Microinsurance NOTE 3

Partnerships: Microfinance Institutions and Commercial Insurers

MFIs, working directly with the low-income market, conducting financial transactions, managing financial controls, and marketing specialized financial products, can be perfect intermediaries for insurers to reach the low-income market. This partner-agent model has significant potential for expanding microinsurance access to millions of low-income families. Today, at least 15 million low-income people are covered by some microinsurance product sold through partnerships with MFIs. This number is likely to expand dramatically as products and processes improve, and low-income consumers come to better appreciate the benefits of microinsurance.

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As discussed in Microinsurance Note #2, a critical component of successful microinsurance is efficiency in transactions and operations. Without greater efficiencies, the only way to reduce the premium costs to affordable levels is by reducing coverage. Providing a good product at an affordable price therefore requires efficient, yet controlled, processes. The key to efficient processes is in effectively selling the product to the policyholders, and then smoothly transacting information and premiums between policyholders and the insurer.

In order to make the insurance transactions efficient, the insurer requires an effective means of linking to the low-income market. Because they work directly with the low-income market, already conducting financial transactions, managing financial controls, and marketing specialized financial products, MFIs might be the perfect intermediary for insurers to reach the low-income market. Over-laying insurance products on top of the activities MFIs already do with credit and savings can make the sales and service of microinsurance extremely efficient.

HOW MFIS ARE ATTRACTED TO MICROINSURANCE

One particularly common scenario for MFI managers was to see a client do well for the first few loan cycles, only to fall back into financial trouble. MFI managers saw that when clients were having difficulty repaying their loans, it was often because of idiosyncratic financial risks such as a death or illness in the family. For organizations that used group lending methodologies, a personal crisis affecting one member could also undermine the cohesion of the group and contaminate the quality of several loans.

Many MFI managers have recognized that insurance might reduce the impact of these problems. Some MFIs wanted to protect their portfolio through insurance; others also wanted to aid their clients and their families in difficult times. Once the objective was understood, the decision then was to find a mechanism to insure their clients without distracting management and staff from their core products.

While some organizations decided to self-insure, for most, the choice was easy: turn to commercial insurers who already have mechanisms to address these issues. As many have found since, this model is usually the simplest, cheapest and quickest way for an MFI to start offering risk-management services beyond traditional credit and savings products they already offer their clients. As a bonus, this model can be implemented with little additional risk to the MFI. An expanded product line, a source of fee-based income, protection for the MFI and its clients, little risk and virtually no financial input—how could it get any better?

INSURERS

Insurers in these arrangements get instant access to potentially tens, even hundreds of thousands of low-income potential policyholders, often through a single group policy. Though some insurers were reluctant at first, now in many places insurers actually compete to serve MFIs and their clients. Indeed, when Compartamos in Mexico was looking for an insurance partner, its three finalists were all major international insurers who fought hard for the business. These partnerships between MFIs and formal insurers seem like matches made in heaven.

