Making a market for microinsurance:

the success and failure of different channels of delivery

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micro insurance network

This document is focus note 12 in a series of 12 produced as part of a five country study on the role of policy, regulation and supervision in making microinsurance work for the poor. See page 7 for further details.

1 Introduction

Access to insurance may be an important strategy for reducing poverty. Financial markets, and particularly insurance services, can help poor people manage critical risks such as death in the family, illness, or loss of income or property. Despite the growing importance and expansion of microinsurance services geared to low-income people, microinsurance penetration remains limited, leaving the vast majority of poor people without adequate protection.

A variety of models are being used to intermediate microinsurance, with varying degrees of success. This focus note categorises the models found in Colombia, India, the Philippines, South Africa and Uganda and assesses their relative success in driving the uptake of insurance. The experience is remarkably consistent across the five countries, making it possible to conclude on what is required for people to use microinsurance.

This note explores how the various models used

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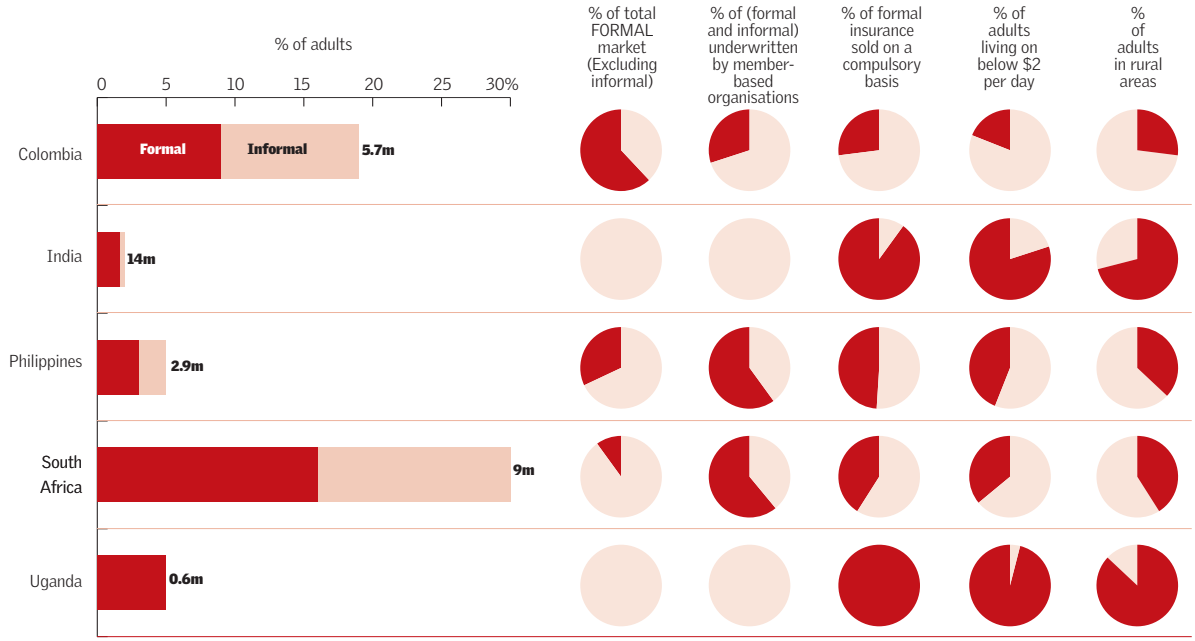

Figure 1. The penetration (% of adults) of microinsurance in Colombia, India, Philippines, South Africa and Uganda

in selling microinsurance have performed, and the lessons that can be drawn from this. It does not present an exhaustive discussion of all possible models[1], but highlights key model categories and the salient features that may help in understanding their success or failure in intermediating microinsurance. This has relevance for market players looking to serve the low-income market and regulators seeking to design appropriate regulation for microinsurance.

Our analysis draws on evidence drawn from the study of the development of microinsurance markets in five countries, specifically considering the impact of regulation. The individual country reports and summary findings can be accessed at www.cenfri.org.

2 Trends in micro-insurance penetration

The uptake of insurance varies across countries and insurance products, but some common trends are apparent, as captured in Figure 1. Three trends are of interest:

- Microinsurance consists mostly of compulsory credit life on the back of credit. Clients are compelled to take this, and no "selling" of the product is required. As a result, clients are often unaware that they have insurance cover.
- Where they exist, member-based insurers seem to have more success in selling voluntary microinsurance than their commercial counterparts. Some of this occurs in informal markets[2].
- Of all voluntary insurance products, funeral insurance is the most popular and the only product to be sold on a significant scale. It accounts for 72% of the microinsurance market in South Africa and at least 52% in Colombia, the two countries where a breakdown by product was possible. Superficially, this could be ascribed to "culture", but the fact that funeral insurance leads the market in a range of countries suggests that other factors are at work. It is worth considering this in evaluating the performance of different insurance models.

