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INSIGHT

**INSURANCE IN
DEVELOPING COUNTRIES:
EXPLORING OPPORTUNITIES
IN MICROINSURANCE**

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EXECUTIVE SUMMARY

- The potential market for insurance in developing economies is estimated to be between 1.5 and 3 billion policies. There is significant demand for a range of insurance products from health and life, agricultural and property insurance, to catastrophe cover.
- Besides profits, there are several other benefits for commercial insurers providing microinsurance: a larger and diversified risk pool, benefits to reputation, and market intelligence and innovation that can be applied to other business activities. In the longer term, the combination of first mover advantages and sustained growth in developing markets can lead to strong future business prospects.
- The success of microcredit worldwide has shown that people with low incomes are a proven market for financial services and are effective consumers if given appropriate products, processes, and knowledge. In the insurance field, microinsurance can provide the specialised insurance products demanded by under-served low income markets.
- Microinsurance already covers around 135 million people, or around 5% of the potential market. In many countries, annual growth rates are 10% or higher.
- The trends that will shape the future of microinsurance include: economic growth, urbanisation, financial sector development, climate change including more extreme weather events and structural adaptation, the rapid pace of product and logistics innovation, and innovative use of communication and information technology (mobile phones, internet).
- Microinsurance is effective even in markets with little experience of insurance, as long as products, procedures and policies are simple, the premiums are low, the administration is efficient, and distribution channels are innovative.
- The main suppliers of microinsurance are commercial insurers. Most international insurers and reinsurers are involved in microinsurance initiatives or offer products directly. At the same time, international organisations, donors, non-governmental organisations (NGOs) and governments are important facilitators.
- Community-based and informal insurance schemes will prove valuable sources of innovation, but it is likely that, as communities develop, opportunities for regulated insurers with appropriate products and processes will increase and these insurers will become market leaders.

INTRODUCTION

Microinsurance is a unique topic for a Lloyd's 360 Risk Insight report. Usually, we advise businesses on managing emerging risks but this report focuses more on opportunity than emerging risk.

Produced by Lloyd's and the MicroInsurance Centre, this report sets out the understanding, mechanisms and partnerships needed to deliver insurance to three billion low income individuals across the globe, and how this will bring benefits to both the developing world and the insurance industry.

Microinsurance is not charity, it is business, but it will require insurers to change their mind-set. How do you sell insurance to someone who has never heard of the concept? How can you adjust claims in remote and inaccessible parts of developing countries, and most crucially, how can you make any money from a policy where the premium is just a few dollars a year?

In many ways, microinsurance challenges insurers to go back to their roots and find quick, cheap, simple ways to provide cover for people who have little money.

The report doesn't pretend that there is easy money to be made in microinsurance. Currently profits are modest, but there is the potential for significant returns in the future. And there are other benefits to the commercial insurer, ranging from developing innovative new policies to building a brand and client base in economies that have largely been untapped. Today's low income communities in China, India or Latin America could be tomorrow's affluent consumers.

We tend to see insurance as a non-discretionary product and, for most of the Northern hemisphere, it is just that. But the picture is very different if you are a farmer in India, existing on a few dollars a day, or newly arrived in Jakarta or La Paz, looking for opportunities in a growing city. From this perspective, insurance is seen either as a luxury product or mistrusted – why should you pay money for something that you can't see, touch or feel?

Of course, it is the poorest people in the world who are most in need of the security that insurance brings. They have little access to health services and they are more likely to live in areas which are prone to floods or natural disasters, a situation aggravated by climate change.

It is tempting to think of the world's poor as living in a far-flung part of the world - permanently poor, cut off from enterprise and reliant on aid parcels. But this is not a true image. The developing world is highly responsive to global trade. The emergence of the Chinese and Indian economies in the 1990s

has lifted 0.4 billion people out of extreme poverty. In 2009, global recession will plunge 50-90 million others back into poverty.

So, over the last two decades, the microfinance revolution has provided financial services to developing countries on a small scale. This has proved successful and if microcredit is helping people to acquire new wealth, microinsurance will help them to keep it.

Microinsurance has focused mainly on insuring health and life. However, agricultural products are now in high demand because of growing food scarcity. Insurance can lessen the impact of a loss of crops or livestock and therefore help raise the living standards in rural areas, as well as pave the way for advancements in the industry as increased revenue spurs on development.

The time is ripe to explore microinsurance. Big players, such as AIG and Munich Re are investing in microinsurance and exploring its commercial viability. Small scale pilots in many parts of the world have already been successful.

This report leaves the reader in no doubt that microinsurance requires a lot of hard work and commitment. No two developing countries are the same: Bangladesh faces flooding, Kenya faces drought and Mexico faces earthquakes and volcanoes. Therefore a tailored approach is imperative and most likely to be successful.

