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Microinsurance NOTE 1

What is Microinsurance?

Because most low-income people in developing countries are self-employed or employed in small firms, they have not had access to insurance products that fit their needs through adequate delivery channels, premiums, coverage, premium collection, and product simplicity. Fortunately, there are a variety of new innovations that hold the promise of both reaching the poorest and being profitable. This is the first in a series of short notes exploring this exciting new expansion of access to financial services.

“The protection of low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved. Low-income people can use microinsurance, where it is available, as one of several tools to manage risks. Other tools include community-based mutual support systems; risk avoidance and reduction; access to other risk-managing financial services such as savings and emergency loans; and social protection options available through the state. Together, these tools form a complex matrix through which low-income people manage their risks.” — *The CGAP Working Group on Microinsurance*

A BIT OF HISTORY

Microinsurance is not a new invention. The “industrial insurance” sold at factory gates in American cities in the early 1900s made the Metropolitan Life Insurance Company the largest company – not just insurance company – in the world at that time. Their industrial insurance was the forerunner of today’s commercial microinsurance. It was simply a response to a market demand managed in a manner that made the products appropriate for the market. The delivery channels - agents at the factory gates – were specific to this market. The premiums reflected the particular risks of the factory worker market. Coverage responded to the workers’ specific needs. Premium collection – on payday as the workers exited the factories – was efficient. In short, industrial insurance was a response to a market niche

September 2006

This publication was produced by Michael J. McCord and Jim Roth of MicroInsurance Centre for U.S. Agency for International Development.

U.S. Agency for International Development
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that provided access to quality insurance products for low-income workers, and access to a huge market for the insurers.

From industrial workers making premium payments at the factory gates, to increased efficiency of factory management collecting premiums, or even covering their employees directly, this historical microinsurance moved into the mainstream. From here, many developed countries were able to generate substantial pools of investment funds that helped drive ever-growing economies.

In developing countries, access to this market has not been easy and insurance products have remained focused on the high-end and corporate markets. Because most low-income people in developing countries are self-employed or employed in small firms, they have had little to no access to insurance products that fit their needs. The appropriate delivery channels, types of coverage, product simplicity, premiums, and premium collection methods that this market requires have not been available.

Other microinsurance mechanisms have substituted for the lack of commercial microinsurance in these markets. Mutual insurance (where a group owned insurance business is professionally managed) and

community-based microinsurance (where local people manage an insurance fund) have been available for many years. Mutual products often cover a wide range of low- medium- and high-income individuals and have offered often simple and limited insurance products directly appropriate to their members. Such products and programs have been available for over two hundred years in some form.

NEW MODELS FOR POOR COMMUNITIES

Much interest over the last few decades has focused on helping communities to establish mutual or community-based insurance schemes. Professionals typically manage mutual insurance companies. Community-based schemes, promoted by ILO STEP and CIDR among others, tend to be run by well meaning local people who give freely of their time, but are not insurance professionals. Often people who were simply in need of insurance end up being insurance managers with these schemes. One member of the management committee of a community-based scheme in Tanzania noted that he “wants insurance, but doesn’t want to be an insurer.”

In community-based schemes, the limited management capacity frequently leads to a range of

difficulties. The key issues of concern for community-based schemes include:

- Pricing – Often the process of pricing is focused on what people say they can pay rather than being linked to the cost structure of benefits that the group wants to receive.
- Insurance is subject to cash flow fluctuations and thus requires significant reserves. These schemes frequently have insufficient reserves or no reserves at all. Also, commercial reinsurance is rarely available to unregulated insurance schemes thus leaving them with no ability to manage cash flow deficits.
- Controls on management are weak and temptation is strong. Fraud by management is frequently a problem.
- These schemes are limited in size to those people within the defined local area. This reduces their ability to diversify a rather small risk pool, and enhances the potential for adverse selection, both of which make sustainability a serious challenge for local management.
- Finally, in many countries there is no legal framework for these schemes. Indeed regulators are often

unwilling to allow such schemes for fear that they will not be able to adequately supervise many small schemes run by non-professionals. This is the case in India.

Service providers, most typically hospitals and other healthcare providers, have offered pre-financing mechanisms that act somewhat like insurance. These products, it is argued, will attract more people to the facility and the people who come will be able to pay for the services. Often this becomes a problem because providers have limited ability to manage the insurance administration issues. One overseer of a particular group of hospitals noted that attemptin to offer microinsurance could present a dual threat to the hospital network for which he works. He noted that the hospital administrators “do not even know how to price their own healthcare services”. Therefore, they mis-price their premiums based on those prices, which are typically too low. The resulting increase in patients using the insurance leads to even higher losses, due to higher administrative costs and incorrect fees that do not cover the actual costs of services.

Governments also provide a form of microinsurance through the programs they provide for low-income citizens. Unfortunately, in

many countries these programs are simply insufficient to address the financial risks of the low-income and destitute populations. Certainly there is a population that will not be covered by commercial or other non-government microinsurance. However, if a proper balance could be found, it is possible that the combination of government programs, commercial microinsurance, mutual insurance, and traditional commercial insurance could make each of these more efficient, and make the government interventions more effective in addressing those that truly require such services.

