WOCCU World Council of Credit Unions, Inc.

A Technical Guide to Rural Finance

Exploring Products

Tackling Rural Finance

The historical focus of rural finance has centered on the extension of credit, often subsidized and directed, to rural areas. In fact, rural people demand a diverse array of financial services, including savings, money transfers, insurance and credit. These financial services support wider real goods sector production, contributing to employment, economic growth and income generation. Today's financial systems approach to rural finance recognizes that sustainable institutions offering a menu of financial services priced to cover costs reach the greatest number of rural producers and enterprises.

Current initiatives in the field raise the level of development of rural finance systems, including financing, as one element of a broader farmer support package. Promising arrangements suggest that the financial and non-financial components of service to a rural producer household must remain separate for the service providers to attain financial sustainability and for both institutions and clients to know the costs of each service.

Unlike many large commercial agricultural producers, most rural producers are not solely dependent on agriculture income – they diversify their income generating activities. Given that rural households have diverse strategies for accumulating assets and minimizing their vulnerability, rural finance institutions need to:

- Assess the demand of rural clients for multiple financial services;
- Identify and examine all income sources and expenses of their clients at the household level; and
- Assess environmental credit risks associated with production and market cycles.

Sparse and geographically dispersed populations characterize the rural operating environment, making it difficult for financial institutions to achieve economies of scale. Financial products and services need to suit the rural agricultural environment where production and market cycles affect client income and expenses.

This guide discusses a spectrum of rural finance products and delivery mechanisms that contribute to advancing the provision of the following financial services to rural areas:

- Lending
- Savings
- Leasing
- Insurance
- Remittances

What is a Credit Union?

Credit unions, or savings and credit cooperatives, are user-owned financial institutions that offer savings, credit, insurance and money transfer services to their members. Membership in a credit union is based on a common bond, a linkage shared by savers and borrowers that can be based on a community, organizational, religious or employee affiliation. Depending on a country's legal framework, credit unions may be authorized to mobilize member-client savings either by the Superintendency of Banks, the Central Bank, the Ministry of Finance, the Ministry of Cooperatives or a freestanding law. In countries where they have legal authority to do so, credit unions serve non-members with deposit and remittance services.

Lending

> ***"Rural lending requires greater effort to assess and design loans than in urban lending due to the greater complexity of rural households' economies which arises from seasonality and diversified incomes."***
>
> Juan Buchenau, "Innovative Products and Adaptations for Rural Finance," 2003, p. 6.

Families in rural areas seek to diversify their sources of income beyond agriculture. Households often have a number of income sources that include agricultural production, non-agricultural production and both on and off-farm labor income. Lending to rural households requires tailoring products to meet client demand and assessing client repayment capacity based on multiple income streams.

The assessment of a client's repayment capacity should include an analysis of projected cash incomes and expenditures for a household's different economic activities. Once repayment capacity has been determined, a payment schedule can be agreed upon and from this information, a tailored loan repayment schedule is drawn up (Buchenau, 2003). Rural finance institutions must consider the time necessary for the research needed to provide a realistic assessment of income and expenditure.

Large enterprise farmers generally are able to gain access to formal financial services and capital markets. Rural households with multiple income sources have restricted (if any) access to formal financial services and rely on informal providers such as traders, moneylenders and agricultural processors for financing. This section on rural lending discusses long-term agriculture investment loans, short-term rural enterprise and farm loans, lending against warehouse receipts, group-based lending and buyer and supplier credit.

Long-term Agriculture Investment Loans

Long-term agriculture investment loans finance production, processing and marketing of agriculture-related businesses (Buchenau, 2003). Yet, insufficient forms of collateral and uncertainty about long-term agricultural output restrict the availability of agricultural investment loans for smaller agricultural enterprises.

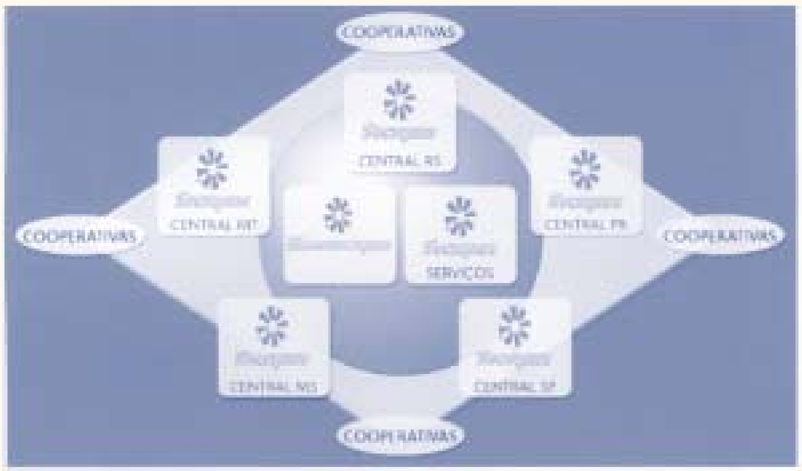
The repayment of long-term agriculture investment loans is projected not only from existing income, but also by the outputs of the long-term agriculture investment. (Buchenau, 2003). A loan officer must assess the yield (production) and price (market) risks before loan approval:

- Production risk includes climatic disaster, such as drought or flood, as well as incidence of pests and diseases.
- Market risk depends on the stability of future pricing of agricultural commodities, and may be highly variable depending on regional and/or global supply, in addition to government pricing policies and trans-border trade agreements.