In most cases, insurers need to form partnerships with governments, communities and non-governmental organisations (NGOs). NGOs may be able to identify opportunities and support initial research and community organisations may be able to provide a low cost means of distribution. But it also requires a shift in thinking. NGOs will need to understand that the primary motivation for commercial engagement is profit, and insurers will need to understand that, for NGOs it is about development.

Microinsurance, in Lloyd's view, can be a win-win situation. It is just a question of adjusting the way we work. Reaching for a new mindset and new solutions can move us forward - we are already seeing highly innovative models coming out of the developing world: for example, in some parts of Asia pre-pay cards provide insurance cover for flood damage.

With these high levels of innovation, there is a real possibility that microinsurance will influence a wider sphere than just the developing world. Our conclusions? That innovative insurers who welcome a challenge and have their eyes on long term strategy stand to benefit the most from this new form of insurance.

UNCHARTED TERRITORIES FOR INSURANCE

Low income markets in developing economies are receiving attention from business thinkers in ways that were unimaginable even 10 years ago. Within the private sector, reducing poverty is now seen as an opportunity for business rather than simply corporate social responsibility.

Providing insurance products for low income communities is not a new concept. Classic industrial insurance of the 19th and early 20th centuries was the predecessor of today's microinsurance. Nevertheless, most low income markets in the developing world remain undiscovered by insurers. Less than 5% of people on low incomes have access to insurance – and rarely to the products they need. These are the markets for microinsurance that are beginning to be explored.

What is microinsurance?

The International Association of Insurance Supervisors (IAIS) defines microinsurance as “protection of low income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved.”

However, the concept of microinsurance means different things to different people. Commercial insurers see its potential as a way of reaching large under-served markets. Development institutions, such as the World Bank and the United Nations, focus on its potential to secure poverty reduction. Financial journalists and analysts highlight the size of markets at the “bottom of the pyramid”. Academics argue that financial sector development is as essential as industrialisation for sustainable economic growth.

In essence, microinsurance has the same purpose as traditional insurance – to allow consumers, whether they are individuals or businesses, to transfer their risks and purchase the security they need to live their lives or grow their businesses. Microinsurance, with the promise of profits and welfare gains in markets of billions of clients, therefore, deserves a place in both business strategies and development agendas.

For our purposes we can define microinsurance simply as insurance that is designed specifically for the low income market.

MICROFINANCE, MICROCREDIT AND MICROINSURANCE

Among financial services designed for low income markets, microcredit is best known in the industrialised world, especially since Mohammed Yunus and the Grameen Bank were awarded the Nobel Peace Prize in 2006. Microfinance institutions offer specialised credit, and where regulation permits, savings and other products like leasing and cash transfer services to about 150 million low income people

across the developing world. Some also generate savings among their clients for commercial banks. As The Economist put it in its 2005 Microfinance Survey, “one of the most encouraging trends in microfinance is that the world’s largest banks and insurers are becoming interested.”

While microcredit helps people to grow economically and to move out of poverty, microinsurance helps to make this growth sustainable and prevents people from falling back into poverty. Because of this fundamental link, microinsurance is often sold by microcredit organisations, and often offered in combination with loans. Some microfinance institutions sell insurance as an additional service. Others make insurance compulsory for their clients, for reasons ranging from reduced credit risk to building an insurance culture.

Microinsurance and traditional insurance

Microinsurance draws on the same generally accepted practices as traditional insurance, for example actuarial pricing, reinsurance and claims handling.

However, microinsurance products are not simply downsized off-the-shelf traditional products. Experience of microinsurance in low income markets has shown that there are fundamental differences.

Table (i): Differences between traditional insurance and microinsurance

	Traditional insurance	Microinsurance
Clients	<ul style="list-style-type: none"> • Low risk environment • Established insurance culture 	<ul style="list-style-type: none"> • Higher risk exposure/high vulnerability • Weak insurance culture
Distribution models	<ul style="list-style-type: none"> • Sold by licensed intermediaries or by insurance companies directly to wealthy clients or companies that understand insurance 	<ul style="list-style-type: none"> • Sold by non-traditional intermediaries to clients with little experience of insurance
Policies	<ul style="list-style-type: none"> • Complex policy documents with many exclusions 	<ul style="list-style-type: none"> • Simple language • Few, if any, exclusions • Group policies

