CHAPTER 14:

Micropensions: Old Age Security for the Poor?

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How can microfinance be expanded to include approaches to the problems facing poor and very poor people in developing countries when they become too old to support themselves? Microfinance clients have long been signalling their demand for such services by doing their best to use current microfinance products, such as microcredit, in ways that create assets that can help protect them in old age. However, "micropensions" will not, at least at first, look like miniature versions of developed-country private pensions, because most would-be clients are not formally employed and do not "retire." The most promising platform for developing suitable products can be found in medium term "commitment savings" plans for the poor that are now growing in popularity and scale in a number of countries. This chapter describes the challenges that face the microfinance industry as it strives to scale up these financial instruments and to make them ever more appropriate for their users and potential users.

A Framework for Micropensions

Pensions are generally understood as a regular flow of receipts from retirement to death. They became common in the rich world as industrialisation advanced and formal employment replaced casual or self-employment as the main source of income for most people. Pensions are therefore coupled with the notion of "retirement." Rich-world pensions answer the question "what happens after I retire and stop earning?"

To the extent that formal employment has grown in the developing world – where microfinance has its main focus – employment-based and private pensions resemble those in advanced economies. Government and private sector formal employees are usually enrolled in retirement pension schemes, and some workers buy private annuities.

But in many developing countries formal employment is not the norm. Most poor people in villages and slums patch their livelihoods together from a mix of

self-employment, casual employment, or low-grade formal employment – full-time, part-time or intermittent. To them, the idea of "retirement" is foreign. The question they raise about their old age is "what happens when I can no longer support myself?"

Two forms of pension provision can help them answer that question. The first is the public or "social" pension, where the state raises revenue (sometimes from general taxation, sometimes through dedicated contributions) and redistributes it to citizens when they reach a stipulated age in order to guarantee them a dignified life. Such schemes command huge public support from taxpayers (and pensioners), are virtually universal in the developed world, and are spreading to developing countries. And, the debate on how to fund them is fierce in both the developed and developing worlds.

The Case for Social Pensions …

Some of what we know about pension use and impact on poor people comes from groups that lobby for social pensions. The NGO HelpAge International, for example, estimates that 80% of the old people in developing countries have no regular income and that 100 million old people live on less than a dollar a day. By 2050 the number of over-60s in the developing world may jump to 1.5 billion from 375 million today. As life expectancy rises, the accumulation of funds that will be needed to deal with pensions grows steadily greater. HelpAge has studied the impact of social pensions on health, longevity and child-care (many old people live in multi-generational households where grandparents care for the young). These surveys and case studies have been conducted in poor countries that have advanced social pensions provision, such as Brazil and South Africa. Research results make a good case that even low-value pensions can make a big difference to household welfare (Gorman 2004).

But these figures point in two directions. While they make a strong case for extending and improving social pensions, they raise doubt about whether state revenues will be able to manage such a massive task.

… and for Micropensions

So it looks as if there is plenty of room for *micropensions* – pensions for poor and very poor people. But formal employment and formal retirement are rare among this group. This requires a search for a broad understanding of the purpose of micropensions: to help poor and very poor people answer the question – "what happens when I can no longer support myself?"

Microfinance clients have long been signalling their demand for micropensions. Early microfinance was almost exclusively microcredit. Loans could be invested in microenterprises (as most lenders insisted) and some of the resulting businesses have contributed to income and asset growth and thus to improved security in old

age. But many microcredit clients have sought more direct ways to invest in their futures. Todd (1996), for example, describes the lengths to which some women clients go to retain the capital value of successive yearly loans – repaying them from any available source while storing them in cash at home or with a money guard, or as livestock or as on-lending – until they had accumulated enough capital to buy a small piece of land that would offer them some security in their widowhood. Rutherford (2000) points out that saving and borrowing are simply alternative ways of converting saving capacity into usefully large lump sums, and that when poor people have restricted access to safe ways of "saving up" they will find ingenious ways of "saving down" (borrowing) to satisfy their most pressing money-management goals. As Todd's example shows, these cases include security in old age.

Micropension products will enable the poor to focus on managing money for old age. These products will consist principally of medium- to long-term saving schemes that produce capital for reinvestment in real, human, social or financial assets that can create a flow of income to support the non-working elderly. In some cases the reinvestment will be in real property for rental, or in the businesses or education of family members in exchange for future income or subsistence support. But, crucially, micropension products will also offer the option of reinvestment in a financial asset that produces a flow of income: either interest income, or perhaps by the purchase of an annuity, which is the financial product that specialises in maximising income streams.

Microfinance and Micropensions

How far has microfinance travelled on the road to micropensions? At first glance not far – if in early 2005 you had typed "micropensions" into the search engines of microfinance initiatives such as CGAP or *MicroSave*, you would have found no answers.

Nevertheless, microfinance products are becoming more diverse and more widely available, and each improvement makes it easier for clients to use microfinance for old-age security. But as each new opportunity opens up, new challenges appear. The opportunities and challenges created by a small selection of microfinance products are summarised in Table 1.

Growing Old Poor

In Bangladesh, wives are customarily younger than their husbands, and women tend to live longer than men. Women must anticipate a long widowhood, a cause of much anxiety. When a panel of near-poor, poor and very poor men and women were asked how they thought they'd survive in old age and widowhood, answers came out in hesitant stages (Rutherford 2002). Many women felt obliged, first, to acknowledge that the matter lies in the hands of Allah. They would then say that their children (especially their sons) would care for them. But their faces showed

Table 1. Managing money for old age: the opportunities and challenges of a selection of current and future microfinance products (the products are listed in ascending order of their direct relevance to pension provision)