THE LOW-INCOME POLICYHOLDERS

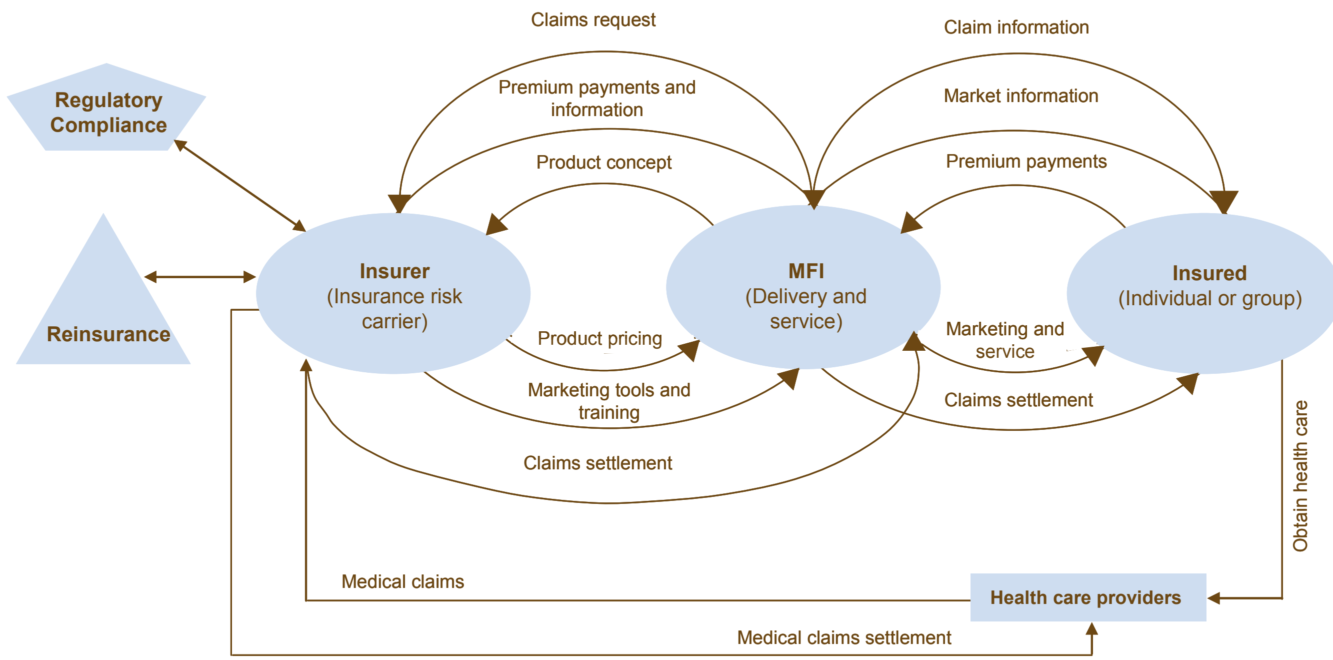
This model could also be beneficial for low-income policyholders. They could obtain professionally-managed insurance products, to which they would otherwise have had very limited access. For clients of large MFIs, sheer numbers should allow the clients some control over product design, and the premiums should be more favorable. Finally, if there are disputes, the MFI is there to support them, rather than the low-income policyholders having to pursue the insurer to enforce the policy coverage. This model clearly has the potential to be beneficial to all parties and can indeed provide a win-win-win situation.

STRUCTURING PARTNERSHIPS FOR MICROINSURANCE

In this model, shown on page 3, the MFI delivery channel is at the center. Ideally, the MFI gathers information from its clients to create a detailed product concept that directly satisfies their clients' real demands. Once there is a clear product concept, the MFI then identifies an insurer to offer the product. Because the insurer is responsible for regulatory compliance and absorbs the insurance risk of the product, they must have the final say about pricing and product design. Again ideally, the MFI should market the product concept to several insurers so that they get the best combination of premium and coverage for their clients.

THE SPECIAL CASE OF CREDIT LIFE INSURANCE

The most common form of microinsurance offered by MFIs is credit life insurance. This insurance covers the institution for the loss of the loan due to death of a client. Such a policy is often rather profitable for insurers. Indeed, MFIs will



frequently offer their own credit life policy (where the MFI takes the insurance risk). Often, MFIs will use this product simply as a means of increasing non-interest income. These MFIs charge up to 3% of the principal value of the loan, and account for the "premiums" directly as income. When there is a loss, it is typically covered from the reserve for possible loan losses. Such abuses notwithstanding, credit life is a product that MFIs may be able to offer on their own without linking to an insurer. This may be possible if the MFI has a clear understanding of the death risk within its portfolio, and actually does create and fund a reserve for possible client death. Because of the various components of premium costs applied by an insurer, credit life insurance offered by an MFI responsibly should be extremely cheap for clients, and reasonably safe for MFIs. Some organizations, like ECLOF in Uganda, started offering credit life on their own and have subsequently shifted to working with an insurer to offer better products in a better managed way.

Other MFIs such as SEWA and ASA in India offered microinsurance on their own for a time. Recognizing the risks they faced, they have subsequently shifted to a partnership arrangement with insurers.

FORMALIZING THE RELATIONSHIP

Once the product concept is developed, and the insurer and MFI have identified each other, it is important that the parties identify the roles they will play in the microinsurance process. Formal agreements will clarify roles and minimize the potential for future disagreements, foster a smoother working relationship, and form the foundation for governing relationships. Key responsibilities that must be addressed within an agreement include the following:

Underwriting

One benefit of working with MFIs is that credit screening can be a substitute for life insurance underwriting (the assessment of risk to the insurer). For example, AIG Uganda takes every policyholder provided by its MFI partners. Any additional underwriting is effectively done through the claims verification process. This strategy can dramatically reduce the cost of insurance sales.

Staff training

Generally, the MFI agent's front line staff members require training in insurance principles, insurance marketing, and the details of the particular product. This training can be provided directly by the insurer.

Alternatively, the insurer can help develop the training materials for the MFI's training staff to deliver. La Equidad in Colombia, for example, has developed a special program to train the credit analysts of its MFI partners. Other staff need training and guidance on such issues as scheme administration and MIS applications.