Premium calculation	<ul style="list-style-type: none"> • Good statistical data • Pricing based on individual risk (age and other characteristics) 	<ul style="list-style-type: none"> • Little historical data • Group pricing • Often higher premium to cover ratios • Very price sensitive market
Premium collection	<ul style="list-style-type: none"> • Monthly to yearly payments, often-paid by mail-based on an invoice, or by debit orders 	<ul style="list-style-type: none"> • Frequent and irregular payments adapted to volatile cash flows of clients • Often linked with other transactions (eg loan repayment)
Control of insurance risk (adverse selection, moral hazard, fraud)	<ul style="list-style-type: none"> • Limited eligibility • Significant documentation required • Screenings, such as medical tests, may be required 	<ul style="list-style-type: none"> • Broad eligibility • Limited but effective controls (reduces costs) • Insurance risk included in premiums rather than controlled by exclusions • Link to other services (eg credit)
Claims handling	<ul style="list-style-type: none"> • Complicated processes • Extensive verification documentation 	<ul style="list-style-type: none"> • Simple and fast procedures for small sums • Efficient fraud control

As table (i) illustrates, while it is true that microinsurance involves smaller premiums and coverage, the structural differences when compared to traditional insurance can be even more significant. Take, for example, BancoSol in Bolivia, which offers health insurance from Zurich for less than \$5 per month. The premium is surprisingly low, but perhaps more astonishing for a traditional insurer is the fact that the policy is only two pages long and that no medical examination is required.

Low income people in developing countries are exposed to a variety of significant risks to their wealth and life. To manage these risks, they resort to a number of strategies such as:

- Informal risk sharing arrangements
- Conservatism (ie avoiding risky activities)

- Self-insurance through savings, reduced expenditure (including withdrawing children from school) and acquiring additional work
- Emergency credit from family or money-lenders
- Liquidation of assets
- In some countries, selling children into bonded labour.

Several of these common risk management strategies bring with them severe secondary costs to the families, significantly increasing the cost of the loss. When funds are borrowed from money lenders, interest rates are often excessive. In emergency situations, assets such as livestock or land - both critical for continued income generation - are usually sold at a fraction of their full value and then families are left without a source of income. This leaves families in desperate financial situations.

Insurance may not rank high on their list of risk management strategies, but that is usually because an insurance culture is underdeveloped – in fact, their initial perception of insurance may be negative rather than neutral.

Supplying something, which is both new and not trusted, requires investment in market education, sensitivity and realism about whether the product is necessary. In some circumstances, existing risk management practices may work. Others, for example avoiding risk or maintaining high levels of savings, may hamper development.

MICROINSURANCE IN UGANDA: A SUCCESS STORY

In 1997, American International Group (AIG) Uganda entered into an agreement with a microfinance institution (MFI), called FINCA Uganda, to offer insurance products to FINCA's credit clients. The resulting personal accident product was one of the first success stories where a large insurance company proved that microinsurance could be profitable in a low income market.

Six years after the introduction of the product in 1997, most Ugandan MFIs were offering it to their clients. It led to 1.6 million lives being covered in three countries. By 2003 the product was contributing 17% of the profits (\$100,000) of AIG Uganda.

This example attracted much attention in the microinsurance sector and encouraged other large insurers to enter the microinsurance market in several other countries. AIG Uganda became part of Chartis in 2009.

Source: CGAP Working Group on Microinsurance, Good and Bad Practices, Case Study No. 9.

The key to understanding microinsurance is one word: simplicity. Because of the relatively small premiums and claims involved, transaction costs have to be low for both the insurers and the insured. This demands highly efficient products, policies and claims handling processes that avoid misunderstandings.

The need for simplicity may rule out practices such as risk adjusted pricing. It may mean that insurers have to adapt their normal business practices and consider using unorthodox mechanisms for controlling moral hazard, adverse selection and fraud. For example, proxy underwriting, group policies, and waiting periods mitigate adverse selection.

It is critical to assess each decision for its impact. For example, insurers traditionally have a given set of exclusions to reduce their costs and exposure. In microinsurance, many of these exclusions prove needless, yet have a significant cost, as shown by the Madison Insurance case study below.

MADISON INSURANCE: A CASE OF EXCLUSIONS

Madison Insurance in Zambia offered a basic life cover with HIV/AIDS exclusion, which it sold through microfinance institutions. The HIV/AIDS exclusion proved problematic and costly from the outset. Firstly sales agents found the exclusion was time-consuming to explain and this severely limited sales. Secondly, when deaths occurred, additional documentation was required from the beneficiary to prove the death was not due to HIV/AIDS. Furthermore, Madison had to make their checks to determine whether HIV/AIDS had caused the death. Therefore, after about two years of limited growth and costly claims confirmation, Madison decided to eliminate the HIV/AIDS exclusion and noted that, even without it, microinsurance is still “very profitable” for them.

Source: Working Group on Microinsurance. Good and Bad Practices in Microinsurance, No. 10, 2005.

THE LANDSCAPE OF MICROINSURANCE: PRODUCTS AND MARKETS

The demand for microinsurance

Currently around 135 million, or 5%, of low income people in developing countries are using microinsurance products. But the low income market size, if measured by the number of potential clients, is several times larger, amounting to 1.5 to 3 billion potential policies.