Products	**Opportunities**	**Challenges**
Microcredit	Clients can store loans and convert them to larger assets (like land) that can produce 'unearned' income for the aged. Business investments strengthen household economies and create assets, and like social investments (e.g. in health, education, social links) they strengthen a household's capacity to care for its elderly. Compulsory savings (which often accompany microloans) can build up to valuable 'terminal' sums that can help retiring clients.	Relatively few. Microcredit is well established and profitably practised by both specialist microfinance institutions (MFIs) and, more recently, formal banks; and outreach is growing quickly if erratically.
Basic microsavings	Reliable current accounts and passbook savings help poor people to save more (in both senses: they can deposit more, and can build up larger balances) than in most other savings vehicles available to them: for many poor people, saving is a better way of building capital sums for reinvestment than microborrowing.	*Safety of deposits:* Savings (in situations where clients hold savings balances that exceed their loan balances) require that MFIs develop new management skills. In many countries only *licensed, regulated and supervised* providers can take deposits, though in some cases MFIs with good track records have been found to be safe savings mobilisers.
Medium-term commitment savings plans	Huge potential, now rapidly growing. These plans allow clients to amass financial assets over time in rhythm with their own savings capacity. Matured sums can be reinvested in real or social assets, or can be retained as financial assets producing income streams for the elderly in the form of interest income (or even as fixed-term annuities).	*Fund management:* where these plans achieve scale, MFIs will need to master advanced fund management skills – using these funds purely as loan capital may be risky. In addition, *governance, training and information management* need upgrading. *Inflation losses, currency collapse, and product pricing:* as savings terms lengthen, risks to providers and consumers grow. *Privacy and client identity:* MFIs may have to recognise a greater demand for privacy, which may

Table 1 (continued)

		be hard to reconcile with the poor or uncertain legal identities of many poor and very poor people. These challenges have led observers to recommend *partnerships* between MFIs skilled at working with the poor and formal providers with advanced management capacity.
Endowments	Endowments attach life insurance policies to commitment savings plans and therefore add further security, especially where the life insured is that of a main bread-winner. Experiments in endowments for the poor are becoming more numerous: this is a promising development.	*Formal insurance skills* are essential to handle endowments properly – another reason for advocating *partnership*. As products become more complex and sophisticated, the risk of *overselling or fraudulent selling* grows.
Annuities	Could help some formally-employed low-paid workers, but may not yet be of immediate relevance to the mass of self-employed or irregularly employed poor.	*Formal actuarial skills* are required: the challenges of developing them for the illiterate self-employed or irregularly-employed poor are formidable.

they doubted this, and this sorrow often led them to express bitter feelings: "I hope to die before my husband," or "before I'm unable to care for myself," and even "an old woman without wealth is kicked like a dog." They spoke of their envy of women with solid assets like land or housing. When they recovered their spirits more than half the women – perhaps because they remembered that we has asked them questions about money – told how nice it would be to save up money against old age, but they said it in a tone of voice that showed that they doubted that would ever be possible. This was true even though the sums of money that women thought would be sufficient were often surprisingly small – as little as $300, thought one slum-dweller in Dhaka.

This story illustrates how difficult it can be for poor people, especially women, to plan for a secure old age. As many researchers have found:

- traditional systems of inter-generational care are either breaking down or are no longer perceived as reliable
- assets, especially land and property, are seen as the best way to guarantee old-age security, but seem out-of-reach for many poor people. As one near-

poor villager with some land put it, "if the children turn out good, they'll get the land, work it, and look after me; if they turn out bad I'll keep the land and rent or sell it."

- poor people usually have a low estimate of and little experience with their capacity to use savings as a route to old-age security

Scepticism about building up savings for old age is expressed by men, too. Here is a transcript of another Dhaka slum dweller, Rahman, a low-paid transport worker:

> "On the one hand there are my own parents, on the other my wife and children. I can't manage so many things. How can I save? Here is two taka: what shall I do with it, eh? Shall I take care of my family, or of my parents, or educate my kids, or marry off my daughter? Or you think I will save it for when I'm old? Which?" (Recorded in Dhaka, March 2005).

But Rahman does save: minutes later he was showing me his piggy bank: it takes about 6 months to fill up with coins, and yields about $40 each time. Then I saw the up-to-date passbooks for the two ten-year term commitment savings accounts he and his wife have in local banks where they save a total of $13 each month. Then the passbook for his wife's membership of a well-known microfinance institution, ASA, where she has $28 of savings stored and pays in another $1 each week and also has a loan.

Such situations are not uncommon, and from them we learn that:

- poor people have surprisingly active and complex financial lives
- when appropriate instruments are available, poor people may choose to make regular savings that are large relative to their incomes
- poor people do not reject the idea of saving for old age, it is merely that current demands for cash tend to push pension-savings to the bottom of the priority list

In southern India children may be enrolled soon after birth in 'marriage funds' managed by institutions which are permanent but whose main function is not financial services – institutions like churches, temples, and workers' clubs. Their parents (including many poor people) then pay in small regular deposits at convenient intervals – each Sunday as they come out of church, for example. The rules are simple and uniform across whole areas: savers take out double what they put in, but only after a minimum of fifteen years of regular deposits and only if the child has reached the legal age for marriage and is betrothed or reaches age 25 unmarried. Meanwhile, the fund is lent out in small loans to savers, short-term, at 4% a month. This way of investing the fund not only provides short-term liquidity to savers, but has the happy effect of reassuring them that the fund is still there and well-managed.