Successful repayment of loans is in part dependent on careful measurement of:

- Conditions for agriculture production related to climate and pests;
- Future prices and markets;
- Borrower management capacity; and
- Value of collateral and constraints in the legal framework related to mortgages (Buchenau, 2003).

Brazil – Succeeding With Traditional Agriculture Credit



The *Sistema de Crédito Cooperativo* (SICREDI) provides financially sustainable rural finance to its agriculture community common bond members. The savings-based SICREDI system operates in five Brazilian states: Mato Grosso, Mato Grosso du Sul, Paraná, Rio Grande du Sul and São Paulo. The system, characterized by vast outreach and geographical coverage, serves 592,978 members through 128 credit unions and their 774 points of service as of December 2002.

SICREDI provides loans to meet the demands of rural agricultural members who want to develop a crop, an agribusiness or upgrade their production technology or equipment. The system does not finance non-agriculture activity. There are different types of loans for purchasing livestock, livestock feed, equipment, aquaculture (fish), rice and vegetable crops. Approximately one-third (35%) of the loan portfolio is invested in rice production.

The loan amount approved for a rice crop is determined by the projected return on sale at harvest. If the credit union deems that the amount requested is unusually high, then it will conduct a site visit to ensure that the potential borrower has the capacity to produce the amount projected. The credit union will finance up to 50% of what the producer needs.

Each loan requires collateral (typically production machinery) and another credit union member must serve as a co-guarantor. All borrowing applicants are checked with the credit bureau. The borrower must present receipts for inputs financed with the loan and has up to 60 days to submit these receipts.

SICREDI has achieved outreach and self-sufficiency while serving clients specifically engaged in rural agriculture. Cautious to prevent term mismatches in assets and liabilities, the SICREDI system relies on member savings deposits to fund short-term agriculture and off-farm productive activities. SICREDI credit unions access long-term credit to finance long-term loans for lengthy crop production cycles, livestock raising and equipment acquisition.

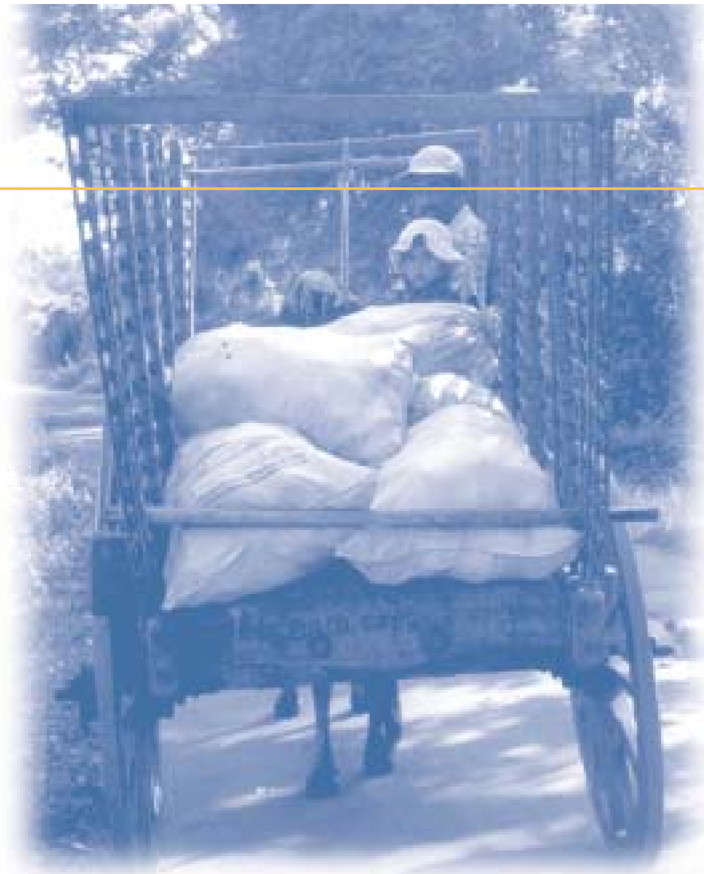
Short-term Rural Enterprise and Farm Loans

A working capital loan for rural family enterprises is geared to households with diversified income sources from agriculture and/or other rural enterprises. This type of loan is comparable to an individual urban microlending product, yet differs due to flexible/tailored loan repayment plans subject to a client's repayment capacity (Buchenau, 2003). A loan officer defines a repayment schedule based on a households' projected cash income from and expenditures on economic and non-economic activities. Specific repayment schedules are listed in the table below:

Repayment Schedule	Frequency of Interest Payment	Repayment of Loan Principal
Bullet	All interest paid at maturity	All principal paid at maturity
Regular Interest	Monthly interest payments	All principal paid at maturity
Irregular Interest	Uneven size and frequency based on borrower's projected income pattern	Uneven size and frequency based on borrower's projected income pattern
Up-front Interest with Flexible Maturity	All interest paid at start of borrowing period	Client follows individual payment schedule in accordance with maturity date

(Buchenau, 2003)

Flexible short-term rural loan products that cater to borrowers with seasonal income and consider household repayment capacity have permitted regulated microfinance institutions such as *Caja Los Andes* in Bolivia and *Financiera Calpiá* in El Salvador to serve more rural clients and to disburse larger loan amounts than what would have been permissible with a traditional microenterprise working capital loan product (Buchenau, 2003).