According to research carried out by Swiss Re in 2007, most growth in the insurance industry over the past decade has come from the wealthy and middle income markets in emerging economies. Premiums grew by 3.3% globally and by 11.8% in the emerging markets in that year. In part this was due to a growing number of clients moving into the wealthy and middle income brackets in these countries, but it is also attributable to insurance expanding into new markets.

Traditional insurance serves affluent markets, mainly in industrialised countries, where insurance penetration is high and markets often seem saturated. However, this market is notably smaller for the lower income countries.

Many low income people are insurable in that they have assets and livelihoods to protect, and sufficient incomes to pay premiums. However, most do not have insurance as they are unfamiliar with the concept of insurance as a risk management tool. Educating them on the potential benefits of insurance is the first challenge for microinsurance providers.

Research has shown which risks cause most concern to low income people. Table (ii) summarises the available surveys. Risks to health (hospitalisation costs) are the priority concern, followed by death of the breadwinner. In rural areas, loss of crops and livestock, as well as price fluctuations, are considered to be important risks.

Table (ii): Priority risks for low income people in selected countries

Country	Priority risk
Uganda	• Illness, death, disability, property loss, risk of loan
Malawi	• Death (especially in relation to HIV/AIDS), food insecurity, illness, education
Philippines	• Death, old age, illness
Vietnam	• Illness, natural disaster, accidents, illness/death of livestock
Indonesia	• Illness, children's education, poor harvest
Lao PDR	• Illness, livestock disease, death

Georgia	• Illness, business losses, theft, death of family member, retirement income
Ukraine	• Illness, disability, theft
Bolivia	• Illness, death, property loss including crop loss in rural areas

Source: Overview of surveys in Churchill, edited 2006

Table (ii) indicates a demand primarily for health insurance, life insurance and agricultural insurance. However, extrapolating from risk perception to demand for insurance products should be done with great care. Experience has shown that low income groups will not necessarily choose formal insurance as a risk management tool. Entering a low income market requires a thorough understanding of potential clients' needs, options, and resources for coping with risks; and an ability to respond to these needs with products.

Microinsurance supply chains

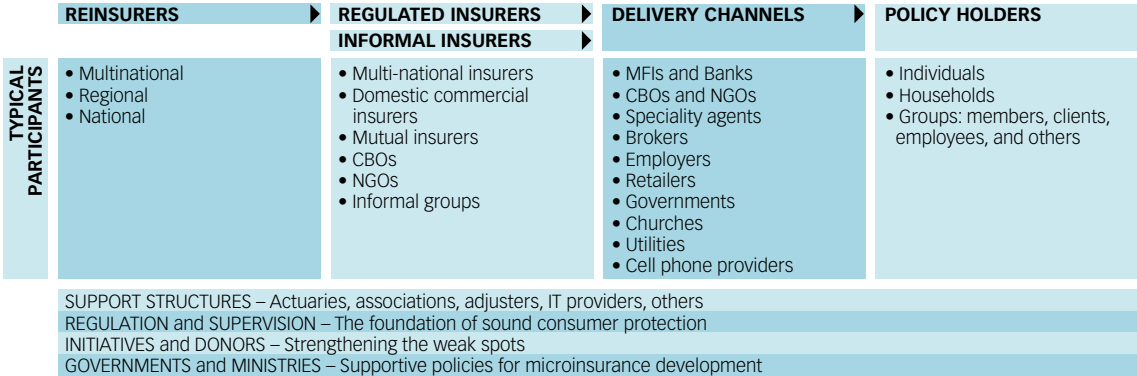
A variety of businesses and organisations are engaged in microinsurance and they often join forces in diverse, and at times, innovative ways to deliver services to clients.

Typical models include:

- Partnerships between commercial insurers and MFIs and other delivery channels
- Regulated insurers that serve low income clients directly, often with separate agents
- Healthcare providers offering a package which includes both insurance and healthcare services
- Community-based organisations (CBOs) that pool risks and/or funds of members
- MFIs that offer insurance to their clients and act as risk carriers themselves
- Government-subsidised insurance schemes

Figure 1 gives an overview of key actors and their possible roles in a supply chain.

Figure 1. Key players in a microinsurance value chain



Not all the organisations involved in the supply chain are discussed here, as this report focuses primarily on commercial insurers that provide microinsurance products for profit in the long term. Within that context, the following observations can be made about the involvement and role of the different market players:

Insurers

Both national or multinational insurers set the price for products, carry the risks and pay claims. Their products may be developed with distributors, which, in many cases, initiate the collaboration.

Insurers may be regulated or unregulated. Unregulated microinsurance providers are usually small and tend to be community-based organisations and NGOs. Mutuals, run by professional insurance staff, are normally regulated and supervised, sometimes under a Cooperatives Act.