Although this story is not about saving for old age, it does illustrate some important aspects of poor peoples' propensity to save over the long term:

- they may be willing to save continuously for long periods – of up to 20 years
- small, local, convenient and frequent pay-ins make it easier to save
- a well-established local institution can be trusted with long-term savings
- savings accounts in the names of children can be popular
- if the rules are clear, simple, and uniform in the community, they will be understood and followed
- very strong illiquidity safeguards (you can't get your money back until you are 17 and betrothed) may be actively welcomed by many savers
- savings for a specific purpose (such as marriage) may spur a greater effort to save
- being able to tap the savings – even if through relatively expensive borrowing – helps foster confidence, and helps to avoid conflicts between long-term savings goals and current liquidity needs as well as financing the interest paid on the savings

In the Philippines, Dean S Karlan and his team from Princeton University (Karlan 2004) ran a unique experiment that studied how commitment savings devices are used by people in developing countries. As part of it, they designed, in association with a reputable local bank, a commitment savings product that permits users to choose the term and the goal of their savings and to make choices about illiquidity by selecting from a set of product controls on depositing and withdrawing. Their behaviour was compared to a control group of similar bank clients. The results of the experiment include the findings that:

- use of these accounts had a strong positive effect on the overall level of savings: that is, people enrolled in commitment savings devices tend to save more rather than simply shifting their savings from other products into the commitment product
- interviews with savers showed that they were able to identify those aspects of the product that most encouraged them to save (in this particular case, the naming of specific savings goals, the use of "lock boxes" and the ways that illiquidity was safeguarded), and to suggest other features that would have encouraged even greater savings (in this particular case, the use of deposit collectors)

Bangladesh has experienced a rapid growth in the outreach of commitment savings plans for members of many of its NGO-MFI schemes, nearly all of which have adopted the general approach pioneered by the Grameen Bank. Typically, the

commitment savings products are five or ten year schemes with fixed monthly pay-ins and a lump sum payout at maturity. Recent research (Rutherford 2004) shows that, asked what they intend to do with the matured sum, savers most often say, “marriage of daughters,” then “a business or job for a son or husband,” then “purchasing land or property or other asset” and then some unspecified “major work.”

Subsistence in old age is not often mentioned. Yet is it clear that these products are especially popular among older women – who may have been group members for 20 years or more, with children whose education and careers may have been boosted by past loans. At their stage of life they see saving long-term as a better use of their spare cash than repaying loans short-term. Much of their thinking is directed at protecting their own old age, by settling children who will care for them or by acquiring assets. Further, the mere existence of the savings hoard in the MFI’s safe hands is a source of comfort. Ramisa, for example, a poor villager in her 40s from southern Bangladesh, holds a commitment account that she highly values. She told us she was expecting to take a lump sum, but when she heard from us that it could be taken as a flow of monthly interest income she immediately said that she would prefer that option. However, her preference was not so much that she valued the flow of income but rather that keeping the savings in the bank would give her security of mind. This demonstrates that:

- as people age, their financial service priorities change: within multi-generation households it can make sense for the middle-aged to start saving long-term while younger members borrow short-term to invest
- savings can be used to secure future income (asset purchases in this example), to enhance future income (businesses and careers for sons, in this example), or to reduce expenditure (marrying out daughters, in this example): all of which improve prospects for security in old age
- the very poorest may have difficulty with fixed, equal periodic instalments and may need especially flexible, or extremely frequent, payment schedules

In late March 2005, Joyce Mulama filed a story from Kenya for the IPS press service:

> In 1998 Rispah Anyanga’s husband retired after working twenty years as a clerk in a Nairobi office and received the equivalent of $1,600 as his lump-sum pension payout. But Rispah says, “He put it all in a hardware business. The business didn’t do well and after three months it closed down. We had no other source of income and had to pay bills like house rent, electricity, school fees, transport and food. My husband couldn’t take it any more. He just lost hope and committed suicide three months later, leaving me to take care of our three children who were then all in high school.”

The lessons here are clear:

- a pension does not solve every problem for a retiree, and
- lump sum payouts are not always wisely invested

Finally for this section, the popularity of saving for funerals requires elaboration. Although funeral-savings are unrelated to old-age security except in so far as both events occur at life's end, the worldwide concern for putting enough cash together for a decent funeral is an important driver of savings, and may explain some of the popularity of endowment savings (which incorporate life insurance into a savings plan). In southern India research found that of all informal savings devices, local "burial funds" attracted the biggest proportion of the very poorest (Rutherford and Arora 1997). In northern India and Bangladesh desperately poor people are sometimes found, after death, to have tied surprisingly large sums of money into their saris and loincloths to secure a proper funeral. In northern Philippines the number of savings accounts in a rural credit union rose dramatically when funeral costs were included as a benefit for good savers (Rutherford 1998). And in South Africa, University of Cape Town researchers found in their study of a panel of near-poor, poor and very poor households, that informal burial societies are the single most common financial instrument in use (among 23 different instruments identified in the households), with an average of 1.6 memberships per household in a panel of 61 households (Collins 2005).

The Annexes report comments from a panel of poor people in Bangladesh and elsewhere that further illustrate these stories. The picture that emerges is clear and is consistent with other research on the money-management habits of the poor (Rutherford 2000) and with the Women's World Banking paper Asset Building for Old Age Security (WWB 2003):

> *Poor people well understand the purpose and value of saving. They sense that there may be a savings route to old-age security, and grab opportunities when they come their way. But they are beset by many difficulties, both in their own circumstances and in the financial services available to them, so that in practice success remains the exception rather than the rule.*

For microfinance organisations, the solution must be to imagine and test products and alliances that progressively improve our understanding of how to design and deliver the most appropriate services. The next section explores these challenges.

The Challenge of Developing Micropensions

Commitment Saving Plans: The Best Platform for Micropension Development

I first chanced upon commitment savings plans expressly designed for the poor in villages in Bangladesh in the early 1990s. I was surprised, because at that time

there were no formal financial services for poor villagers, and the new semi-formals (NGO-MFIs) were concentrating on short-term credit. But here was a local NGO offering five and ten year savings plans to middle income and poor villagers, and they were very popular. The MFI understood the demand and designed well – a simple plan with fixed monthly pay-ins and a lump-sum payout, easy to understand, producing an attractive lump of capital that capital-starved villagers would have no trouble finding a good use for. They got the delivery right, too: door-step collection at weekly intervals, some scheduling flexibility if poorer users missed or underpaid a week or two, and simple passbooks that allowed savers to track their progress. They kept a close watch on costs, operating with low-paid local agents working out of cheaply rented branches, and spent almost nothing on marketing, relying on fieldworker contact and word-of-mouth recommendation from client to client.

