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Providing Insurance for Good Repayment Performance: The Individual Emergency Fund, Philippines

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Extended Summary

Providing insurance for good repayment performance:

The individual emergency fund, Philippines

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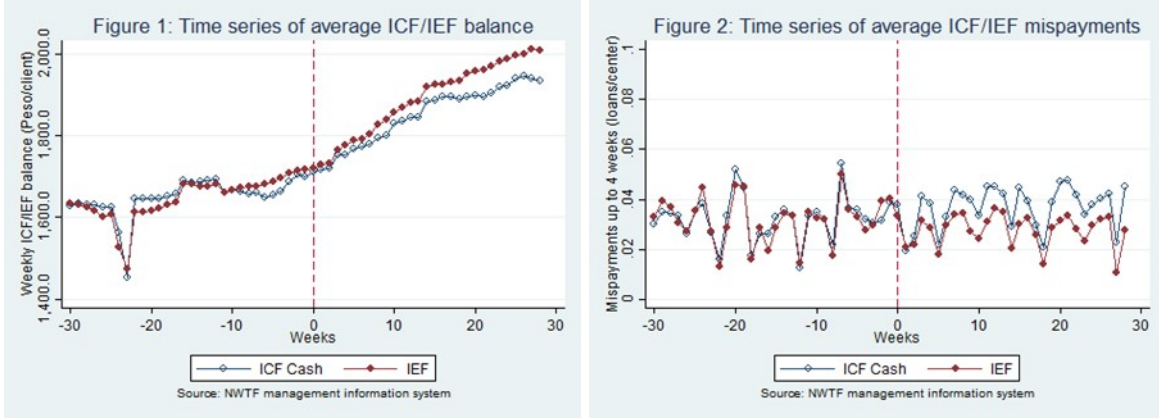
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Asymmetric information impairs the functioning of credit markets, in particular in developing countries where incomplete property rights and lack of collateral are a common joint occurrence. In such an environment financial institutions enable lending by transferring the responsibilities for the screening and monitoring of the borrowers as well as the enforcement of credit contracts, to the borrowers themselves to ease problems of asymmetric information. This comprises non-collateral based lending methodologies such as peer monitoring through co-signers (Klonner and Rai, 2010) and, especially, peer screening and monitoring in individual and joint liability group lending with the possibility to impose social sanctions (Giné and Karlan, 2014). In addition, improved personal identification through fingerprints may alleviate credit market imperfections (Giné et al., 2012). These approaches have in common that they rely on the punishment of non-compliance with credit contracts as principle enforcement mechanism, e.g. through legal action or social sanctions. They contrast with alternative mechanisms which reward compliance, rather than punishing non-compliance, with credit contracts. One example is dynamic incentives, i.e. offering bigger loans sizes to clients when they build up a positive credit history. Another example, and subject to this impact evaluation, is conditioning gratuitous insurance provision for the client through the financial institution on clients good standing with the financial institution (and clients are in good standing if they are neither in arrears with loan payments nor defaulted on their loans).

We evaluate the impact of such a conditional gratuitous insurance provision on the repayment performances of microfinance clients. More specifically, the individual emergency fund (IEF) is an insurance fund for each individual client. It is endowed by the microfinance institution (MFI) as a reward for successfully completed loan cycles. The client may not augment the fund. It triggers a payout only if clients, or members from the clients' households, are affected by a shock (typically, but not exclusively, health shocks which need to be demonstrated by a medical certificate). The payout is limited to the individual balance in the IEF. However, payouts are conditional on a clients good standing with the microfinance institution before a shock happens. For the evaluation, we experimentally vary



the size of the IEF contribution from the MFI between 10, 15 and 20 percent of the total interest payments made during a completed loan cycle. The two control groups receive an equivalent payout either in cash or in form of a transfer on an easily accessible bank account. Given that we randomize the IEF on top of an existing insurance fund (the ICF), we evaluate the impact of the IEF at the intensive rather than the extensive margin.

The impact evaluation employs weekly data on the financial activities of roughly 22000 clients in 700 client centers from the management information system (MIS) of the microfinance institution. To evaluate the impact of the IEF on clients, we complement the weekly MIS data with weekly data on a subsample of 500 to 700 clients collected through phone surveys. The data collection began in September 2013. The implementation of the treatments began with the IEF 10 in April 2014. The evaluation runs until April 2016. Thus, at the *Jahrestagung* we will be able to present results from the first 15 months of treatment implementation. The target population of the microfinance institution are poor and marginalized women, typically self-employed and with limited access to the formal banking sector, to whom the microfinance institution provides financial services.

Figure 1 and 2 present some preliminary evidence. Figure 1 shows how the average ICF/IEF balance develops for the control group with cash payout (ICF cash) relative to the treatment group with the 10 percent IEF contribution through the MFI (IEF) clients over time. Three observations are noteworthy: First, before the introduction of the IEF both time series move closely together (as expected because there was no IEF). After the introduction of the IEF in week 0, we see how the time series start to diverge with the IEF series steadily moving to higher averages.

Second, both series show a slight upward trend. Constantly increasing ICF/IEF balances reflect that there is little attrition of clients. This results in a higher ICF/IEF balances due to an increasing number of completed loan cycles.

Third, there is a clearly visible negative peak after Haiyan, demonstrating that the adverse consequences of the devastating typhoon were strongly covariate among NWTF clients. Health shocks, in turn, seem by and large idiosyncratic. Despite being the most frequent reason for accessing the ICF/IEF no other dramatic negative peaks are visible.

One of the main reasons for evaluating the IEF on a larger scale was to test for an effect on

repayment performance. If clients are averse to losing the entitlement to access the IEF in case of emergencies, they may be more willing to demonstrate a good repayment performance, especially in terms repayment discipline (i.e. paying installments always on time without going into arrears). Figure 2 shows how the average repayment performance (per week per center) develops over time for the ICF Cash/IEF 10 clients. Before the introduction of the IEF both time series move closely together (as expected because there was no IEF). But after the introduction of the IEF, the time series start to diverge with the IEF series moving to lower averages. Clients in IEF centers show a higher repayment discipline, i.e. they have fewer mispayments compared to clients in the ICF Cash centers.