Lending Against Warehouse Receipts

A grain-specific form of rural lending is offered through warehouse receipts. In order to access this type of credit, a farmer delivers a minimum grain quantity to a grain warehousing facility that then produces a receipt to document the quantity of grain delivered. The farmer pays a monthly storage fee. The farmer can then sell grain during favorable market conditions or as is needed to meet expenditures. Warehouses often have minimum grain requirements for storage. Small farmers not able to meet minimum grain storage quantities independently may be able to overcome this constraint through affiliation with a cooperative or other type of farmer association.

In addition to providing a storage mechanism for grains, the warehouse receipt may be used as collateral by the producer to obtain a loan from a financial institution (Buchenau, 2003). For a financial institution, lending against warehouse receipts reduces the need to assess repayment capacity (Buchenau, 2003). The success of using warehouse receipts as collateral depends on:

- Sound warehouse management facilities that will preserve the quality and condition of the stored good (pest control monitoring, humidity control, air movement, bacteria control); and
- Reliable futures prices of grain for assessment of the value of the warehouse receipt.

Legal and supervisory preconditions need to be established for this type of lending to be successful. The regulation and supervision of grain warehousing is best done by an independent government agency, a potential constraint in many countries.

Group-based Lending

Group-based lending, wherein group liability replaces fixed asset collateral requirements for borrowing, provides a credit product to clients who would not be considered creditworthy on an individual basis. Group-based lending (loans approved generally for 16-week terms) is useful to finance rural productive activities such as supplying inventory for food vendors. In this case, the short term is an appropriate match for the duration of the activity and the cash flow of the borrowing households. Short-term lending may exclude activities related to an agriculture season or a multi-year investment required for certain types of livestock and crops.

Institutions considering group-based lending must consider the higher operating costs of this type of credit, as compared to individual lending products. Group-based lending in the rural context needs to offer an advantage over individual lending due to its higher delivery costs. One such advantage could be reducing transaction costs for low-income individuals who live in remote locations. If group-based lending is implemented in local villages, then the group-based lending methodology reduces the travel time costs to borrowers.

The Philippines to Ecuador – Deepening Rural Outreach

The WOCCU Philippines Credit Union Empowerment and Strengthening (CUES) program funded by USAID has transformed eleven credit unions from small and insolvent institutions to self-sustainable credit unions.

Batch 1 Key PEARLS Ratios	Standards of Excellence	12/98	12/00	7/03
P1. Allowance for Loan Losses/Delinquency >12 months	100%	10%	100%	100%
P2. Net Allowance for Loan Losses/Delinquency of 1-12 months	35%	0%	35%	32%
E1. Net Loans/Total Assets	70-80%	60%	59%	66%
E5. Savings Deposits/Total Assets	70-80%	32%	54%	58%
E6. External Credit/Total Assets	Max 5%	7%	2%	0%
E9. Net Institutional Capital/Total Assets	Min 10%	-17%	4%	11%
A1. Total Loan Delinquency/Gross Loan Portfolio	<=5%	63%	12%	8%
A2. Non-earning Assets/Total Assets	<=5%	20%	19%	10%
R7. Total Interest (Dividend) Cost on Shares/Average Member Shares	Market Rates >=R5*	8%	9%	21%
R9. Total Operating Expenses/Average Total Assets	=5%	8%	11%	9%
L1. ST Investments + Liquid Assets – ST Payables/Savings Deposits	15%	24%	36%	36%
S10. Growth in Membership	>12%	10%	32%	22%
S11. Growth in Total Assets	>Inflation	6%	24%	10%
Inflation Rate (Annualized)		11%	7%	3%

*R5 = Total Interest Cost on Savings Deposits (Market Rates > Inflation).

Building on the restructuring of these Mindanao credit unions, CUES partnered with Freedom from Hunger (FFH) to launch Savings and Credit with Education (SCWE), a credit union village banking product. SCWE provides poor, economically-active women in rural environments access to financial services and non-formal education. Credit unions offering the SCWE product provide access to savings and credit services by forming savings and credit associations (SCAs) of approximately 30 clients, composed of five or six sub-groups. Each subgroup is made up of five to six clients. Each SCA becomes one member of a credit union.

Rural Filipino microentrepreneurs participating in SCWE have the option to borrow individually, to borrow as a sub-group, or to save only. The SCWE technology focuses on savings mobilization, capacity-based lending and non-formal education on health and nutrition. SCWE borrowing is concentrated in five types of short-term productive activities:

- agricultural production;
- animal husbandry;
- agricultural commerce;
- non-agricultural commerce; and
- handicrafts.

SCWE and individual member-clients increased from 34,716 in December 1998 to 156,273 in July 2003. Among the total member-clients, SCWE members increased from 1,717 to 24,103 in the same period.

Transferring the technology and lessons from SCWE in the Philippines, WOCCU's *Programa Crédito con Educación Rural* (CREER) in Ecuador is working with pilot credit unions to introduce the SCWE product and deepen the credit unions' outreach to poor rural women.