Most of the large international insurers are already involved in microinsurance in some way, either offering microinsurance products or entering partnerships with local insurers and delivery channels in developing countries. Several multinational insurers, including Zurich, AIG and Allianz, now have microinsurance units at their head offices to focus on expanding microinsurance business throughout their networks.

Reinsurers

Many of the world's leading reinsurance companies are involved in microinsurance initiatives. In some cases they provide support in product development, in particular for index-based insurance; in others they reinsure microinsurance schemes (eg Munich Re, which has entered a partnership with a Colombian insurer, Sudamericana, to support microinsurance).

So far, the role of reinsurers has been relatively limited, as most microinsurance is still rather basic. Insurers argue that the covers are so low that even significant losses would not surpass the deductibles on their reinsurance agreements. This is likely to change as products become more sophisticated and market penetration increases.

Microinsurance delivery channels

Delivery channels are essential for bringing products to clients for whom insurance may be fundamentally new. MFIs, NGOs, post offices, employers and other organisations with large networks have the potential to reach significant numbers of clients at low cost.

Because microinsurance premiums are small, delivery channels tend more often to be institutions rather than individual agents. Specialised brokers, such as the Gates Foundation funded MicroEnsure, or commercial brokers such as Aon in Bolivia, act as mediators between insurers and institutions wishing to provide insurance to their members or clients. Sometimes institutions that act as delivery channels take on the role of the primary insurer – an example being some MFIs which offer life insurance and keep the risk on their own books.

Policyholders

Besides individuals, clients may also be groups, such as companies or cooperatives.

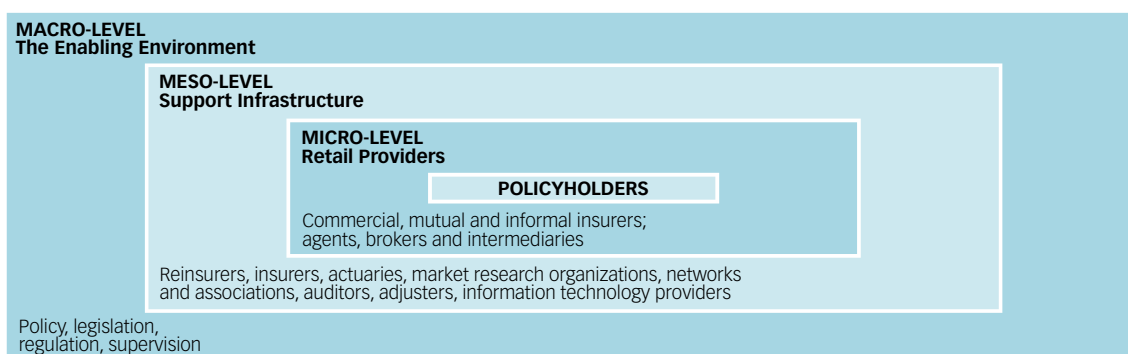
Participants at the meso and macro levels

These participants include government policymakers, regulators and supervisors, international organisations, local and international NGOs, consultants, actuaries, providers of IT services and communication experts. They are not directly in the microinsurance supply chain, but they shape the business environment and provide some of the capacity that allows microinsurance to prosper.

For example, international organisations, NGOs and donors initiate and facilitate microinsurance market development in many countries. Donors typically support the research and development stages where neither insurers nor delivery channels have the ability or the will to invest in microinsurance. Donors also finance market education campaigns, or finance the market studies that provide the quantitative basis for business strategies. This research is important, as risk data and information have been significantly limited to date, resulting in higher loadings to compensate for the uncertainties of the microinsurance market. Donor support also includes a variety of capacity building and technical assistance programmes, such as those offered by the Gates Foundation funded International Labour Organization Microinsurance Innovation Facility.

Another major Gates Foundation funded intervention is the Access to Finance Initiative (AFI) which works to develop capacities between emerging and developing countries to dramatically enhance the volume and quality of financial products, including microinsurance, to and between low income markets. Launched in November 2009, Access to Insurance Initiative (A2II) is intended to “enhance broad-based, demand-oriented and sustainable access to insurance for low income clients; thereby growing financial inclusion in the insurance sphere”. This partnership is hosted by German Technical Cooperation (GTZ) and partners include the International Association of Insurance Supervisors.