AN OVERVIEW OF THE MARKET

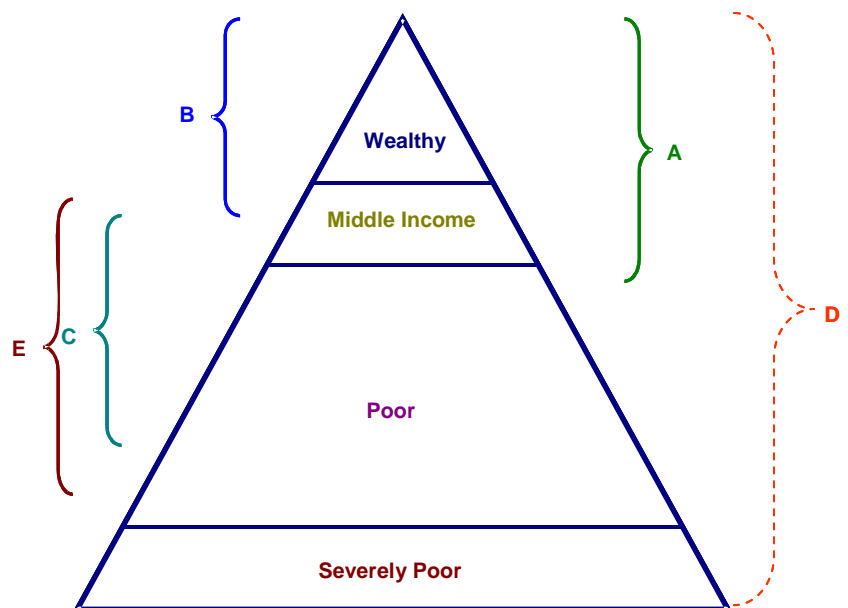
The market for microinsurance is represented by this pyramid diagram. Formal sector insurance companies

generally focus on the area identified as “A”. In this realm the customers are corporations and wealthy individuals, and the products are voluntary products such as life insurance, and obligatory products required either by law (such as motor third party liability) or by banks (such as property loss and credit life). Also offered are products covering employees and civil liability.

Most of the non-auto related commercial products are being sold within the area marked “B”.

The aggregate market for microfinance providers is generally in the area identified as “C”. Some MFPs require borrowers to obtain insurance for property, or credit-life insurance as a means of protecting the institution’s interests.

Area “D” indicates the broad range of products offered by the social security and public health insurance systems of



developing country governments. They include coverage for pensions, disability benefits, primary health care, and medications. The weakness of this sector is indicated by the dashed line that suggests incomplete coverage.

The potential market for microinsurance is indicated as “E”. This extends above the MFP range in providing access to individuals and others that cannot obtain appropriate products from the commercial sector. The microinsurance range also extends below the MFP range because it addresses agricultural coverage in some cases, and is now being sold through many delivery channels other than MFPs. Just a few of these delivery channels include:

- low-income focused retailers in South Africa
- post offices in Indonesia
- on bags of agricultural inputs or through computer kiosks in India..

THE ROLE OF DONORS

For donors, microinsurance has gained a great deal of attention over the past few years and is an area in which several are actively working: KfW has done a series of pre-feasibility studies for microinsurance investment; GTZ has actively promoted programs in India and Indonesia; DfID through its

FDCF has funded several commercial microinsurance programs in Africa and Asia; and CIDA, SIDA, UNDP, CORDAID, CGAP, and Munich Re Foundation are all involved in some way with microinsurance. The ILO has led the CGAP Working Group on MicroInsurance. This group has been highly productive in developing an understanding of key practical aspects of microinsurance, as well as disseminating that information.

USAID has funded programs that promote, among others:

- improved health care financing legislation, through Partnership for Health Reform Plus
- rainfall indexing through Opportunity International in Malawi
- development of microinsurance products in Jordan, with partners including the MicroFund for Women and the MicroInsurance Centre, and
- an understanding of microinsurance demand through MicroFinance Opportunities.

Among the reasons for the intense donor interest in microinsurance are a variety of new innovations that hold the promise of both reaching the poorest and being profitable. Additionally, microinsurance is seen as a means of protecting the gains that microfinance clients have

made, at a time when microfinance institutions are also ready to offer such products to their clients. Over the past two decades, microfinance development has primarily emphasized access to microcredit. However, the poor need a full range of financial services, and microinsurance can play a key role in meeting this need.

THE MICROINSURANCE SERIES

This is the first in a series of Microinsurance Notes to be published on MicroLINKS. Ten upcoming topics are described in the table. The series will also include two Speakers' Corners, which offer an opportunity to ask questions and engage in a lively discussion of the theme.

	Topic	Projected Dates
1	What is Microinsurance?	September 2006
2	How is MI delivered? Discussion of MFI and non-MFI delivery channels	October 2006
3	Partnerships - Making Them Work Working with commercial insurers to reduce the vulnerability of the poor	November 2006
4	Product Development in MI	December 2006
5	Life Insurance for the Low-Income Market	January 2007
6	Health Microinsurance Financing options for health insurance for the poor	February 2007
7	Weather Index Insurance	March 2007
8	Speakers' Corner: Review and discussion of Notes 1 through 7	April 2007
9	Marketing and Market Education	May 2007
10	Regulations and Consumer Protection	June 2007
11	The Future of Microinsurance	July 2007
12	Speakers' Corner: Review and conclusion of the series	July 2007

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