Buyer and Supplier Credit

Product-market credit extended to farmers by input suppliers, retail traders, wholesalers, processors and exporters addresses an unmet demand for formal financial services in rural areas. Product-market credit enables farmers to access short-term advances, seasonal credit for the purchase of production inputs, and technical advice (Pearce, 2003). This type of production financing enables the supplier/trader to secure a certain quantity and quality of produce from the farmer.

Contract farming is one type of financial arrangement in which a wholesaler extends financial credit and may also offer technical assistance to the producer. The farmer obtains credit upon contract signature. The contract specifies the production calendar, required volume and produce quality (Pearce, 2003). While no interest rate is explicitly stated, there is usually a discount on the selling price for the produce built into the contract.

Trader credit provides farmers with in-kind advances or cash advances, contingent upon repayment at harvest or an agreed upon selling price of goods at harvest. Trader credit is not intended for financing long-term investments, such as purchasing equipment or property, expanding operations, improving quality standards or starting new activities (Pearce, 2003). The trader benefits from this extension of credit because it secures a local supply of produce and generates income from the related interest gained from the loan transaction. While trader credit may help farmers with building relationships and obtaining credit, product-market credit is short-term, incurs high transaction costs, and offers little to no transparency (Pearce, 2003).

Pearce notes that formal financial institutions will be more likely to enter into financing arrangements with organized farmer cooperatives or producer associations. Organizations such as these that borrow one umbrella loan reduce the monitoring costs and credit risk to a rural finance institution.

Rwanda – Financing Cooperative Producer Associations

WOCCU is implementing a program (2000-2004) of restructuring and institutional strengthening of the Rwandan second-tier credit union federation, the *Union des Banques Populaires du Rwanda* (UBPR), and a number of pilot *banques populaires* (credit unions) with support from USAID/Rwanda. As of December 2002, the network offered financial services to 318,784 member-clients. The UBPR's central finance facility that manages the liquidity of its 148 affiliated *banques populaires,* finances cooperative coffee producer associations which have coffee washing stations and a harvest purchase contract.

The initiative began after USAID alerted the UBPR that a coffee cooperative needed funding to finance its harvest in 2002. USAID had provided funds to a) build a coffee washing station, b) contract a technical consultant to assist *Abahuzamugambi de Maraba* coffee cooperative with supervising the coffee washing and c) hire a marketing consultant to exhibit the coffee at several international trade fairs to find buyers.

In 2003, UBPR financed three coffee cooperatives in rural areas. Each of the coffee washing stations are located close to individual *banques populaires*. All of the coffee farmers who form part of the coffee cooperatives join their local *banque populaire* and open a savings account. At harvest time, the individual producers bring their coffee beans to the washing station. The coffee cooperative takes note of the contribution of each member. The coffee cooperatives each use one large loan from the UBPR because the loan sizes are too large for individual local *banques populaires* to finance. The coffee cooperatives use these loans to pay each of their members for their coffee. Two weeks after the producers have deposited their coffee for sale at the washing stations, the funds are deposited in members' savings accounts at their local *banques populaires*.

The sales contract between the coffee cooperative and the purchaser stipulates that payment must be made through the coffee cooperative's savings account at the UBPR. The UBPR deducts the loan repayment from the transferred purchase payment; all surplus funds are deposited in the cooperative's account. This arrangement limits the risk of default to the UBPR and reduces corruption at the level of the coffee cooperative when funds are paid to the farmers for their produce. The arrangement deepens and broadens credit union outreach by incorporating all farmer members of the borrowing coffee cooperatives into *banques populaires*. After joining a credit union, a member has the opportunity not only to save, but also to access credit on an individual basis from the local *banque populaire*.

Savings Mobilization

"Savings mobilization is just as important as credit in meeting the financial needs of the rural population."

James Boomgard and Kenneth Angell, The New World of Microenterprise Finance, 1994, p. 226.

At the client level, millions of rural people continue to lack access to safe, reliable and convenient savings services. At the rural finance institution level, savings deposits provide a relatively stable source of funds that can enable an institution to become a sustainable and self-reliant financial intermediary. Savings mobilization increases the supply of internally generated funds that can be invested in rural microenterprise, off-farm small business loans and shelter improvements.

Providing Savings Services

Institutions that are successfully capturing savings consider the features most salient for savers to be: **Safety, Convenience and Returns.**

Savings services are built in three ways. Savings products are:

- Designed to balance the trade-off between convenience (liquidity) and return (interest rate);
- Tailored to the demands of particular market niches; for example, farmers who save in large blocks after a harvest and withdraw savings gradually during the remainder of the year; and
- Tailored to the purposes for which clients save; for instance, to pay school fees for their children or to cover large expense items such as livestock or shelter enhancements (Klaehn, Branch and Evans, 2002).

Accumulating Deposits in Credit Unions

WOCCU savings-driven credit union development programs worldwide illustrate that rural and urban member-clients of diverse income levels will amass substantial voluntary savings deposits – if provided with a safe and convenient place to do so. In most cases, the savers earn real positive rates of return on their deposits. This stable source of funds fuels the ability of well-managed credit unions to invest the savings in productive credit.