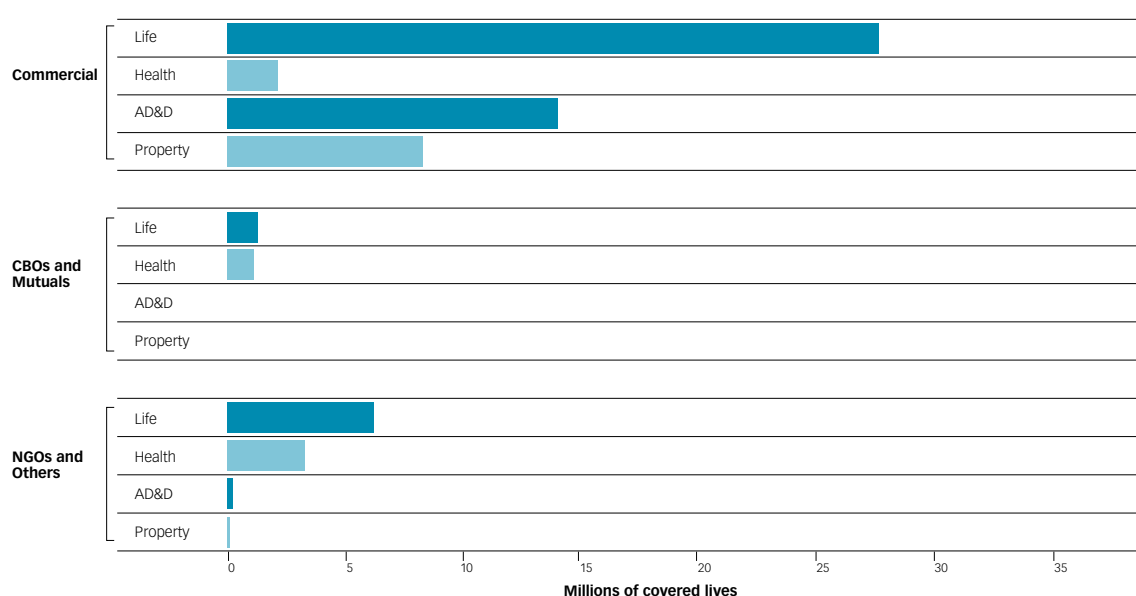
Figure 2. The role of policy and regulation in shaping the business environment of the microinsurance sector



Microinsurance products: an overview

It is estimated that microinsurance now covers about 135 million people. Solutions are offered for most risks covered in the traditional markets: life insurance, health insurance, accidental death and disability, and property insurance.

Figure 3: Covered lives by microinsurance product and insurer



Source: 2007 Landscape Study, MicroInsurance Centre (figures exclude the almost 30 million lives covered by the All China Federation of Trade Unions at that time)

Figure 3 shows the distribution of the main product lines among the three major microinsurance-providing entities: commercial; community based organisations (CBOs) and mutuals; and NGOs and others. As can be seen, for all product lines except health insurance, commercial insurers supply the largest percentage of policies. In many countries, the market is heavily concentrated, with one insurer accounting for the largest part of insured lives. Health insurance is provided largely by NGOs and other risk carriers, which are in some cases subsidised by donors.

Property insurance

Demand for property insurance tends to be much lower than for health and life insurance. Providing coverage for fire, theft and flood is difficult in low income markets. Some of the challenges include: lack of title deeds for informal housing, high claims handling costs and the difficulties of managing fraud risks. Also low income communities are often located in areas with higher exposure to natural hazards.

Demand for agricultural insurance (crop and livestock) is very strong in most rural areas. However, the costs and risks associated with small farmer cover can be major, especially if payouts are managed on an indemnity basis. Claims are difficult to validate, and moral hazard and fraud risks are high.

Catastrophic losses to property and agriculture are becoming more visible, and are attributed in many instances to the impact of climate change. Reinsurers including Partner Re, Swiss Re and Munich Re, have become active in this market. A consortium including the International Finance Corporation and Partner Re have combined efforts to develop a new reinsurance company, Index Re, specifically to address some of these issues. At the same time, much is being done to consider the related issues of adaptation, recognising that the effects of climate change related catastrophes may be better addressed through adaptation.

Index insurance

Index insurance is being proposed as a solution to the problems of property insurance, especially for drought in the agricultural sector and catastrophic risks such as floods, earthquakes, and typhoons. For a holder of an index policy, payments do not depend on his or her individual losses but on an objective index such as rainfall level or earthquake magnitude. Once an index is calibrated and correlates well with actual losses, underwriting and claims verification costs for the insurer are minimal and moral hazard and fraud are virtually eliminated.

On the supply side, investments in weather index insurance are considerable and reinsurers, such as Munich Re and Swiss Re, are heavily involved in research and development in this area. There is an increasing variety of products being tested in pilot projects across the developing world (examples of which are outlined in the following case study).

INSURING GOVERNMENTS: MEXICO AND THE CARIBBEAN

FONDEN, the Mexican natural disaster relief fund, provides a good example of a government buying a macro index insurance product. Swiss Re suggests that this is the first index insurance product bought by a government and the first catastrophe bond issued in Latin America.

