microinsurance innovation facility
PROTECTING THE WORKING POOR

International Labour Office

PATHWAYS TOWARDS GREATER IMPACT: BETTER MICROINSURANCE MODELS, PRODUCTS AND PROCESSES FOR MFIs

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Microfinance institutions (MFIs) can be effective distribution channels for microinsurance. Seventy per cent of 450 MFIs reviewed in a survey provide insurance; of these nearly half offer some type of voluntary cover. The findings suggest that MFIs are evolving beyond basic credit life insurance. However, making the transition to more complex products and business models presents several challenges.

This brief presents **ten key recommendations** for MFIs to improve their microinsurance offerings:[1]

1. UNDERSTAND MARKET NEEDS AND PREFERENCES

The starting point for designing products should be the needs and preferences of the target market. Few would argue with that statement, and yet MFIs and insurers repeatedly design products that suit themselves instead of developing insurance that is suited to the market. It should be the MFI's role to represent clients' interests, and at the same time its own.

To assess risks faced by clients (and itself), a financial institution can start by examining the major causes of delinquency. Indeed, considerable data for developing and expanding insurance already exist within most MFIs' management information systems. Institutions that have undertaken this exercise often find that late payments and loan losses are frequently caused by insurable risks. For example, when Kshetriya Gramin Financial Services, a rural financial institution in India, analysed why women borrowers were late with repayments, it realized that it needed to expand its credit life cover to include spouses. Women were not able to repay loans when their husbands died, not only because they had lost an important source of income, but also because they were not allowed to work for cultural reasons.

2. PRIORITIZE SAVINGS

An MFI's ability to help the poor manage risks can be greatly enhanced if it provides savings services as well as credit and insurance. Insurance linked to savings provides more permanent coverage than credit-linked cover

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[1] This brief is excerpted from the Microinsurance Paper No. 18, which includes details on the recommendations, and examples of MFIs that have successfully implemented these recommendations. The paper is available at http://www.ilo.org/microinsurance. Craig Churchill and Aparna Dalal are part of the ILO's Microinsurance Innovation Facility. Josh Ling is an ILO Microinsurance Fellow.

and appeals to a broader potential target group. It is therefore likely to have a greater impact (see Box 1). Savings accounts can also be a cost-effective means of premium collection, and form a valuable part of risk management.

Further, providing savings products can create a strong foundation for selling insurance, as both products require that clients trust the financial institution.

Box 1 Add-on insurance increases deposits

In 2011 MicroEnsure launched a savings-linked product with a bank in Ghana that had been experiencing low account balances and limited transactions. Although the bank had over 100,000 depositors, more than 85 per cent held a balance of less than US$ 60. Each of these customers actually cost the bank about US$ 0.24 per month in administrative costs. The bank wanted to provide an incentive to customers to increase their savings balance.

MicroEnsure and its partner StarLife Assurance launched an insurance product tied to the savings accounts. Depositors who held a minimum balance of US$ 60 each month were entitled to free life insurance with benefits of up to US$ 180. Clients with a balance of US$ 120 were entitled to life insurance for their spouse and children as well.

In the first five months after product launch, the bank's deposits increased by 19 per cent. Deposits from clients with balances below US$ 60 increased by 207 per cent in five months as clients saved more to access the free insurance. This increase, along with anecdotal evidence from interviews with depositors, suggests that many customers saved more as a result of the insurance cover.

3. MAKE MANDATORY COVER VALUABLE

Insurance that covers all borrowers or all depositors of an MFI is much more affordable than voluntary insurance that is sold to individuals. It is also easier for MFIs to administer, thus enabling them to develop back-office expertise and collect data. But the MFI needs to make sure that its clients know about the coverage and appreciate its benefits. Some MFIs have seen an increase in client retention among borrowers when they introduced mandatory cover that clients liked, and some have even attracted new borrowers because of it.

Credit life can be made more valuable to clients in the following ways:

- provide additional benefits besides loan write-offs
- extend cover beyond the loan term
- cover additional people
- cover additional risks

Such changes increase the chances that the working poor can witness the benefits of insurance, and help to create an insurance culture. Many argue that credit life with additional life benefits should be the starting point for credit life products, and not basic credit life.