Unfortunately they had an inadequate legal identity and got their investment planning badly wrong – failings that proved fatal. At first they ploughed much of the inflow of deposits into household durables – fans, bicycles, hot-irons and the like – that they sold to clients on deferred payment terms. Growing bolder, they went into the business of importing corrugated roof sheets, got into trouble, came to the notice of the authorities, were banned and then collapsed, taking thousands of poor people's savings down with them.

The story helps us to visualise the most obvious lessons and pitfalls of mobilising recurrent savings among poor people:

- know your clients, their conditions, and the transaction values that suit them
- design simple products that clients and low-wage staff can easily understand
- develop delivery systems that suit the environment, such as door-to-door collection or other forms of mobile banking, lock-boxes, and so on
- do not grow faster than you can learn
- do not do it at all unless you know what you are doing and have an appropriate legal identity (in most countries this will mean being a licensed, regulated entity, though in some a track record of reliable service and sufficient size might be enough)

These rules apply to all kinds of savings services, and have been thoroughly explored in several excellent texts (Robinson 2005; Hirschland 2005), so they will not be pursued here.

Scale

Instead, we pursue the Bangladesh story, since Bangladesh may now boast the world's widest outreach of commitment savings plans to poor and very poor peo-

ple, and because learning how to scale-up commitment savings plans is an urgent task for micropension development.

For many years state-owned commercial banks in Bangladesh offered a Deposit Pension Scheme (DPS): a ten-year commitment savings plan much loved by the middle and wealthy classes. The genius of the failed rural NGO whose sad story heads this section was to recognise, earlier than others, that such schemes would be as popular among the poor and very poor as among the better-off. Soon, better-managed NGO-MFIs noticed: BURO Tangail, for example, was an early adopter of DPS type schemes for their group members. ASA, one of the Bangladesh giants, followed. But scale was given a significant boost when the scheme was finally adopted by Grameen Bank as part of the general overhaul of its offerings in 2001 known as "Grameen II." In 2005 Grameen reached about 2.5 million group members with its version of the DPS, known as "Grameen Pension Savings" or GPS.

GPS is a commitment savings product with a five or ten year term and low minimum monthly deposits – less than $1, and to accommodate really poor savers even that can be subdivided into smaller weekly payments. It pays a generous rate of interest relative to the similar DPS product of commercial banks. It is offered to the Bank's 4 million group "members," almost all of whom are women. Take-up has been very rapid and enthusiastic, even after controlling for the fact that a GPS is mandatory for members who borrow more than $130.

Grameen Bank membership ranges from the very poor to the middle-income near-poor, and attitudes to the GPS vary between these extremes. For many middle-income group members the GPS is the main reason to be a Grameen member. At the other extreme, there are very poor members who feel it is "not for them" because they believe they have "no capacity to save." But such members take loans that they service in weekly instalments, and now that the GPS scheme is five years old and better understood, many of them are beginning to see the GPS "saving up" route as a viable alternative to high-cost borrowing. Take-up also varies with household age and structure, with younger, growing households more likely to prioritise borrowing while older ones may favour saving.

Understanding Commitment Savings Plans

Unfortunately, Grameen's GPS initially failed to receive much notice. *MicroSave* fielded a team (Rutherford 2004) that looked carefully at the overall experience of Grameen II in the field over a three year period that ended in December 2005. Its results should shed further light on lessons that can be learned from the massive GPS outreach.

Dean Karlan's team (who conducted the commitment savings experiment in the Philippines) has carried out a recent review of commitment savings products in developing countries. Their paper has important implications for policy makers and MFIs. Chief among these is a call for proper pilot projects to test innovations

in commitment savings, to hasten learning about the relative merits of different product features. Karlan suggests that selected MFIs might take a lead in piloting product features under close scrutiny from researchers in a "careful and scientific randomised launch." Others have suggested that a dedicated entity, perhaps on the lines of the Micro Insurance Centre could help to consolidate advances in learning – or that the Micro Insurance Centre broaden its remit to include work on micro-pensions.

Lessons about proper piloting also emerge from Wright et al (2001). This study examined the processes within ASA, an NGO-MFI, that led to the rapid scaling-up of a GPS-type scheme followed by an equally rapid retreat. Among the tricky questions that ASA faced was whether or not to set targets for their branch managers in opening DPS accounts, and whether or not to link the scheme with lending. Negotiating an understanding with the central bank was also an issue because ASA is not a registered bank.

Grameen's GPS experience also sheds light on the question of how to manage lending alongside commitment savings products. This is a particularly urgent question for the many Grameen or village bank style MFIs around the world in which continuous borrowing is almost a condition of membership.

If opening a commitment savings account is a condition for borrowing, problems may arise when the client finds it hard to service both sets of periodic payments – the loan repayments and the savings. Grameen Bank, for example, where members must hold a GPS in order to borrow $130 or more, soon found it necessary to break larger-denomination GPS accounts into a "red GPS" (a low-value one that satisfies the borrowing requirement) and a "green GPS" (the balance of large-denomination accounts, or additional accounts). SafeSave in Dhaka abandoned the mandatory link between borrowing and long-term savings after a three year trial. Bearing in mind what was said above about savers' preference for accessing their capital in some way during the saving term, the best advice may be: offering loans secured against commitment savings account balances is more workable than requiring a commitment savings account as a condition for borrowing.

Term Continuity and Payout Policy

Most commitment savings plans simply deliver a lump sum at maturity. Some observers believe, based on experience from microinsurance, that there may be a "natural" expectation for this to be the case and some reluctance to take the payout as an income stream or other form of staged payment. However, other evidence is beginning to emerge.

When Dr Yunus, Grameen's founder and managing director, first introduced the GPS (Yunus 2001) he wrote that the matured sum can be taken as a lump sum *or* as income (not an annuity – just monthly payments of interest). This message had not yet reached the field in 2005. My research indicates that staff and clients universally supposed that there will be a lump-sum payout. So I have been testing attitudes of GPS holders towards the income alternative, and many account hold-

ers favour it – as much for the mental satisfaction of retaining the sum as for the sake of the income itself. A strong well-trusted MFI may not find it difficult to attract clients to staged payments – a step closer to a "pension."