What does the varying success of product categories and channels noted above say about the features of a successful insurance model? The findings of the five country studies suggest that success is related to "making a market" for microinsurance.

1 In practice, business models may combine some of the features that we present as distinct categories. Models do, however, exist for each of these categories and even if they are combined, the assessment of the features of a specific category remains valid.

2 See focus note 9 on the role and regulation of member-based insurers.

3 Making the market

Evaluating success: It is important to consider the criteria used in assessing insurance models. In the interest of financial inclusion, people must have access to appropriate and affordable products and actively choose to use them to mitigate their risks[3]. The aim is to facilitate increased uptake of insurance products that are affordable and suit the needs of the poor. However, this is not the only consideration. Consumers may, for example, be forced to take out insurance without realising that they are covered or how they can claim. Alternatively, the wrong kind of selling may lead consumers to purchase insurance, only to discover that they cannot claim because exclusions were not clarified at the time of the sales transaction. The objective is, therefore, to increase the uptake of appropriate insurance products that offer value to clients.

Positive market discovery: The experience of the sample countries suggest that uptake of appropriate products can be achieved when a particular business model ensures positive market discovery. This has two important elements:

- *Market discovery* means that consumers must be introduced to a product in a way that makes them aware of the cover offered and helps them understand the value that insurance has for them. According to the old adage, insurance has to be sold –a "market maker" is needed. The consistent finding across all the countries surveyed is that low levels of knowledge and awareness are a key barrier to inclusion.
- *Positive discovery* means that consumers must have a positive experience of the product – they must be able to claim on it and derive value from it. This results in a positive demonstration of the value of the product and builds the client and community's trust both in the product and the industry, through the demonstration effect and by word of mouth.

If the client is unaware that they are covered by insurance, there can be no "discovery", and the discovery will be negative if a claim is rejected for reasons that were not explained at the time of purchase. Insurance models that result in scant or negative discovery tend to be short-term, and do not help create a long-term market for microinsurance. Positive market discovery also allows other, less expensive models to expand the market.

The proposed typology identifies five models emerging from the country case studies, based on their ability to achieve positive market discovery. They are: compulsion, reinvention, derived demand, passive aggregators and individual agent-based outbound sales.

Compulsion

Dominant microinsurance channel. As noted above, credit insurance on the back of loans is the biggest microinsurance category in all the sample countries. It accounts for the vast majority of microinsurance policies in India and Uganda and, it is estimated, about half the microinsurance market in the Philippines. In South Africa, it is outstripped only by funeral insurance. In Colombia, compulsory credit life is the fastest-growing category, driving the overall growth of microinsurance. Credit insurance has evolved on the back of credit expansion and was initially driven by lenders seeking to manage the risk of default. As result, it is still sometimes seen as covering the risk of the lender rather than that of the borrower.

Compulsion and captive markets. Credit insurance is compulsory because the lender can insist that the consumer buys it as a pre-condition for a loan. It normally takes the form of life insurance or insurance against payment default. In some jurisdictions, including South Africa, the compulsory element is sanctioned by legislation which allows the lender to insist on cover but gives the borrower the right to choose the insurance provider. In some cases, the cover may not be disclosed to consumers, who remain unaware that they are covered, what the cover costs and even that premiums are deducted as part of their loan repayment or funded in advance out of the loan. Even though South African law gives consumers the right to choose the provider of the insurance policy, they are often not told of this. In practice, therefore, the lender has a captive market to sell its own or preferred insurance policies. As there is little threat of competition, this often results in overpriced premiums.

3 See focus note 8 ("Risk it or insure it") for more details on the difference between access and uptake.

Positive discovery depends on disclosure. In contrast with the South African model, some countries place no obligation on the creditor to give consumers a choice or to disclose the insurance policy. Even when the law requires disclosure, limited enforcement means that lenders have little incentive to disclose, leading to abnormally low claim ratios and poor value for the client. If the compulsory model is to result in a "positive discovery" of microinsurance, the credit client must be told that a policy exists and be informed of its terms.

Potential to offer value to consumers. The attraction of the compulsory model is that it significantly reduces the cost of intermediation. The same network and staff are used to market the credit and sell the insurance policies, and premiums are collected via the loan repayment mechanism. In some cases, these policies have evolved to become more client-centred, offering additional benefits and ensuring that the client can use them.