WOCCU TECHNICAL ASSISTANCE PROGRAMS JUNE 30, 2003

Country	Number of Credit Unions	Number of Member-clients	Total Savings Deposits (millions US$)	Deposits/ Member-clients	Total Passbook Deposits (millions US$)	Passbook Deposits/ Member-clients
Bolivia	14	96,314	$46.0	$478	$22.4	$232
Ecuador CGAP	2	110,069	$23.1	$209	$18.2	$166
Ecuador II USAID	7	100,287	$24.0	$240	$17.3	$173
Guatemala	26	484,365	$176.9	$365	$85.0	$176
Mexico CPM	1	622,327	$508.9	$818	$68.3	$110
Mexico Libertad	1	380,061	$293.4	$772	$45.7	$120
Mexico Sagarpa-Veracruz	6	27,138	$16.1	$593	$12.3	$453
Nicaragua	14	26,645	$3.0	$113	$2.2	$84
Philippines	16	265,883	$24.0	$90	$10.8	$41
Romania	26	119,859	$12.1	$101	$1.1	$9
Rwanda*	148	318,784	$32.6	$102	$27.2	$85
Uganda	15	17,980	$1.9	$106	$0.4	$20
				Weighted Average		Weighted Average
TOTAL	**276**	**2,569,712**	**$1,162.0**	**$452**	**$310.9**	**$129**

*Data from Rwanda is as of December 31, 2002.

Savings products exist along a continuum of trade-offs between liquidity (access and convenience) and return (compensation).

Some products offer complete access to deposits. Other products restrict liquidity and consequently offer higher returns in exchange for the reduced liquidity. A mix of products offers savers options of fully-liquid, semi-liquid, fixed short-term and accumulating long-term accounts.

Fully Liquid	Semi Liquid	Predictable Flows	Short-term Frozen Deposits	Accumulating Long-term Accounts
Passbook Accounts	Limited Withdrawals	Programmed Saving	Certificates of Deposit	Retirement Accounts

(Branch and Klaehn, 2002)

Lower-income savers often seek small accounts that offer high levels of liquidity. These savers exhibit strong preferences for accounts such as passbook accounts, with low minimum balances and complete access to savings. These small and lower-income savers have proven willing to sacrifice a return for open access to their funds. Alternatively, wealthier savers seek to maximize their return on savings and have proven willing to sacrifice liquidity for higher return. Rural finance institutions need to mobilize savings from both of these groups in order to be sustainable.

When a rural finance institution has a loan portfolio dominated by medium and long-term agricultural lending, it needs to avoid a term asset-liability mismatch. That is, an institution funded by short-term voluntary deposits should not finance long-term lending with those short-term liabilities.

Nicaragua – Promoting Agriculture Salary Savings

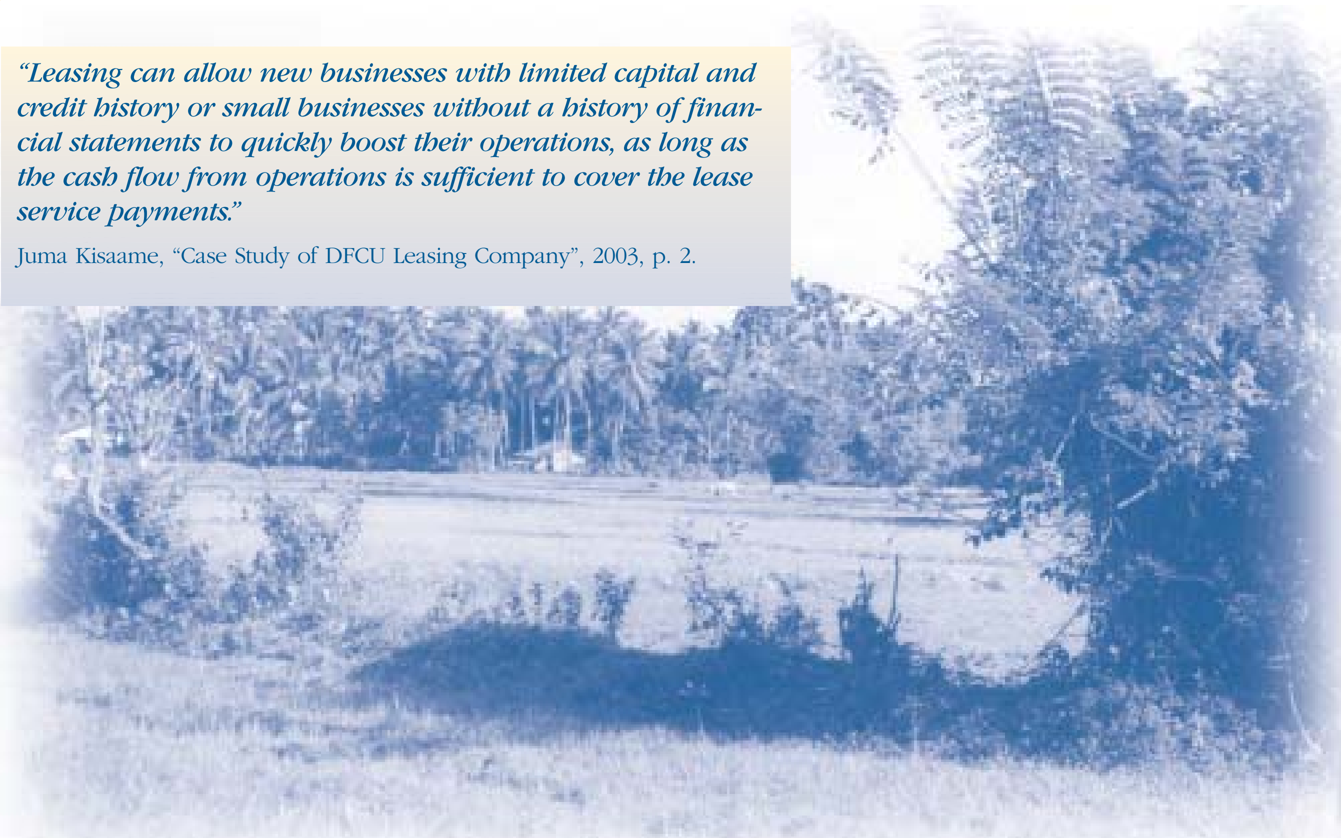
Strengthened by WOCCU Nicaragua with funding from USAID/Nicaragua, the network of Nicaraguan credit unions affiliated to the second-tier *Central de Cooperativas de Ahorro y Crédito Financieras de Nicaragua* (CCACN) ranks third in geographical coverage to rural areas among the country's financial institutions. Offering 23 points of service in 13 of Nicaragua's 17 departments, the 14 credit unions served 26,645 member-clients as of June 30, 2003. More than 70% of these member-clients are rural.

