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Microinsurance NOTE 2

How is microinsurance delivered?

Many insurers are now recognizing the profit potential of the low-income market for microinsurance, and are developing efficient delivery channels by working with a variety of intermediaries. Insurers understand that these channels can help reduce premiums, and also meet the need of the low-income market to buy from people or organizations they trust.

This is the second in a series of short notes exploring this exciting new expansion of access to financial services.

November 2006

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The success of microinsurance is predicated on several key characteristics. Microinsurance products must be demand driven and designed in a manner that responds directly to the needs and abilities of the low-income market. In addition, microinsurance products and the processes to deliver and service them must be efficiently managed to ensure a fair premium with appropriate coverage. It is the efficiency of managing the products, and particularly the means of getting the product to the policyholder, that will be explored in this issue.

ADMINISTRATIVE COSTS ARE KEY

Low-income people have limited, if any, funds to pay for quality microinsurance. Therefore, it is critical that products for this market maintain very low premiums. However, these low premiums must cover the costs of providing reasonable benefits, and the costs to deliver and service the product. All costs of insurance products must be covered by the premium, except in the case of subsidies which will not be addressed here.

Key costs in microinsurance include the cost of the coverage itself, and the administrative costs. Both need to be addressed to generate microinsurance success. However, if it is an objective to provide the best coverage possible at a price that low-income people can afford, one must work to reduce administrative costs in order to reduce the overall premium.

There are several ways in which administrative costs can be reduced. Technology solutions have been proven to greatly reduce costs, once the initial investment has been made. The hospital cash policy of Aldagi Insurance sold through the

Constanta Foundation[1] in Georgia is a good example. The policies are linked to Constanta's credit products. When loans are set up in the Constanta system, there is an indicator for a voluntary insurance purchase. When the loan is disbursed a file is created that is batched and transmitted to Aldagi with a computer generated call. The data is then integrated into Aldagi's system.

Essentially all this is done based only on the indication of accepting insurance coverage in the loan setup process. After that, servicing is automatic, and thus inexpensive.

Many MFI's "offer" microinsurance on a mandatory, group basis. The policies are primarily focused on providing benefits to families when there is an accidental death, or benefits to the MFI (as in loan settlement). Therefore, these premiums can be relatively low and are easily linked to a loan product. This also helps to keep administrative costs down because:

- There is no work required to separate insured individual clients from the non-insured in the institution's activities and records
- Sales activity can be limited to informing and educating clients
- Adverse selection is minimized by requiring both ill and well to join

The now famous case of AIG Uganda[2] exemplifies the benefit of this method. In 2005, AIG Uganda covered over 1.6 million lives yet serviced only twenty-three insurance policies. The policies were to MFIs. Except for one, each of the MFIs required their clients to purchase the Group Personal Accident (GPA) policy that AIG Uganda has developed specifically for microfinance institutions. The method of delivery can have an important impact on the premiums charged to microinsurance policyholders.

PARTNERSHIPS WITH MFIS

The partnership of insurers and MFIs has become quite an important delivery channel for microinsurance. Successful, efficient MFIs appear to be perfect candidates for these relationships. They are actively working in low-income areas, train their clients about financial products, serve a market of clients that tend to be more future oriented, and have efficient mechanisms to handle cash and information transactions. This should be perfect for selling microinsurance. The good, the bad, and the ugly of these partnerships will be addressed as the sole focus of the third issue in the MicroNOTES Microinsurance series. The rest of this issue will look at other delivery channels that insurers are using, with varying efficiency, to get microinsurance products to low-income clients.

Many insurers are now recognizing the profit potential of the low-income market for microinsurance. Insurers like ICICI Lombard [3]and ICICI Prudential[4] in India, AIG and Allianz in Indonesia, Gemini Life in Ghana, SurAmericana Insurance in Colombia, and many others are developing efficient delivery channels by working with a variety of intermediaries. Insurers understand that these channels can help reduce premiums, and also meet the need of the low-income market to buy from people or organizations they trust. Insurers, particularly in India

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[1] http://www.constanta.ge/

[2] http://www.microinsurancecentre.org/index.cfm?fuseaction=resources.detaildoc&showcontributorID=87

[3] http://www.icicilombard.com/app/Customer-segments/Rural-Insurance.asp

[4] http://www.iciciprulife.com/public/Rural-plans/Rural-Plans.htm

and South Africa, have been propelled into identifying delivery channels by regulatory requirements to serve low-income markets. In several cases, intermediaries themselves have initiated a partnership with an insurance firm in order to offer products to their members or clients.

CHARACTERISTICS OF A GOOD MICROINSURANCE INTERMEDIARY

New models for delivery of microinsurance are being tested around the globe in response to the dramatic growth potential of this market. Evidence from many pilot programs as well as those that are in full implementation can provide guidance for identifying good intermediaries. Lessons about how microinsurance intermediation works best include the following:

- The intermediary needs to service regular transactions with low-income people. This facilitates the payment of premiums and eliminates the need for a special trip by a policyholder simply to make premium payments. Microinsurance is being sold through employers of very low-income workers such as house guards in Uganda, or through outsourcing arrangements as with tealeaf pickers in Sri Lanka.
- Insurance is a volume business, and especially for microinsurance, an intermediary must have a large number of clients or customers that are potential policyholders. For example, efforts are being made to link cell phone top-up cards with insurance in the Philippines for the vast number of cell phone users. In China, insurance linkages are being developed through unions, one of which now covers over 28 million low-income people.
- Intermediaries must enjoy the trust of their clients or customers. Because low-income people's attitudes towards insurance are almost universally negative at the start, trust in the intermediary is critical to establishing trust in the insurance that the intermediary is selling. One major insurer is working with the postal service in Indonesia to sell microinsurance through the postal outlets. Credit Unions such as those in Poland have come together to create an insurance company, Tuw Skok[5], to serve the needs of their members who already trust the credit union services.
- Intermediaries must also be trustworthy to the insurer. The insurer must trust the intermediary to represent its products and to manage its premiums professionally, including remitting them to the insurer. Insurers must have legal mechanisms to enforce their claim on premiums, but it is preferable if the intermediary is trustworthy without having to resort to such tactics. Because insurance claims need to be paid quickly, often intermediaries, like ASA[6], are given the authority to pay claims under certain circumstances. This too requires substantial trust. Non-MFI NGOs often prove trustworthy with premiums, as do retail outlets that are accustomed to such supplier arrangements.
- The intermediary should have reasonable financial systems that allow for the management of premiums and basic policyholder information. One very large church group in South Africa collects premiums after services

5 http://www.microinsurancecentre.org/index.cfm?fuseaction=resources.detaildoc&showcontributorID=78

6 http://www.microinsurancecentre.org/index.cfm?fuseaction=resources.detaildoc&showcontributorID=106

using bar code technology. Worldwide, credit unions are very active in providing basic microinsurance to their members.

- Insurers must be willing to provide incentives to the intermediary. Without incentives, the intermediary has limited interest in representing the insurer. Insurers use various mechanisms to provide incentives including commissions on premiums collected, profit sharing, provision of fees, or other incentives that work for the particular intermediary. In the K-Rep[7] and AAR Health Services[8] linkage in Kenya, front line staff are incentivised with trips for high production. Madison Insurance[9] offers profit sharing to their MFI partners in Zambia.

It is important to consider all these characteristics. Strength in one area may not mitigate weakness in another area. For example, trade unions may indeed provide access to a large trusting market. However, insurers in some countries report that unions can be very difficult to work with because (1) the insurer often still has to work directly with the low-income member's employers, and (2) trade unions often do not want to remit the premiums. Taking a comprehensive view of the intermediary is an important prerequisite for microinsurance. Additionally, careful and frequent assessment of intermediaries is important to ensure control of moral hazard, adverse selection, and fraud within the intermediary's operations.

OTHER DELIVERY CHANNELS

Several delivery channels have been mentioned above. Others could also provide significant benefits in moving microinsurance to the low-income markets. Low-income housing providers such as Habitat for Humanity could benefit from insuring the structures through appropriate microinsurance products. Often, these organizations already collect ongoing payments or maintain other relationships that could facilitate the payment of premiums while protecting the investment of both the new homeowner and the organization.

Among the most common channels for microinsurance is direct ownership and delivery by community-based organizations. These typically lack the benefit of regulated insurers backing up the product. Although there is ownership on the part of the member-policyholder, there is usually little professional insurance expertise, limited skills to manage the program, limited reserves, no reinsurance, and frequent fraud and other financial difficulties. Converting these CBOs from acting as "insurers" to becoming simply delivery channels, at least for microinsurance, could mitigate many of these problems.

Retail chains that focus on the low-income market could also sell and service microinsurance. An insurer in Indonesia, for example, offers life microinsurance products through a related retail chain. In Sri Lanka, one insurer

> In India, the Sankat Haran Policy sold by Iffco-Tokio provides accidental death and disability coverage. The coverage is obtained when clients buy a 50 kg bag of fertilizer. The receipt for the fertilizer bag acts as proof of payment and the policy document is printed on the fertilizer bag. The amount of cover is US$90 in the event of an accidental death and US$45 for certain categories of dismemberment and disability. The insured is the purchaser of the fertilizer bag and a single person can hold multiple policies up to a maximum of US$2,260 in cover. Claiming on the policy appears somewhat arduous as claimants must submit a variety of documents to Iffco-Tokio[10] directly. This scheme, however, may well be the largest commercial microinsurance scheme in the world. By the end of 2005, this product covered over 800,000 lives.

[7] http://www.k-rep.org/devagency.asp

[8] http://www.aarhealth.com/#

[9] http://www.microinsurancecentre.org/index.cfm?fuseaction=resources.detaildoc&showcontributorID=91

[10] http://itgi.co.in/aboutus.jsp#

offers a magnetic strip card that people can use to buy and then top up their personal accident insurance at a grocery chain for mere cents per transaction. On the claims side, some insurers are considering providing part of their life insurance settlements as monthly allowances at grocery chains to help families adjust to their new income level after the death of a breadwinner.

Microinsurance is also sold in India through computer kiosks in rural villages. Funeral service chains in South Africa offer funeral microinsurance that is popular among their markets. Hospitals and hospital chains offer microinsurance in many countries. Even schools serving low-income children sell microinsurance, particularly for student health. Leasing companies and lease finance programs also offer microinsurance for low-income (and upper-income) customers.

In MFI circles, the prominence of remittances has generated much interest. Linking remittances to microinsurance to provide for the low-income, often rural family members of the remitter has significant potential.

There is potential for limitations on microinsurance expansion related to regulations. Laws that require licensed agents, for example, have tended to be waived, officially or unofficially, in the recognition that microinsurance is beneficial to the low-income markets. Governments are often interested in finding ways to move financial sector products down-market. For microinsurance, especially when offered by regulated insurers, there tends to be some flexibility. However, it will be necessary to formalize these agency structures as microinsurance provision grows.

Microinsurance is growing rapidly and insurers are finding creative delivery channels that satisfy the characteristics noted above. Innovation in delivery channels will likely continue at a rapid pace, driven by a growing recognition of the potential of low-income markets coupled with the need to keep administrative costs down.