Compulsion can facilitate positive discovery. Compulsory models run the risk of negative discovery or no discovery at all, but with appropriate regulation they can be a powerful tool to extend insurance to the low-income market. A positive experience with credit insurance may encourage consumers to use insurance for other risks without being compelled to do so.

Reinvention[4]

Spontaneous informal risk-pooling: When formal insurance is not available or unaffordable, low-income communities often reinvent insurance by developing informal risk-pooling mechanisms to cope with risk events. They form burial societies, cooperative insurance societies and other member-based structures to support members. Such informal schemes may evolve over time into formal insurance programmes or remain informal providers of risk cover. Risk-pooling is not always the main catalyst of a community-based institution. Many cooperatives evolve to provide financial and other services, and only start to offer in-house insurance or risk-pooling at a later stage.

Trust in the mutual mechanism. Focus groups showed a lack of awareness and trust of formal insurance, but highlighted community and member-based organisations, such as cooperatives and mutuals, as a trusted source of risk mitigation. This was the case even when member-based institutions were unregulated and much weaker than commercial institutions, suggesting that the trust in them might be misplaced. Nevertheless, such feelings of trust allow mutuals to overcome some of the barriers to insurance uptake.

There is evidence of member-based activity in all the sample countries.[5] In Colombia and the Philippines, the bulk of microinsurance is provided by member-based channels. If the informal market is included, this is also true of South Africa.

Derived demand

Voluntary insurance uptake is often the result of demand for another product or service. Derived demand for microinsurance happens when the client does not set out to purchase insurance and may not even be aware that insurance products exist, but is induced to buy a product because he or she wants another product or service. The secondary demand for insurance is, therefore, derived from the primary demand for another product or service. Examples include the following:

- In South Africa, an expensive funeral is regarded as an "unavoidable expense", pushing people to plan ahead by taking out funeral insurance. The demand for funeral services drives the demand for insurance, rather than the need for life insurance in general. This is supported by the fact that 40% of formal funeral cover in the low-income market is bought via funeral parlours. This is also the case in Colombia, where funeral service providers selling funeral cover –albeit outside the formal definition of insurance – account for more than half the total microinsurance market.
- In India, voluntary insurance, where it exists, often relates to the need to take out insurance to cover spending on healthcare, a service people know that they will not be able to afford when the need arises.

4 See Focus note 9 ("The role and regulation of member-based insurers") for a more detailed discussion on this category of insurer.

5 While cooperatives exist in Uganda, there are no cooperative insurers. Focus groups do, however, indicate some level of informal risk-pooling.

- The South African focus groups revealed that even when people consider non-life insurance important, they will only buy it when it is related to the credit purchase of household goods or a cellphone, which is generally seen as essential for social, business or employment purposes. Demand for cellphone insurance has also increased among Colombia's poor, together with the insurance of motorcycles, a vital transport and business asset for many people.

Distribution through same channel as underlying product or service. Insurance based on derived demand is most often distributed through a service provider, such as a funeral parlour, or a product distributor, for example of mobile phones. They provide a product or service which the client set out to purchase in the first place, reducing the distribution costs of insurance. The credibility of the service or product provider may bolster confidence in the insurance product.

Passive[6] aggregators

Innovative new models are emerging to intermediate microinsurance at a low cost, without attaching it to another product or service. These models may leverage existing client bases, for example retailers, or reach out to large numbers of people through clever marketing combined with low-cost passive sales strategies. For products to be sold through such channels, they must be simplified. Examples include:

- *Retail client bases:* Insurance is sold to the existing client base of a retailer who focuses on the low-income market. The target market consists of the clients of the retailer –the aggregator –to whom the retailer's sales personnel sells insurance products, either passively or actively.
- *Public utilities:* In Colombia, Codenza, an electricity utility company in Bogota, extended funeral insurance to most of its electricity clients by using a tick-box option on the utility bill.

Low cost but limited success. The low cost of distribution in such models is appealing. However, they have had limited success except in regard to funeral insurance, which can be easily commoditised and where other players, such as funeral parlours, have "made the market" using the derived demand model. Passive aggregators can extend existing markets at a lower cost, but the evidence suggests that they cannot create a market for products that low-income clients know less well.

Individual agent-based outbound sales

Greenfield insurance sales. This is the traditional model, in which an individual agent sells insurance which is not attached to another product, typically through a face-to-face interaction with the client or through outbound call centres. Agents generally distinguish themselves from the other channels by advising customers on the appropriateness of the insurance products they sell. Although sales to groups, such as religious groups, trade unions or employers, and the innovative use of technology can reduce the costs involved, this remains an expensive channel. As the insurance must be sold on merit, considerable time needs to be spent with clients to explain the benefits. This is particularly challenging when clients have no previous exposure to insurance.