These days, annuities are seen by insurance professionals as income streams paid from a certain date (usually retirement) until an uncertain date – death: hence the difficulty of pricing them. But that was not always so. Annuities have also been paid for fixed terms. Matured sums from commitment savings plans such as the GPS could be paid out as "fixed term" annuities,[1] at least on an experimental and voluntary basis, as a further development towards micropensions. Monthly payments of interest plus returned capital over ten years would be relatively easy to calculate and price. The resulting increase in the size of the income may make such a product attractive to some poor people in certain situations – such as waiting for an offspring to finish her education and start earning, perhaps. We do not yet know. Testing is required.

The fact remains that most GPS holders do not associate it directly with old-age management. This may be because the time horizon is too short – GPSs have terms as short as five and ten years. However, Grameen already offers attractively priced fixed deposit products (CDs), especially its "seven year double" scheme which is already very popular with better-off non-members with spare cash to invest. Thus although not many younger people appear to be thinking about it yet, in theory they could start saving in their twenties and use the GPS in tandem with the fixed deposit scheme: over their working life they could build an attractively large "retirement fund" from very modest deposits – as little as $2 a month. Talking to women in Bangladesh recently about this arithmetic can have a strong effect: several mothers-in-law listened in and then wagged figures at their daughters-in-law and told them, "You be sure to open a GPS at the very next Grameen meeting!"

The arithmetic, in nominal terms, is as follows: assume the saver starts at age 20 and saves 100 taka a month (about $1.75) for life, in four successive ten-year GPS terms. Each will produce 23,000 taka at maturity. If the first three matured sums are invested in a series of "seven year double" fixed deposit accounts, the total sum at age 60 will be 598,000 taka, producing a monthly income of 3,987 taka. This is about $63 per month, equivalent to a lower-middle-class salary – at 2005 prices.

Inflation and Interest Rate Risk …

But some say that holding a high proportion of one's savings in a bank account is a mug's game: inflation makes losses inevitable. For those with the least to save –

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[1] Not to be confused with 'term life insurance,' which is a form of life insurance in which the policy holder pays a premium for a fixed term in return for a payout should she die during that term: there is no savings element – when the term expires the policy holder has no further claim on the insurer.

the poor and very poor – a high proportion of cash savings may be particularly risky. Are those Bangladeshi mothers-in-law wise to recommend continuous saving to the next generation? Maybe, since in South Asia inflation has not been rampant. Besides, inflation-caused losses in bank deposits, as work by *MicroSave* in Africa has shown (Wright et al 2001) may still be less severe than losses in other savings vehicles such as livestock, home-saving or on-lending.

Nevertheless, as the terms of savings plans lengthen, the savers' risk of losses from inflation rises, especially where interest rates are fixed. Also, as terms lengthen, the risk to providers of offering fixed-rate savings plans also rises, since market rates may fall during the term. If the provider then fails to adjust rates downward for new savers, it risks attracting too much savings, multiplying the problem.

In the principal current pro-poor savings plans, such as Grameen's GPS, rates are indeed fixed, and these risks are held in check in only one way – by limiting the term length (in Grameen's case to no more than ten years for commitment savings and seven years for fixed deposits). The rates paid on the GPS through 2005 were high relative to the market, attracting many non-poor savers to the bank. Grameen's deposits grew to be larger than its loan portfolio in December 2004, for the first time in the bank's 28 year history. The bank welcomes this liquidity, which has allowed it to expand its lending and experiment with new forms of (higher value) enterprise loans. But Grameen is also diversifying its fund management: in 2005 it announced the opening of its mutual fund scheme, under which some of the pool of members' savings will be placed in the Dhaka stock market.

Clearly, Grameen will face challenges as it continues to go it alone, developing its own in-house expertise as its business grows. Grameen is a large institution: most providers will find that to move beyond ten-year terms, and into experiments with income-streamed payouts, endowments and true annuities, partnerships with formal sector providers skilled in sophisticated fund management will have to be sought. This could lead to fewer of the deposits being recycled as loans and more of them invested in inflation-safe vehicles, held in hard currencies or otherwise hedged.

… and so, a Role for Donors?

As microfinance has matured, the role of official foreign assistance in promoting it has changed. Especially, and happily, the role of donors as suppliers of funds has diminished, as other sources become available. However, cash set aside by donors (and, perhaps, by the international insurance and pension industry) expressly to protect poor savers from currency crashes and inflation losses could be, as J D von Pischke in this volume has put it, "the final hurrah" for donor-driven microfinance funds. Carefully designed, it might be less prone than other forms of subsidies to

the risk of distorting natural markets, and unlikely to do much damage through the moral hazard of undermining incentives for sound economic and financial policy.

Aside from that, there is scope for donors to spend a little money on encouraging MFIs to learn higher-level management skills and fostering their collaboration with formal providers.

Privacy

Many MFIs rely on carrying out all transactions in public meetings as an internal control mechanism, and by and large this has been successful. However some transactions need more privacy – even for poor people! This issue came up in relation to the GPS surprisingly often in my Grameen research – surprising because Bangladesh's is one of the least private of all cultures. Here is a typical extract from my notebook:

> *[in a poor rural household in central Bangladesh]* There is another young man here who's a visitor. His wife is in Grameen and he says that she doesn't have a GPS. She is present and we ask her why and she refuses to reply, pretending to be asleep. We stop pursuing the story when we realise from whispers that she is keeping her GPS secret from her husband. I hope we didn't spill the beans. The young man himself ostentatiously goes on to say that he approves of the idea of the GPS, but his wife keeps her eyes, and her mouth, firmly shut.

The privacy problem may not be an easy one for Grameen or village bank style MFIs to solve, but it requires attention.