Credit life plus: four ways of enhancing credit life insurance

4. PROACTIVELY DEVELOP THE PRODUCT MENU

MFIs should develop insurance products that are aligned with their institutional strategy and core operations. Proactive product development can start with mandatory products and then move to mandatory-plus and voluntary products as MFIs build internal capacity. Mandatory cover is a logical starting point. The problem with some mandatory products, though, is that there is no real demonstration effect if institutions do not consciously make this an objective.

One option is for MFIs to offer a "mandatory-plus" product. In this product evolution, the basic cover is mandatory, but there are voluntary add-ons or riders that can be purchased by the policyholder. For example, a credit-linked insurance could offer hospital cash benefits or cover spouse and family members at an additional cost (see Box 2). Including this voluntary component introduces choice for clients and prompts field staff to take a more active role in providing insurance education and selling. Expertise with voluntary options could open the door to offering purely voluntary products to existing and prospective customers.

Before scaling up sales of products, it is critical to pilot test them to validate the product design and streamline operational processes.
MFW successfully used its pilot to validate and improve the design, administrative processes and promotional materials for Caregiver.
Before commencing, MFW designed a protocol for the pilot that defined how the pilot would be conducted, the processes to be tracked, and the performance indicators to be measured.
In particular, the protocol outlined key features of the pilot, such as duration, scope, and expected activities, roles and responsibilities of the pilot test team, reporting requirements, performance indicators (KPIs) and desired targets, and success/failure conditions, i.e. conditions or results based on which the pilot would be placed on hold or permanently halted.

Box 2 Microfund for Women's Caregiver hospital cash product

In 2010, Microfund for Women (MFW), a Jordanian MFI, introduced Caregiver, a hospital cash product, in collaboration with Women's World Banking and Zurich Financial Services. Initially, Caregiver was piloted as mandatory insurance that provided borrowers with cash payments after one night of hospitalization to help offset the incidental costs of travel to the hospital, lost wages, child care and other expenses incurred during a hospital stay. Based on feedback from MFW's clients during the product design phase, Caregiver included benefits during hospitalization for childbirth, which was a high priority for MFW's primarily female client base.

After the successful roll-out of the mandatory cover, MFW began a pilot to offer voluntary cover for family members in one branch in May 2012. Extending the possibility to cover family members acknowledges the care-giving role that women play in their households. If a family member is hospitalized, women are likely to be away from their businesses to care for them. This product is currently being pilot tested with 450 policies issued in the first month.

5. IMPROVE CLAIMS PROCESSING

Claims processing is perhaps the most important aspect of microinsurance operations because it provides the best opportunity to demonstrate value. Insurance hinges on trust between clients and insurers; if claims are badly managed, clients will not trust insurance. Whether the MFI is the risk carrier or the interface between the customer and the insurer, it is important that it advocates and contributes to a process to administer claims efficiently, prudently and in a way that maximises client value. MFIs usually play an active role in claims processing as this is where clients see the most value from products. Typical involvement includes assisting clients to complete forms and submit necessary documents. With their reputation at risk, some MFIs have gone further and taken on more responsibility by negotiating with their insurers to delegate authority to verify and approve or pay claims. The innovations outlined in Box 3 illustrate how MFIs can improve claims processes and make them client-centred.

Box 3 Innovations to improve claims processing

Claims advances for clients: MFIs can advance a portion of claim payments to clients while claims are being processed. This helps clients with immediate needs, and reduces the need to borrow. For example, Prodem FFP in Bolivia advances a quarter of the benefit for life insurance (US$ 365) within 24 hours after a claim is submitted, to cover burial costs. The insurer pays the balance (US$ 1,100) within 15 days of the death certificate being submitted.

Delegation of claims approval: Another option is for an insurer to delegate authority to the MFI to approve payment of some claims. This arrangement allows the MFI to approve smaller claims, while the insurer approves larger claims, which may be more complex and carry greater financial exposure. For example, with MFW's hospital cash product, the MFI can approve claims for hospital stays of up to six nights; if clients are in hospital for more than six nights, the claim goes to the insurer for review and approval.