CCACN is marketing its "Agriculture Salary" savings product to farmers. The goal of the product is to smooth the flow of income from the proceeds of an annual or semi-annual harvest. Each credit union works with its farmers to identify their individual expenses and determine a monthly "salary" (portion of harvest proceeds on deposit combined with an above-market interest rate) to be withdrawn from the credit union. In its infancy stage, the credit unions have noted an interest from agriculture-based clients in such a savings management program; however, most farmers continue to keep their savings in fully withdrawable passbook accounts.

Leasing

"Leasing can allow new businesses with limited capital and credit history or small businesses without a history of financial statements to quickly boost their operations, as long as the cash flow from operations is sufficient to cover the lease service payments."

Juma Kisaame, "Case Study of DFCU Leasing Company", 2003, p. 2.



A financial lease allows a rural finance institution to purchase equipment and rent the equipment to a client until the client has repaid the purchase cost of the equipment and interest on those installments. When leasing equipment instead of lending funds to a client to purchase equipment, the financial institution will possess the title to the equipment until its purchase costs are completely repaid with interest. In the legal frameworks of some countries, if the lessor maintains the title to the equipment, then seizure and repossession of the piece of equipment in the case of repayment default by the lessee will be facilitated. The lessor insures the equipment and the lessee is responsible for equipment maintenance.

The clients who prefer leases to loans are typically those individuals who would not meet an institution's credit criteria for borrowing the funds to purchase the same item of equipment. Through leasing, clients can surmount intense capital investment requirements for direct purchase and strict collateral requirements for borrowing funds. Leasing can make equipment accessible to new or small businesses that do not have sufficient capital or borrowing history to purchase efficient equipment (Kisaame, 2003).

At the Development Finance Company of Uganda (DFCU), leases range in amounts of $25,000 to $250,000 for periods of two to five years (Kisaame, 2003). On average, an equipment lease at DFCU is three years and a deal is processed within two weeks. The lessee is expected to make a down payment in cash of 10-15% of the total equipment cost. Kisaame notes that leasing has allowed for transfer of technology and added efficiencies in production and processing methods.

A Financial Lease:

1. Requires that the client (lessee) pay in installments the full cost of the institution's (lessor) purchase cost in addition to market-priced interest on the purchase amount.
2. Provides the lessee with the opportunity to buy the equipment at the end of the lease term for a nominal fee.
3. May not be cancelled unless both parties agree; however, the lease is pre-payable by the lessee (Westley, 2003).

Insurance

> ***"Successful insurance programs require that the insurer have adequate information about the nature of the risks being insured."***
>
> Jerry Skees, "Risk Management in Rural Financial Markets: Blending Risk Management Innovations with Rural Finance," 2003, p. 13.

In order for an insurance program to be viable, total premiums collected must outweigh total indemnities paid plus administrative and operating expenses (Skees, 2003). To achieve viability, there must be a critical mass of policy subscribers who do not all have the same risk profile. When risks cannot be further mitigated at the program level, then the next step to reducing risk is to reinsure the insurance portfolio with a global reinsurer. This section discusses three types of insurance, each with a different type of protection for a specific client.

- Credit Life
- Savings Life
- Funeral/Burial Insurance
- Crop Insurance

Credit Life is an insurance product offered by credit unions to protect the institutions from default in the event of death by a member-client that has an outstanding loan. Loans have credit life insurance premiums built into the interest rate structure of each loan so that funds can be available to cover the default of a deceased member-client. With credit life, debt "dies" with the debtor; thus, the burden of debt repayment will not fall on family members or co-guarantors.

Savings Life is another credit union insurance product that offers an indemnity to the beneficiary of the deceased member-client in the form of a multiple of the amount of voluntary savings on deposit at the credit union. Savings life is made available to all savers. The product is paid for as an operating cost of each credit union.

Funeral/Burial Insurance is an elective product offered by credit unions. The member-client pays a monthly premium for individual coverage and additional monthly premiums for elective coverage for any dependents. The indemnity paid upon proof of death contributes to the costs incurred by the family of the deceased for funeral and burial expenses.

