the centre
7. Give cash payout to everyone in the Centre but only eliminate debt of those most affected!

Second Year - Evaluation

Although the establishment of MiCRO and the first-year's implementation presented big challenges, the challenges since then have proven even more demanding. In 2012, Haiti was hit even more frequently with disasters. There were a total of *5 major events* and almost *28'000 accepted claims* – far more than the first year. The *cost of the payouts* was a whopping *USD 6,3 million*! But the insurance *only paid out USD 4,7 million*. The reason was that, while the parametric measures worked very well with hurricane Sandy – the insurance paid out USD 3,3 million which covered all 12'000+ victims –, it did not work well during tropical storm Isaac. The *parametric payout for Isaac was USD 217'000*, but our *10'300 claims totalled over USD 2,.9 million* after assessment.

Eventually, Fonkoze was liable for the gap!, Both MiCRO and Swiss Re had protected themselves by establishing limits on the indemnity amounts they would pay, but Fonkoze had never really come to terms with the *lack of limits* in its promises to clients. The challenge, in addition to determining how to limit our liability, was untangling all of the different flaws in the design: a) the *parametric methodology* b) the *triggers* that had been set c) the *claims assessment process* and d) the *benefit package* we provided to victims…

Due to the policy limits for rain that were completely depleted after Sandy, we were *forced to stop renewing clients* 5 months before the end of the policy year. First, we had to determine whether there was an obvious way forward or we would have to abandon the programme altogether. We anticipate that the programme will not be resumed until after the hurricane season at the earliest.

Policy year	**2012-2013**
Number of Clients Insured	64'744
Total Premium Amount by Clients	399'030 USD
Price of Insurance Policy (parametric and basic risk coverage, incl. taxes and fees)	1,6M USD
Number of Accepted Claims	27'906
Total Cost Of Cash Payouts & Loan Balance Elimination	6,3M USD

6. Finding a Way Forward

Fortunately for us, not only our original stakeholders but even some new ones like the International Finance Corporation (IFC) have stood by us to ensure the institution did not go bankrupt. Everyone is working hard to redesign the programme with few aspects left untouched! First, it is clear we need to get the *programme off the institution's balance sheet* and *place strict limits on the risk* that we assume. Second, there are problems with the functioning of the *parametric methodology* but they seem to be addressable and *improvements are being put in place*. Third, our *benefits were set too high*: the combination of the cash payout and the debt cancellation were just too much to finance given the number of victims. Fourth, we need to *rethink how we define eligibility* – do we need to require full losses rather than partial losses of merchandise and home? Fifth, a *redesign of our claims assessment process* is in order. Sixth, *incentives need to be in place to encourage clients to protect their assets* to the extent possible. One technique for doing this is to charge less in premium for clients who have never had a claim and more for those with multiple claims.

The biggest challenge though is *communicating* these *changes to 65'000 women* spread all over the most rural, isolated regions of the country, many of whom are illiterate. The majority of them have been convinced of the necessity of insurance, but now we have to make certain they understand that the insurance is not in force today. We are working hard to help them better understand the risks they face and how to manage them. I am convinced this requires a number of different tools that have to be made available to them. Insurance is one of the most important ones and on a par with disaster risk mitigation.

Throughout these last two years, we have learned a tremendous amount from this experiment that we undertook. Here are some of the lessons:

1. *Accompaniment*: Our clients cannot do it on their own, accompany them to get back on their feet. Complementary risk management and disaster risk reduction tools are needed to make their ascent out of poverty. Insurance is just one part of the solution.
2. *Reliability*: It is important that clients know that you are there for them as soon as possible following a crisis.
3. *Client feedback*: They know best what they need. Conduct focus groups frequently.
4. *Testing*: Whenever possible, conduct a pilot of a new product before launching it institution-wide.
5. *Perseverance:* Once you start on the path, you must have the determination and the passion to continue the search for solutions.

«We have not gotten it right yet, but most of us are not giving up yet either.» Anne Hastings, Fonkoze

7. Potential and Prospects

Insurance is proving to be an effective risk management tool that allows vulnerable households to recover and resume their productive activities fast following a disaster. The faster they receive insurance pay-outs, the less they are forced - as in the case of slow and uncertain relief operations - to revert to negative coping strategies.

In Haiti, Fonkoze has pioneered successfully an 'agent partnership' model where mature microfinance institutions (MFIs) manage the client-related insurance process. The Board of Directors and stakeholders of MiCRO remained confident that what Fonkoze and MiCRO have learned from these turbulent years will be put to good use. The redesign of the product is under way to be able to replicate this innovative insurance approach first in Latin America and later in other countries.

SDC and Swiss Re have already joined forces to support MiCRO in strengthening the natural disaster resilience of vulnerable households through access to appropriate catastrophe insurance cover on a sustainable basis. MiCRO is preparing a business plan on the feasibility of providing such insurance to 250'000 vulnerable households in Central America, Columbia and the Dominican Republic. Swiss Re is providing technical assistance in the preparation of the business plan so that MiCRO can pilot and subsequently scale up the catastrophe insurance product.

The experiences from the Haitian pilot also stress the strategic need for complementary delivery of financial education and disaster risk reduction campaigns. These are both areas SDC intends to bring in its long experience to complement Swiss Re's expertise to MiCRO. Since 2005, SDC has promoted disaster risk reduction in Haiti through various measures. In addition, SDC has fostered financial education in Central America for many years and built up a strong cooperation with local microfinance institutions.