Premium collection and remittance

The premium collection process is extremely detailed and must be documented so that each party is clear on the timing and its role in the process. Efficiency is critical. Since MFIs already manage financial transactions with their clients, it is relatively easy for them to collect premiums as part of loan payments or from policyholder savings. This is an important advantage of partnerships with MFIs. Any agreements should ensure that as much as possible is done electronically. The use of computers and electronic communications is an important way to reduce the cost and effort of managing microinsurance, as well as of collecting the necessary client demographic data. With their electronic systems, the health products of Aldagi Insurance and Constanta Foundation in Georgia were particularly good examples of transaction efficiency.

Claims processing

Since timely claims payment is critical to the credibility of the institutions (not to mention to the needs of the beneficiaries), an agreement on service standards is imperative. In some of the early experiences with this partnership model, insurers generally insisted that they pay claims, but often with very poor results. In ASA's experiences with Life Insurance Corporation of India (LIC), claims regularly took three months or more to be paid. To avoid these problems, many MFIs, like ASA and Kashf in Pakistan, decided to settle claims directly. Where it is done, beneficiaries profit from the practice.

While it may be possible for the MFI to pay claims for life insurance, it is more difficult for other types of coverage. Even making the distinction between natural and accidental death may be difficult for the MFI's field staff. Health insurance is even more complicated and should generally be avoided by MFIs (as shown in the diagram on page 3).

CHALLENGES FOR MFI PARTNERSHIPS WITH INSURERS

The potential for seamless integration of microinsurance into MFI activities has not always been fulfilled. Expectations for cross-selling efficiencies have not been realized in many institutions, primarily because microinsurance is not the agents' core business. Insurance may support the core business, but when delinquency problems arise, marketing and servicing the microinsurance product line may not receive adequate resources as the attention of management and staff shift to address portfolio problems.

The expectation that microinsurance could be merged into an MFI with essentially no additional cost has proved overly optimistic. Several institutions have recognized the need to have someone within the agent institution liaise between the insurer and the MFI. In some cases, the agent allocates someone to manage the relationship from their side, to oversee training, manage the reporting and communications with the insurers, answer questions from staff and generally act as the insurance product manager. In some cases, as with Gemini Life Insurance (Ghana), the insurer will actually place one of its agents with the MFI to ensure proper sales and service.

The assumption that MFI staff will actively cross-sell insurance has generally not been confirmed. Demand and customer satisfaction studies have shown that microfinance clients often have little understanding of the insurance products they have purchased. This is especially true of mandatory products. However, commitment to keeping clients knowledgeable and informed is necessary for success in microinsurance. Without such a commitment, policyholders only see mandatory insurance as an additional cost to borrowing, and voluntary products are likely to experience low renewal rates.

KEYS TO SUCCESS WITH MFIS AS MICROINSURANCE AGENTS

Where insurer/MFI partnerships have been most successful, the following characteristics of the products, processes, and relationships have been present:

- Products are directly related to the products of the agent institution.
- The MFI has sufficient knowledge and motivation to actually represent its clients in negotiations with insurers, and manage the product development process.
- The MFI recognizes the benefit of insurance not only for its direct benefits to the MFI—commissions and portfolio protection—but more importantly for the indirect benefits of healthier and more financially stable clients.
- Products are simple in all respects, from the initial entry requirements to the policy language, with a minimum of exclusions and a settlement process that makes it easy to submit valid claims.
- The products are valued by the MFI's clients, and are mandatory. This requires conveying product information to clients to ensure that they not only understand insurance, but appreciate the protection garnered from their premiums.
- Premiums are fair for all concerned. The product can be profitable to the insurer, the MFI experiences benefits and some commissions, and the insured (as a group) receive a majority of the premiums back in claims.
- The agent's field staff are sufficiently skilled and actually take the time to explain insurance and the product clients are buying. This requires training, often from the insurer, and monitoring of field staff, as well as tools to facilitate insurance interactions with clients.
- The insurer develops a different business model for the low-income market than for its traditional clientele. High client volumes coupled with relatively low premiums require a different approach from that of the wealthier insured.

The partner-agent model has significant potential in expanding microinsurance access to millions of low-income families. It is still early in its evolution, and progress is being made based on lessons learned.

Today, at least 15 million low-income people are covered by some microinsurance product sold through partnerships with MFIs. This number is likely to expand dramatically as products and processes improve, and low-income consumers come to better appreciate the benefits of microinsurance.