Commitment Savings Plans Today

Karlan (2003) concludes that "savings products with commitment mechanisms are a valuable complement to flexible savings products….More suitable to meet long term goals…" and he notes that there is strong interest on the part of MFIs to develop new savings products (74 of the 80 MFIs that responded to his web-based survey reported an interest in new savings products and marketing strategies). The Women's World Banking paper notes that the four commitment savings products it reviewed enjoy "high profitability, efficiency, and client satisfaction." Grameen Bank alone has enrolled more than two million savers into its Pension Savings scheme in the last five years. Commitment savings plans for the poor are becoming well established and are growing in visibility, popularity and design. Nevertheless, Grameen's massive GPS roll-out has begun to demonstrate that large scale operation will require sophisticated management skills, above all in fund management and pricing.

Endowments and Annuities

Endowments expand the scope of commitment savings plans by linking them to life insurance policies, thereby giving added security to participating households. If the policy-holder survives the term, the matured sum is taken, but if he or she dies, the household can use the proceeds of the insurance to mitigate the loss, which is especially useful if the policy holder was also an important income earner.

Among the best known and probably the largest-scale endowment schemes deliberately designed for poor people are the "Grameen Bim' and „Gono Bima" (village, and peoples' insurance) schemes of Delta, a private sector insurance company in Bangladesh. The products featured medium-term (mainly 10-year) savings plans linked to a life insurance policy for which no medical checks were needed, and up-to-date savers were guaranteed access to loans repayable Grameen-style in small, frequent instalments. Sales of policies and collection of premiums and of loan repayment instalments were done door-to-door by local agents. Profits were redistributed to savers as bonuses: in this part of its business Delta's motives were social. The scheme, started in 1988, grew quickly – a decade later more than 400,000 policies were sold in a single year.

The Delta scheme convincingly demonstrated the popularity of the endowment idea among low-income groups. Although it is not absolutely clear to what extent the promise of a loan inflated the take-up of the scheme, research in the slums of Dhaka suggests that many users were as attracted by the savings and insurance elements as by the loans: some did not even ask for loans.

However, the schemes fared badly: and although they are now being rescued by new management at Delta, many clients lost their savings in the process. The story has been told in detail by Michael McCord (2005) and is not repeated here. Management's errors included inadequate internal controls, poor policy design, and massive failure in the part of the business with which it was least experienced – microlending. Ironically, Delta had at first sought an alliance with an MFI (I was present at some of the early meetings): an instinct that, in this case sadly, turned out to have been right. It would be an oversimplification to say that the story shows that formal institutions cannot easily go "down market" without access to the expertise in working with poor people that MFIs have built up over many years. However, it does strengthen the view that an alliance between formal and semi-formal (MFI) players is likely to be the best way of massifying the sale of the more complex financial instruments, such as insurance and pensions, to the poor.

Financial Literacy and Overselling

But even when endowment schemes are more professionally managed, and become common and popular among the poor, poor people may have difficulty using them effectively. This is shown in research by Jim Roth in South Africa (Roth 1999).

For at least three decades endowment policies have been sold in large numbers to low-income South Africans. The introduction of electronic debit orders, and the ease with which a client can commit to a monthly direct debit, have facilitated the rapid growth of these schemes.

The policies are sold to township residents with formal employment. In the study of financial services used by township residents in a small rural town in South Africa conducted by Roth, half of all respondents reported owning at least one privately bought endowment policy, and some respondents owned more than one. Although these policyholders were formally employed, many were not well-off, as they supported large households.

The policies were designed to coincide with the end of the policyholder's formal employment. However, many policies were sold that did not coincide with this period. As a result many policyholders cashed in their schemes and received only a low surrender value.

International experience has shown that where there is an abundance of such schemes and competition to attract deposits is great, fraudulent or unethical selling practices often emerge. Over the last two decades many Grahamstown Township residents who were unhappy with their endowment policies approached a community advice office run by Black Sash, a human rights organisation, for assistance. In the last six months of 1994 this office assisted 157 rural people with insurance policies (Roth 1995). In the vast majority of cases, agents had misrepresented the nature of the policy to their clients.

Agents frequently misled buyers into believing that they were purchasing a simple savings plan, when in fact they were being sold a hybrid of savings and insurance. In other cases, clients were insufficiently informed about surrender values. This has an especially significant impact on illiterate and semi-literate buyers who relied on the good faith of the insurance agent. The root problem is that the vast majority of insurance agents work on commission. This encourages poor selling practices as the agent's income becomes dependent on the volume of policies sold. In such a situation, rural people with little formal education become prime targets for unscrupulous agents.

But in spite of such practices endowment policies remain a popular financial instrument among poor South African households that have few alternative illiquid savings instruments.

An Example of a Formal/Semiformal Partnership

More recently, Roth has been looking at a new attempt in India to market endowments to the poor that feature a link between a major formal institution and a well-established civil-society body (rather than an MFI as such).

In India insurers are legally obliged to sell a percentage of their policies to low income clients. For the most part they have sold straight term insurance (see footnote 1). However they are increasingly requested to combine insurance with savings policies. Unlike the endowment policies in South Africa, the terms are typi-

cally quite short – 5 to 15 years at the moment. These policies are new and experimental (and not specifically aimed at providing old age security). TATA-AIG, an Indian insurance company, has such a policy called the *Jana Suraksha Yojana*, that has a small savings component and a large insurance benefit (up to $900) for a $1.60 per annum policy. The entire private insurance industry in India is relatively new (the market was denationalised early in the present decade), and it is difficult at this stage to see how these products will develop. But there are signs that insurers may develop more endowment policies for the poor in India.

Annuities

"True" annuities, as currently understood, are the purchase, for a fixed sum, of an unlimited flow of fixed periodic receipts until death. They require reliable information about clients, and highly sophisticated pricing technology combined with advanced fund management – matters familiar to formal institutions, which have few poor clients, but virtually unknown to MFIs, who have many. CARD's brave but doomed venture in the Philippines provides a vivid illustration (McCord 2004).