This model is unlikely to make significant inroads into the low-income market, unless it moves away from the traditional agent model to less traditional channels such as micro-finance institutions and other groups, and their staff, acting as agents (see channels 1-4 in Figure 2). This is particularly the case where market conduct regulation increases the regulatory burden on advice-based sales, as in South Africa.

Inbound vs outbound. The insurance discovery process and the channels through which people are introduced to insurance are shown in Figure 2. It is interesting to note that channels 1-3 are inbound, and clients often acquire insurance while accessing some other product or service. Channel 4 is inbound purely on the merits of the insurance offered, while channel 5 is outbound, providing the means to actively sell insurance on its merits.

6 This refers to the fact that the product is not actively sold to the client. In some cases, it is simply placed on a retailer's shelf or advertised on a poster, and consumers are expected to purchase it of their own volition.

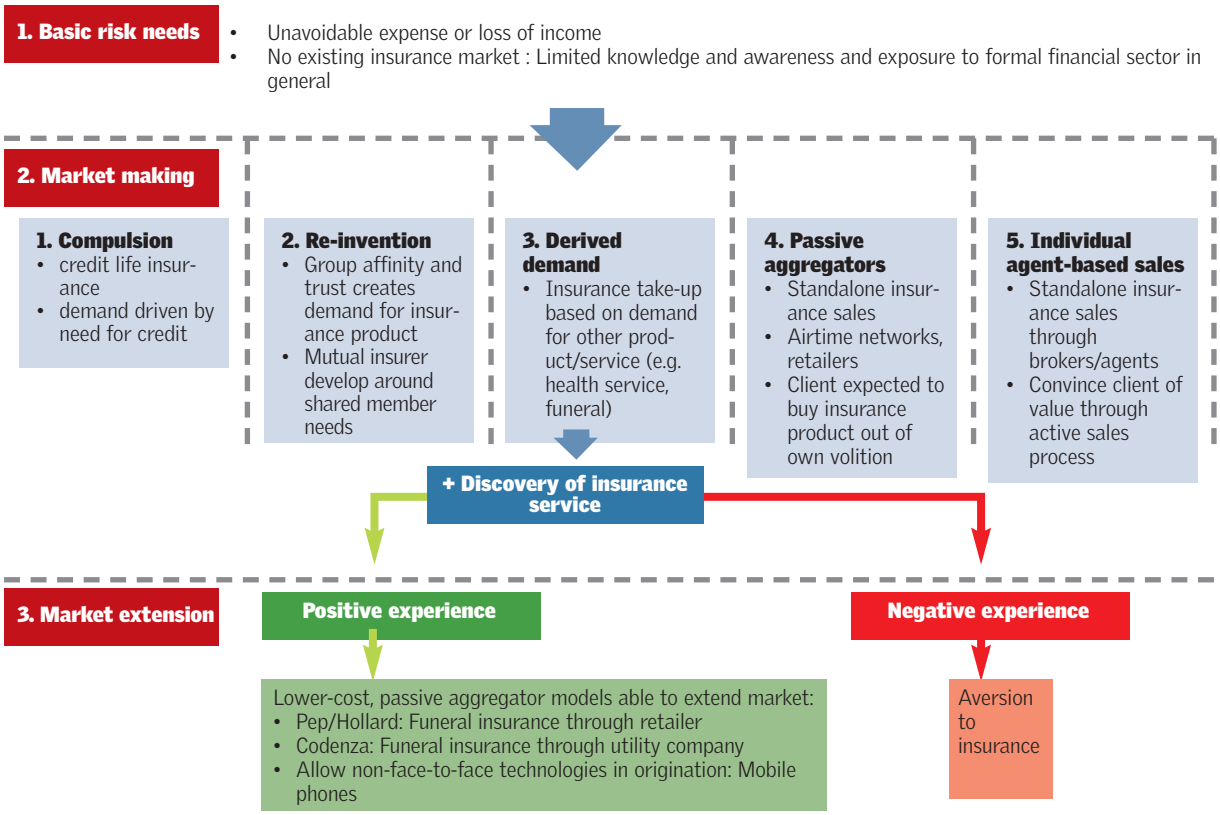

Figure 2: The evolution of the microinsurance market

Source: Bester and Chamberlain, 2008.