The index reinsurance solution for FONDEN provides cover for earthquake risks that are beyond the capacity of the fund. According to Swiss Re “three events of \$150 million each... are covered within a three-year period.” The index is based on earthquake magnitude as measured on the Richter Scale. Part of the risk is placed on the capital markets as Cat Bonds (\$160 million) and the remainder is reinsured.

A further example of macroinsurance aimed at indirectly protecting low income groups through insuring governments is the Caribbean Catastrophe Risk Insurance Facility (CCRIF), which involves the Lloyd’s market on the reinsurance side. CCRIF was set up in 2007 with funding and support from the World Bank and other donors. It pools the natural catastrophe risks of 16 Caribbean countries into one facility and offers coverage that was previously unavailable in the commercial markets, or only at high costs. The facility paid over \$6 million to the Turks and Caicos Islands after Hurricane Ike and has expanded to

provide greater coverage at each subsequent renewal. The success of CCRIF is expected to be followed in other catastrophe exposed regions and several initiatives are already underway.

Source: Swiss Re, sigma 1/2007; CCRIF “Scaling up index insurance”, MicroInsurance Centre, 2007.

Life insurance

Life insurance is the most prolific microinsurance product in developing countries according to the number of policies sold. Most of this is credit life insurance, typically compulsory and covering the outstanding balance of a loan on the death of a borrower. Overall, most life microinsurance products are short term.

Term life insurance is easy to provide, and has already proved to be profitable. Many MFIs offer mixed credit and life insurance. An example is the microfinance arm of ABA (Alexandria Business Association) in Egypt: if a borrower dies, his or her family receives the full initial loan sum less the outstanding credit.

There is high demand for life insurance that provides more substantial coverage in case of death of the breadwinner. In many African countries, for example, life insurance that covers funeral costs is very popular.

“The products most in demand in this under-served market, such as health insurance, are precisely those that are the least available “
Craig Churchill, ILO

Health insurance

Almost all surveys have shown that health insurance is the product most demanded by low income groups. Health issues not only mean treatment expenses, but also result in income losses, not only for the affected person, but also for family members who, whilst providing care, may not be able to engage in productive work.

The health microinsurance products that are available are limited, relatively small in terms of lives covered, and in some cases, donor-funded and subsidised. Nevertheless a number of schemes exist. Outpatient, hospitalisation and comprehensive policies are available in several countries. Variations include hospital cash models, which provide a fixed sum per day in hospital, and targeted benefit models, which provide coverage for a precisely defined list of treatments.

“Increasingly, however, supervisors and other microinsurance promoters realise that a more conducive and enabling regulatory environment is required for the development of microinsurance.”
LAIS

Accidental death and disability

Demand for this coverage is high and this is also a common microinsurance product. Accident cover is one way for insurers that are not life insurers to legally address a type of life cover. Disability is more difficult to manage with efficient and cost effective controls.

MICROINSURANCE REGULATION AND SUPERVISION

Government policy on microinsurance has to strike a delicate balance between promoting access to insurance and protecting consumers. On the one hand there are new market-focused microinsurance providers that need to be given time to experiment, evolve and grow. On the other hand there are the priorities of institutional and systemic stability, as well as consumer protection; all related to ensuring trust in insurance in the long term.

What are the policy options and current practices in microinsurance market development and regulation? What are the roles of the public sector, donors and international organisations in contributing to a business environment that stimulates microinsurance development?

“Stand-alone microinsurance still faces many obstacles which can be overcome by public-private partnerships.”
Michael Schwarz,
Swiss Re

INDIA: MICROINSURANCE QUOTAS FOR THE INSURANCE INDUSTRY

The year 2002 marked a revolution for Indian microinsurance. In that year it became a legal requirement for all insurers doing business in India to provide insurance to the “rural and social sectors”. This legislation, and its amendments in later years, was aimed primarily at bringing insurance to low income groups.

Existing insurance monopolies had to ensure that their microinsurance business did not fall below a specified volume, while a system of increasing quotas set targets for new entrants into the market. For example, in a company’s first business year 7% of new life insurance policies have to be policyholders from rural areas – a quota which rises to 20% over ten years. Sanctions for failing to meet quota targets include fines and possible revoking of licences. Currently six million people in the quota markets are covered under life insurance policies and more than 10 million under non-life insurance.

Because the new legislation ensures that all commercial insurers are involved in microinsurance, there has been a surge in product innovation and experimentation with new distribution channels. The negative side of the legislation has been evident with some insurers offering products with little value apart from satisfying the letter of the law. Others stopped selling microinsurance policies as soon as they met the quota. As not all insurers consider low income markets as a profitable opportunity, a significant proportion of the six and ten million lives covered may not even be in the low income markets. Even with the current regulations in force, the penetration of the microinsurance market in India remains only at an estimated 2% of the adult population. The total market for microinsurance in India is estimated between 140 and 300 million policies.