CARD offered an insurance/pension scheme to its members that offered a guaranteed monthly income flow from retirement to death. It was very popular but its pricing flaws threatened to bring the institution down. Happily, CARD acted in time to buy its way out of the problem, link up with a formal provider, and relaunch a more measured life-insurance scheme which is still running well with more than half a million subscribers.

Early participation in CARD's scheme by a formal pension institution using actuarial skills may have eliminated the more egregious pricing flaws. However, such collaboration may not have solved the many other technical problems that arise in marketing low-value annuities to large numbers of illiterate and informally-employed poor people with poorly defined identities and age, shifting addresses, and little or no experience with the insurance and pension industries. Micropension activity for the foreseeable future is unlikely to feature "true" annuities. Rather, it will focus on scaling up and improving commitment saving plans and learning how to offer endowment schemes to the poor.

Conclusions

It will be many years before developing world states are able to offer social pensions to low- income households, particularly those who lack formal sector employment. Meanwhile, the demand for financial solutions to the problems of the poor in old age is growing. It is time for the microfinance industry to start thinking about micropensions.

Precisely because members of most poor households in developing countries are not formally employed and do not look forward to retirement, micropensions are unlikely to be scaled-down versions of the typical pension scheme found in

rich countries, in which savings made during the working life are swapped for an annuity at a defined retirement age. The best platform for developing micropensions is the medium-term commitment savings plan. Such plans are already available to the poor in some countries, and are growing in number. A key task is for more MFIs in more countries to experiment with, and then scale up, their commitment savings schemes.

Several challenges will emerge as this process takes place. When savings portfolios held by MFIs begin to outgrow their loan portfolios, the question of how to safeguard deposits arises. In most cases, this will require MFIs to become licensed, regulated and supervised deposit-takers, although in exceptional cases a good track record as a deposit taker may be sufficient.

When MFIs take commitment savings deposits as well as short-term (passbook) deposits they will need to improve their knowledge and practice of fund management. In many cases this will reveal the importance of improved governance, training and information systems. As the length of term offered to savers grows, the risk to the saver of losses through inflation or currency collapse increases – and the risk to providers of losses through poor fund management and pricing policy also increases. When MFIs proceed to the next level, and offer endowments (commitment saving schemes with attached insurance policies) or even begin to experiment with annuities, they will require advanced fund management and actuarial skills. The example of microinsurance has shown that a good way – perhaps the best way – of climbing this steep learning curve is to go into partnership with professional formal sector insurance and pension providers.

Much of the initiative in developing micropensions has been taken by MFIs themselves, and this will continue to be the case. However, outsiders can help. One intriguing suggestion is that donors and the international insurance and pension industries might work together to develop a global facility to insure the value of poor people's long-term savings in the face of hyperinflation or currency collapse – devastating events for which poor people cannot be blamed and over which they enjoy no control.

Annex 1: "How Are You Preparing for Your Old Age?" Responses from Poor People in Bangladesh

During the preparation of this chapter, Stuart Rutherford (assisted by Imran Matin, S K Sinha, Md Yakub and Rabeya Islam) asked a number of poor rural and urban respondents in Bangladesh about their attitude towards securing their livelihood in old age. In the summary which follows, a small number of typical responses are reported. The responses are ordered by the age, then by relative wealth and location (urban slums or rural villages) of the respondents. Monetary values have been converted to US dollars.

Young People

Rural very poor young woman: Ramisa said, "I didn't think anything about it [my old age]. However, I have my son. I am working very hard to raise my son. I hope that my son will look after me in future. And, if my son or my husband does not look after me, I will remain as Allah pleases to keep me." Later, she said that she deposits 16 cents every week in the NGO BRAC as savings. She said, "This savings will help me in future. Whether I take loans from BRAC or not, I will always deposit savings there." She said that at present she has $16 savings at BRAC, deposited from her earnings from bamboo and cane work.

Urban upper poor young woman: We asked Monoara about her old age: she says she isn't married yet but when she is married her husband and/or children will take care of her. She'd like to save if she could and would preferably do it in a bank.

Rural poor couple in their 30s: For their old age, they are saving money weekly in the NGOs World Vision and Caritas. They say that it is not possible to keep small sums like 8 or 16 cents at home as savings. Soon they will have to arrange her daughter's marriage, which will erode their life-savings this year. They assume that they will have to continue to earn from now on for their old age. They have no son, but two daughters. There is therefore likely to be no one to look after them in their old age.

Rural upper poor woman in her 30s: Sayed's wife Asma said, "I have not thought about my old age yet. However, I have planted several hundred trees, for the future." She added, "My husband hopes that in future, from the income of his timber business, he will buy cultivable land on which he will be able to depend in his old age." Later she said, "I do not intend to take an insurance policy. However, if we can earn a lot from the business, we will save in the bank."

Urban poor man in his 30s: Siraj said his old age is entirely up to Allah, but then added that his sons will look after him. Then he said, "If I could open an account in a reliable organisation I could save as a much as possible and buy a house at Savar, but that would require around $6,600." Then he confessed that he is not entirely sure whether his sons will look after them in their old age.

Urban upper poor man in his 30s: Karim says that his wife Asma is much cleverer with money than he is: she bullies him to save and not to smoke. He says that he likes to support his parents and expects that his sons will support him in old age, whereas Asma doesn't like him supporting his parents and advises him to save up for his own old age. So he tries to hide his support to his parents from his wife. But he says he is beginning to think about his old age.