4 Implications for players and regulators

What are the implications of the above analysis for market players and regulators? The following need to be considered:

Models required to create a market for microinsurance. Our analysis shows that it is necessary to make a market for insurance and models applied to entering this market must be able to do so. The low-cost and innovative passive aggregator models (channel 4) have great potential for supporting market development, but the evidence suggests that they cannot create a market for new products, as they rely on prior discovery through another channel. Low-cost models are not necessarily successful.

Aligning regulation with market realities. The country case studies indicate that the bulk of microinsurance is sold through channels 1, 2 and 3. However, regulatory models often favour channel 5, as it theoretically provides advice through face-to-face engagement. In some cases, regulatory systems may even restrict distribution to a particular model, typically channel 5. In practice, however, advice-based distribution by brokers and agents may be too expensive for low-premium products, making this model unattractive to insurers.

Limited priority given to consumer protection. Sometimes unintentionally, regulation may also facilitate channel 1 by allowing compulsion. However, few regulators take into account the consumer protection concerns that arise from a captive client base and limited competition. While this channel may be efficient in achieving uptake, incentives are not always in place to ensure positive market discovery. Regulation should ensure that efficient channels, such as credit life, are effective both in encouraging uptake and providing value to clients. It is crucial that the existence of the insurance policy, and its terms, are disclosed.

Regulation needs to accommodate innovation. These categories oversimplify the picture – in reality, there are a wide variety of models which may combine features of different categories. Ten years ago few would have predicted the innovative

use of mobile phones in various distribution models. Regulatory systems that restrict intermediation to traditional agent models may, therefore, exclude these innovations and undermine market development. Given the accelerating rate of change, regulators need to find a way of accommodating innovation while monitoring risks. ■

The focus note series

Focus note 1: What is microinsurance and why does it matter? The rational for microinsurance from a regulator's perspective.
Focus note 2: The role of policy, regulation and supervision in making insurance markets work for the poor: Executive summary and emerging guidelines;
Focus note 3: The role of policy, regulation and supervision in making insurance markets work for the poor: The experience of Colombia;
Focus note 4: The role of policy, regulation and supervision in making insurance markets work for the poor: The experience of India;
Focus note 5: The role of policy, regulation and supervision in making insurance markets work for the poor: The experience of the Philippines;
Focus note 6: The role of policy, regulation and supervision in making insurance markets work for the poor: The experience of South Africa;
Focus note 7: The role of policy, regulation and supervision in making insurance markets work for the poor: The experience of Uganda;
Focus note 8: Risk it or insure it? Understanding the microinsurance purchase decision;
Focus note 9: Ensuring mutual benefit: The role and regulation of member-owned insurers;
Focus note 10: Informal insurance: a regulator's perspective;
Focus note 11: The impact of policy, regulation and supervision on the development of microinsurance markets; and
Focus note 12: Making a market for microinsurance: the success and failure of different channels of delivery.

About this document

To support the development of microinsurance markets, a project was launched under the auspices of the IAIS-MIN JWGMI[I] aimed at mapping the experience of five developing countries – Colombia, India, the Philippines, South Africa and Uganda – where microinsurance markets have evolved in varying degrees.

The objective was to assess how much regulation has affected the evolution of these markets and gain insights which can guide policy-makers, regulators and supervisors looking to support the development of microinsurance in their jurisdiction.

To disseminate the findings of this project, a number of focus notes have been written to highlight themes that emerged from it. This document is the 12th focus note in a series of 12 – six thematic focus notes and six notes summarising each country study.

The project was majority-funded by the Canadian IDRC[II] (www.idrc.ca) and the Bill and Melinda Gates Foundation (www.gatesfoundation.org), with funding and technical support from the South African-based FinMark Trust[III] (www.finmarktrust.org.za) and the German GTZ[IV] (www.gtz.de) and BMZ[V] (www.bmz.de). FinMark Trust was contracted to oversee the project on behalf of the funders. With representatives of the IAIS, the ILO, the Microinsurance Centre and the International Cooperative and Mutual Insurance Federation (ICMIF), the funders are also represented on an advisory committee overseeing the study.

I International Association of Insurance Supervisors (IAIS) and Microinsurance Network (MIN) Joint Working Group on Microinsurance
II International Development Research Centre
III Funded by the UK Department for International Development (DFID).
IV Deutsche Gesellschaft für Technische Zusammenarbeit GmbH.
V Bundesministerium für Wirstschaftliche Zusammenarbeit und Entwicklung - Federal Ministry of Economic Cooperation and Development

These focus notes and other material related to the project can be downloaded at www.cenfri.org.
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