Nicaragua – Expanding Insurance Offerings

In partnership with the Americas Association of Cooperative and Mutual Insurance Societies (AAC/MIS), 14 credit unions affiliated to *Central de Cooperativas de Ahorro y Crédito Financieras de Nicaragua* (CCACN) offer credit life and savings life insurance as a benefit to their individual members. The credit unions pay CCACN a premium of 0.65 Nicaraguan Cordobas for every 1000 Cordobas of their total loans, savings and shares. In the event of a member death, any outstanding balance on a member's loan is covered by the indemnity and the member's family receives three times the amount the member had accumulated in savings.

In May 2003, CCACN rolled out a pilot insurance program, "Family Protection," in six credit unions. For annual premiums ranging between $12-$40, credit union members can elect coverage for their nuclear family between $500-$1000 in the case of death of the insured. The pricing of the new insurance product was established based on the findings of an actuarial study carried out by AAC/MIS assessing Nicaraguan national data on mortality and comparing it to the credit union member profile to examine age, gender and occupation to determine risk levels. The elective insurance product will be offered by all 14 credit unions by year-end 2003.

The individual credit unions pool their risk at CCACN. In turn, CCACN reinsures with the International Cooperative and Mutual Insurance Federation (ICMIF).

HIV/AIDS challenges the viability of rural finance institutions. Savings life, credit life, funeral and life insurance are products that can mitigate the risk of the pandemic.

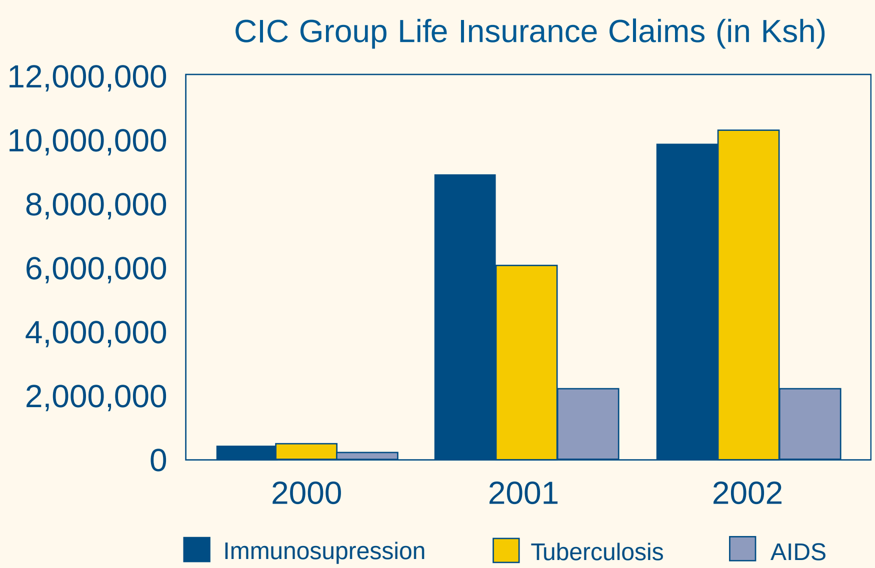
A WOCCU study on savings and credit cooperatives (SACCOs) in Kenya indicates that HIV/AIDS poses high levels of risk to rural finance institution soundness. The risks include increased: member-client and staff deaths, delinquency, loan defaults, absenteeism and savings withdrawals associated with the pandemic.

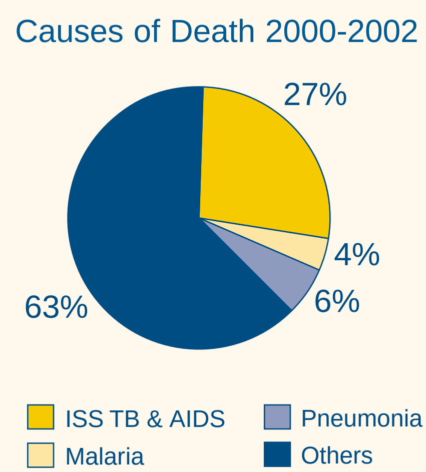
Some rural finance institutions have begun to self-manage benevolent funds (a type of funeral insurance) in an effort to meet client needs. There is substantial risk involved with self-managing insurance schemes without actuarial expertise and reinsurance, particularly if mortality rates increase and insurance premiums do not rise accordingly.

Kenya—Insuring Credit Unions in the Context of HIV/AIDS

One risk mitigation strategy is for credit unions to offer credit life and funeral insurance through a professional insurance provider that offers specialized expertise. The Cooperative Insurance Company (CIC) insures over half of Kenya's more than one million credit union members. CIC offers a variety of insurance products to credit union members subscribed to policies through their credit unions. Individual credit unions subscribe to group policies with CIC. CIC has been grappling with the pricing, coverage and design of its insurance products, particularly group life insurance, in order to cover its costs while claims related to HIV/AIDS have risen dramatically since the year 2000 (see charts below).

In response to the pandemic, CIC has excluded HIV/AIDS claims made in the first six months from coverage start date and has made two reinsurance arrangements with global reinsurers. Also, CIC has implemented a rating structure where the pricing of each insurance product is adjusted upward based on its particular claim experience. In addition, CIC asks questions directly related to HIV/AIDS on their policy applications in order to incorporate appropriate premiums for higher mortality risks. CIC has also established a special reserve fund that it is building up in anticipation of losses related to HIV/AIDS associated with its existing portfolio. The cost of the fund is paid for by existing policy holders and shareholders.