Delegation of claims payment: Some MFIs and insurers have set up a float whereby the insurer provides an advance to the MFI, from which it pays some or all claims on behalf of the insurer. At the end of each reporting period, the actual claims are compared to the float, with a net transfer made to reconcile the accounts.

Processing claims in-house: Some larger MFIs have set up in-house claims processing centres. BASIX in India, for instance, has a dedicated claims processing unit that acts like a third-party administrator (TPA). The MFI's objective was to standardize the processes and have greater control over quality.

Guarantee fund: When using the partner-agent model, MFIs are particularly concerned about their reputation and client satisfaction, so they want to minimize claims rejection. On the other hand, insurers may focus on accurately applying pre-established claims payment criteria to adjudicate the claim, regardless of whether it is approved or rejected. To manage this difference in perspectives, some MFIs have created a guarantee fund from which to pay claims that the insurer rejects if the MFI believes they are valid, or otherwise feels it is in the MFI's interest to pay.

Service standard agreements: When MFIs partner with insurers or TPAs for claims processing, it is important to have an agreement on service standards to enforce timeliness, accuracy or other terms of performance. The service standard agreements should outline the maximum number of days in which claims should be settled; for example, the insurer could agree to pay all claims within 10 days of receiving proper documentation, or else pay a penalty.

Negotiating document requirements: Claims processes need to align with the circumstances of the low-income market. MicroEnsure and TSKI found that the insurer's documentation requirements were burdensome for life insurance beneficiaries. As a result the documentation requirements were reduced; for example, certificates or affidavits from village heads were accepted in place of death certificates.

6. APPLY HOLISTIC RISK MANAGEMENT

To increase the potential impact of insurance, it is useful to take a holistic view of the clients' risk management needs and design a package of financial and non-financial services that can respond appropriately. A risk management framework includes preventing risks, preparing for them, and coping if they occur. Insurance is just one aspect of this broader approach.

7. CREATE A DEMONSTRATION EFFECT

MFIs should look to create a culture in which low-income households naturally see insurance as part of their risk management strategy. To achieve that objective, MFIs need to ensure that the poor can witness that insurance really works. This can include providing simple products that are easy to understand, maintaining clear claims processes, minimizing claims rejections, making use of testimonial marketing material and holding claims ceremonies.

8. STRUCTURE FOR SUCCESS

MFIs have a range of institutional options to consider to deliver microinsurance, including various hybrid models, and they may change their model over time. The partner-agent model often works well in the beginning when MFIs are developing an understanding of insurance and building in-house capacity. To increase benefits offered to clients, sometimes MFIs will complement what is offered with an insurer partner with additional benefits. Brokers might be helpful for MFIs that are considering more complex products. Table 1 outlines the advantages and disadvantages of the various institutional options available to MFIs.

Table 1 Institutional models

	Self-insure	Partner-agent model	Work with an intermediary	Create an insurance company
Makes sense for:	Simple risks Large client base	Starting microinsurance operations Building in-house expertise Complex products	Early stages of programme MFIs that do not want to develop in-house expertise Complex products	Large MFIs or networks Regulatory compliance Jurisdictions with low capital requirements
Advantages	Flexibility and control Cost-efficient Potential for greatest returns	Partner brings insurance expertise Limited risk exposure	Servicing & support Broker understands how insurance companies think Contacts with insurers	Flexibility to work with different partners Retain profits Can offer more complex products
Challenges	Riskiest option Capital requirements Regulatory restrictions & questionable legality Capacity constraints Complex products Covariant risks	Reputational risk if partner does not deliver Revenues are divided	Another mouth to feed in the value chain	Involves risk Capital requirements Insurance expertise

9. BUILD INSURANCE CAPACITY

Regardless of whether an MFI self-insures, partners with an insurance company or works with a broker, it should enhance its in-house capacity for a variety of insurance functions, including marketing and sales, claims management and performance monitoring. Although MFIs often prioritize consumer education, they should perhaps give greater attention to staff education. If the frontline staff do not believe that insurance is a valuable risk management tool, it will be difficult for them to persuade clients to purchase the cover or even promote the benefits of mandatory cover.