Middle-Aged People

Rural poor women in her 40s, talking about Grameen Bank's "Grameen Pension Savings" scheme: Her group fell into severe problems and now it mainly consists of borrowers who do not attend the weekly meeting and are not repaying. Kohinoor has been in the group since the 1988 floods and says that the group is now more or less finished. However there are a few regular members that pay their loans and have a GPS and Kohinoor is one of them. Her GPS is for about $3 per month. She has two sons, both teenagers, both dropped out of school and now working, one in the brick field as a brick moulder ($1.36 per 1000 bricks, average monthly take home pay $41 – $50), and one as a mason. Her husband is sick and only works occasionally, collecting honey. She said the most common use that people have in mind for a GPS is marrying daughters but she has no daughters, so she hopes to buy some land for her sons. Part of the reason why she took a large GPS is to get a bigger loan: at present her loan is for $230, used to recover land that had been mortgaged out. But she also opened a large GPS in order to achieve a large lump sum. We explained to her that she could choose to take her mature GPS as income rather than as a lump sum, and we calculated roughly what that would be in her case. ($3.33 per month produces $400 capital or about $766 with accumulated interest after 10 years: at 8% a year that would produce $5.10 per month). She liked the monthly income scheme very much, especially after we told her that she could always take the lump sum if she wished at any time, and that on her death the lump sum would be inheritable by her sons.

Urban poor widow in her 40s: On old age, she says, "Allah will look after me" but then "my children will look after me" and then "but I don't really believe for sure the children will look after me." So we asked what she might do and she said she'd try to save – that's why she opened the insurance plan at $5 per month: "I'll continue as long as I get a wage. If I can save for 10 years I'll get more than $1,666, and I'll buy land in the village to build a room to rent out, or I'll send a son abroad (to work)."

Rural poor woman in her 50s: We asked her about ageing: she says she didn't think much when she was young, and her husband Hakim was lazy for a long time. When we asked what advice she'd give to younger people she started to cry, so we dropped it. Husband Hakim said, "Now I have become old. I do not have any other way except death. Thinking about anything is useless. The time of earning has passed. Now there is no time. Now there is no other way for me except going to the street and begging from people."

Urban poor woman in her 50s: On old age, she hopes she'll die before her husband does, so that she doesn't have to face the problem of surviving in old age – there's no chance of her son looking after her as he's married and has to look after his own family. If she had to, she'd go back to her village and take an NGO loan,

trade rice and try to build a small hut on a piece of land. If more money came her way she'd buy farmland or invest in a bank.

Urban poor widow in her 50s: In old age "only Allah knows" what will come of her. "I'd like to die before I become inactive, before my son beats me: if I had money in a bank – say Janata – that would help: $830 would do. My son isn't a real man so I can't expect to live off his income. I'm very dependent on my daughter – she's my main resource."

Old People

Rural poor woman in her 60s: Jamila is saving at an NGO, thinking about the future. She said that in the end of their life, when they won't be able to go out to work because of being very old and sick, this savings would help them.

Rural poor man in his 60s: Saman Ali says that one year ago he gave $5 to one of his neighbours. In future, at any time if he becomes very sick he will use this money as a provision against funeral costs. He gave it to his neighbour for this reason only. He will not take any interest. But the neighbour will invest this money in a business and Saman hopes to get a share of any profit from the business. Saman said that his wife, sons and daughters do not know about this money. He asked us not to disclose the secret.

Rural elderly poor couple: When they married they imagined their children would care for them in old age, yet this has barely happened. So the advice they'd give to their own children is (after thought), "earn and save for the future with an NGO or bank, and buy assets." But he says his own son Zia isn't saving because his income is barely enough to support his family. In this village the children of wealthy families care for parents (especially if the parents have set them up with a home), but in poor families they don't or can't.

Urban poor elderly man: With regard to old age management, Hossen Ali said, "it is the will of Allah. I think when I'm much older, my sons will look after me." Later he said, "but my sons may not look after me. It would be better if I could have saved some money. If I would have some regular income, I could have saved at least $333 in any commercial bank and it would be possible to cover my daily expenses out of the interest. Then I would not need to depend upon my sons. Though my wife still has her garment factory job she can't make any savings out of her monthly salary."

Urban near poor couple: man in his 60s, wife in 30s: She says they're bringing up the children well, spending money on their education: they'll look after her and Sultan in old age. "And then I have the insurance policies as a back up. Then I have a bit of land, too."

Annex 2: "How Are You Preparing for Your Old Age?" Responses from Poor People in Africa

In a similar exercise, staff of *MicroSave*, a microfinance initiative working out of Nairobi, Kenya, recorded some interviews with rural and urban poor households. Here is a sample of responses.

Rural poor men, Kenya: You ask us, "what do we do when we are too old to work? I'll tell you what the answer is – we pray to die. Quarrymen like us have no savings or pension schemes." (Collected by *MicroSave*, 1999)

Urban poor man, Dar es Salaam, Tanzania: "If I had some kind of insurance or pension plan I could be saving for my old age. As it is, I give money to my brother in the village to buy goats and cows. Whether he'll look after them for me, and whether he'll pay me in the end, only God knows." (Collected by *MicroSave*, 1999)

Clients of Pride, an MFI in Tanzania: They said their preparations for old age include investing in children's education and future, for example by building a house so that they can live without much difficulty should they die "prematurely." They said they were happy that PRIDE was contemplating introducing savings as one of the products, because it would enable to them to save for old age. (Collected by Leonard Mutesasira for *MicroSave*,1999)

Rural elderly man, Uganda: Kyamala passed away in 1992. However at the beginning of 1999 one of the big trees in Kyamala's compound was cut down and inside one of the holes they found many torn old currency notes. When he died, nobody knew where old Kyamala was keeping his money – if they had known, the money would have been used to pay school fees for his grandson who dropped out of school soon after his death – for lack of money. (Collected by Graham Wright and Leonard Mutesasira for *MicroSave*, 2001)

In the slums of Kampala, Uganda: "The difference between comfortable and struggling old people is how they planned for the time of their old age," says an MFI client in Katwe slums of Kampala. "If you build rental houses while you are still young and energetic you are likely to have a relatively comfortable old age. If you do not you will be miserable, striving, working, and perhaps even begging until you die. You will have no money for food and medical care. Under those circumstances you cannot live for long." (from *Savings and Needs in East Africa: An Infinite Variety*, Leonard Mutesasira for MicroSave,1999

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