Crop Insurance is a type of insurance product offered to farmers to protect them against unexpected losses in agricultural earnings from production and/or market shocks.

Many countries have provided farmers or their financial institutions with multi-peril crop insurance, intended to cover income loss due to shocks in production from natural disasters such as flood, drought or tornado. Historically, this product has failed due to expensive administrative costs and high losses. The losses stem from asymmetries in information, where the client purchases insurance with better information about the likelihood of production shock than the insurance company (Skees, 2003). Once the insurance is purchased, moral hazard may play a factor, whereby the insured farmer sees no incentive for high performance behavior such as careful crop management, since the insurance will pay for any losses at the end of the season. The losses negatively affect the financial institution's rate of return.

Skees, in addition to Wenner and Arias (2003), document and recommend a more cost-effective insurance product for farmers: index insurance. **Index insurance** addresses moral hazard and asymmetric information by providing insurance based on regional indices, with indemnities based on area yields or weather information. An example of this type of insurance product is insurance for a crop indexed to a certain level of rainfall. In this case, the indemnity paid on the policy is related only to rainfall. Farmers still have incentives to tend their crops to the best of their ability and information is constant for the insurance company and the farmer.

Remittances

> *"The demand for financial services by remittance receiving households represents the intersection between the role of microfinance institutions, such as credit unions, and rural sector development."*
>
> Manuel Orozco, "Remittances, the Rural Sector and Policy Options in Latin America," 2003, p. 1.

During the last three decades, many countries have seen a growing inflow of capital in the form of remittances, particularly in Latin America. Remittances are a vehicle for deepening financial markets in rural areas. They contribute to the financing of agricultural and non-farm productive activities. Remittances provide alternative funding to rural businesses and supplement household income needs (Orozco, 2003). They may pay for farming inputs, may allow rural households to tide themselves over in order to sell their crop later in the season for a better price, may permit rural enterprises to purchase inventory and may finance school fees for youth.

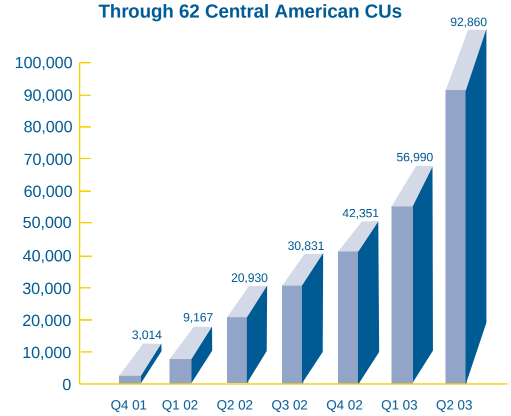
Remittances sent by immigrants to their homelands far exceed official development assistance. For-profit companies are the leading providers of money transfer services. Certain remittance markets have begun to experience pricing competition. This competition comes from new market entrants including commercial banks, regulated financial institutions and credit unions.

Central America – Incorporating Remittance Receivers into Financial Institutions

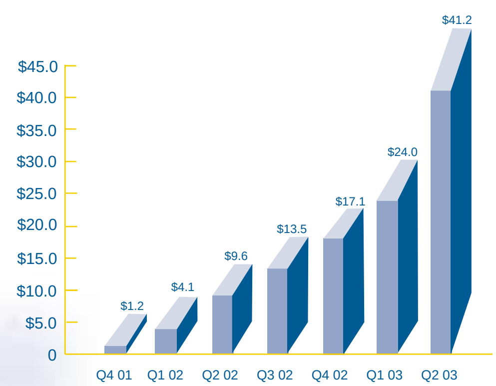
In late 1999, WOCCU, in partnership with Vigo, a money transfer firm, launched the International Remittance Network (IR*net*). Using IR*net*, federations of credit unions in El Salvador, Guatemala and Honduras have distributed more than 255,000 remittances amounting to over $110 million. Since the first transfer, the average size of remittances sent to 62 Central American credit unions was $432.

In 2003, IR*net* remittance distribution by credit unions expanded to Jamaica, Mexico and Nicaragua. As of June 2003, 173 credit unions in 29 states offer IR*net*, expanding the possibilities for sending remittances through 800 US credit union points of service.

Number of Remittances Distributed Through 62 Central American CUs



Volume of Remittances Distributed by 62 Central American CUs in US$ millions



The Central American credit unions distribute remittances primarily to rural clients (members and non-members). The distributing credit unions help to integrate remittance recipients into the formal financial sector through trained staff who cross-sell services. When a non-member enters a credit union to pick up a remittance, a staff person will encourage this person to become a credit union member and save a portion of the remittance in an interest-bearing voluntary savings account.

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Advancing Rural Finance

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ABOUT WOCCU

World Council of Credit Unions, Inc. (WOCCU) has credit union affiliates and programs in Africa, Asia, the Caribbean, Central Asia, Central and Eastern Europe, Latin America, North America and the South Pacific. WOCCU affiliates commit to International Credit Union Operating Principles and to International Prudential Standards of Safety and Soundness. WOCCU manages long-term technical assistance programs to develop, strengthen and modernize credit unions around the world. WOCCU also works to create appropriate regulatory environments for safe and sound credit union operation.

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