Perhaps the most important sales incentive for an MFI's staff is to see the strong link between insurance and their core business. If remuneration is tied to loan repayment, and if insurance enables better repayment by protecting clients against relevant risks, then staff can see clearly how they benefit from insurance. Some MFIs, like Fundación Mundial de la Mujer Bucaramanga in Colombia, emphasize to loan officers the other benefits that could accrue because of insurance, including fewer loan payment lapses with clients who have insurance; more stable clients who are more likely to borrow more money; and happier clients who are more likely to be retained in a competitive market (McCord, 2011). Similarly, if tellers are rewarded for new accounts and larger account balances, and insurance increases account balances as described in Box 1, then they will be more motivated to sell insurance.

10. MONITOR PERFORMANCE

MFIs should monitor the performance of their insurance products and assess how they affect both their core operations and their clients. Institutions need to know if the revenue from the product is sufficient to cover costs, and this is only possible if costs are allocated properly across the different activities. Besides tracking viability, there are a number of reasons why MFIs should carefully monitor insurance performance indicators:

- **To monitor client value:** There are many dimensions to client value, and small changes can make a significant difference in how clients perceive insurance. MFIs should examine the effect of their product and process changes from the client's perspective.
- **To assess product profitability:** Microinsurance helps to diversify an MFI's income stream though commissions, fees or profit sharing. A diverse product portfolio provides cross-selling opportunities and spreads the cost of acquiring clients across multiple products, enhancing product profitability – or at least one assumes that microinsurance can make these positive contributions. To verify that it is indeed the case, there is a need to monitor relevant income and expenses.
- **To assess client retention:** Insurance may help MFIs to retain existing clients and to attract new clients. Through exit interviews and customer satisfaction surveys, MFIs can validate if that is the case.
- **To establish leverage with insurers:** A detailed understanding of the performance of products provides MFIs with the ability to negotiate better terms with insurers if the product is performing well. In this case, information is indeed power! BASIX negotiated better products from insurers because it was armed with convincing evidence. When the MFI first introduced credit life plus, a lack of data made it difficult to price and conservative assumptions were used. After one year, the mortality experience was better than expected. The premium could have been reduced by 50 per cent, but instead the product was redesigned to cover the borrower and spouse for the same premium. Similarly, when BASIX's hospital cash product had better than expected claims experience, the MFI negotiated an increase in the daily benefit from INR 300 per day to INR 500 per day.

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CONCLUSION

For MFIs, microinsurance products are like a buffet, with lots of dishes to choose from. It is a good idea to begin with the starters (credit life plus). Some MFIs might stop there. Others will make sure that the starter is well digested before moving on to the main dishes, perhaps savings-linked cover or riders for credit-linked insurance. The dessert is voluntary insurance for the general public, and MFIs that want to watch their weight might steer clear of it.

It is true that offering insurance can add certain risks for MFIs, especially if they are carrying the insurance risk themselves. Even if they are partnering with an insurance company, they are still exposed to reputational risks. There are also numerous operational challenges, including how to structure the roles and responsibilities of field staff, how to transition beyond mandatory cover, and how to provide incentives for sales. Perhaps the biggest challenge is to manage a streamlined claims process so the poor can easily appreciate the real benefits of insurance. If they are effective, MFIs can lay the foundation for an insurance culture in low-income communities that will enable the poor to manage risks more efficiently and thereby make a valuable contribution to breaking the vicious cycle of poverty.

Insurance has the potential to improve the health and welfare of low-income households, and consequently enhance the social and financial performance of the MFI, especially when considered as a component of a broader risk management framework. The hope is that MFIs will think critically about the options described here and consider their insurance opportunities carefully.

Housed at the International Labour Organization's Social Finance Programme, the **Microinsurance Innovation Facility** seeks to increase the availability of quality insurance for the developing world's low income families to help them guard against risk and overcome poverty. The Facility was launched in 2008 with generous support from the Bill & Melinda Gates Foundation to learn and promote how to extend better insurance to the working poor. Additional funding has gratefully been received from several donors, including the Z Zurich Foundation and AusAID.

See more at www.ilo.org/microinsurance

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