Some commentators have suggested that if the regulator is set on such mandated growth, and if some suppliers see this as simply a cost of doing business in India, it may be more productive to approach the market with tradable credits whereby surplus units could sell their excess to deficit units.

Sources: Infrared Data Association, Micro-Credit Ratings International Limited

Why microinsurance requires regulatory caution

Good microinsurance regulation builds on the same principles as regulation for traditional insurers, such as solvency and the protection of policyholders from marketing abuses. However, given the differences in scale and structure, regulation of this sector may differ from traditional insurance in decisive details in the following ways:

Delivery channels: Instead of requiring specialised, licensed agents, regulators could accept the sale of simple products by unorthodox (cross-selling) institutional agents or individual agents with limited insurance expertise.

Insurance risk control: Regulators could recognise policies with few exclusions, and also recognise alternative control mechanisms such as proxy screening, short term contracts, waiting periods or limited benefits. A possible trend for efficient regulation may lie in risk-based approaches. For example, the simplicity of most microinsurance products could justify simplified reporting, and minimum capital requirements could be adapted to their low-risk characteristics.

Premiums: Regulators could recognise alternative calculation methodologies, and accept undifferentiated premiums or group pricing adapted to limited actuarial data, limited information on policyholders and different (or in some cases unknown) risk structures.

Policies: Regulators could approve simple products and accept simple policies phrased in language that is understandable to low income consumers.

Claims handling: Regulators could recognise fast and cost-effective settlement mechanisms, which may include simpler documentation requirements and possibly even include claims handling by the distribution channel. There should be simple recourse possibilities for policyholders in case of disagreement, such as an easily accessible ombudsman, at least in more urban areas.

Looked at from a cost-benefit perspective, the regulation of microinsurance should neither lead to prohibitive compliance costs for insurance providers, nor add to the total costs of insurance for consumers. In addition to the nominal price of a policy, opportunity costs could include the working time lost to premium payments and claims settlement.

SOUTH AFRICA: A FINANCIAL SECTOR CHARTER

South Africa has one of the highest insurance penetration rates in the world, yet poverty rates remain high and low income groups still find it difficult to access financial services. The Financial Sector Charter, which came into effect in 2004, was drafted by industry representatives and other stakeholders with the objective of “transforming the financial sector.”

With regard to insurance access, the Charter states the following targets for 2014:

- 6% of the low income population (1.2 million) to have access to short term insurance
- 23% (4.5 million) to have access to long term insurance
- 0.2% or more of post-tax profits of all financial institutions, including insurers, to be invested in consumer education

Criteria for effective access include physical access as well as a range of appropriate products, affordably priced and understandable for low income consumers.

The Centre for Financial Regulation and Inclusion (CENFRI) summarises the positive impact of the Charter as follows: “Financial inclusion policy drives low income market expansion and triggers innovation. The access targets in the Financial Sector Charter have been the main driving force in formal sector expansion over the past few years. Bringing down transaction costs has been essential in the attempt to achieve this. Intermediation innovation has emerged as the most viable avenue for achieving lower transaction costs and larger scale reach.”

Under the Charter, each participating financial institution is given a yearly rating in order to measure progress of institutions and the sector overall. The annual review of 2007 is optimistic about achieving the targets set for 2014.

Sources: CENFRI (2009), www.fscharter.co.za.

Policy options and supervisor practices

In many emerging economies, the insurance supervisor has an additional market development role. Examples include the Insurance Regulatory and Development Authority in India, and similar structures in South Africa, Brazil, the Philippines and China. Supervisors combine the supervisory and development mandates in various ways. Five general strategic options have emerged:

A. Motivating existing insurers to adapt or innovate their systems, products and sales strategies.

One approach, which could be called the compulsion strategy, is to require local insurers to underwrite minimum levels of microinsurance, as is the case in India. Instead, or in addition, insurance supervisors could choose to promote market research to enable insurers to assess the business opportunities. Workshops on microinsurance are also a good way of promoting learning and initiating collaborations between insurers, distribution channels and regulators. Finally, foreign

insurers may also be allowed to undertake microinsurance activities. Competition resulting from their addition may lead to lower premiums and increase the diversity and quality of products offered.

B. Motivating informal insurers to formalise and grow in a sound way.

Informal microinsurance schemes, often community-based and providing health benefits for their members or large burial societies acting outside any legal mandate, can make up a significant share of the low income market. For example, in Colombia, according to CENFRI, such schemes make up 52% of the market, primarily funeral parlours providing funeral insurance. It is worth noting that informal does not necessarily mean illegal.

Regulatory barriers and burdens, such as minimum capital requirements, can be adapted in order to encourage formalisation of informal schemes. The supervision of an expanded number of formal insurers contributes to stability and provides additional consumer protection by limiting abuse. Furthermore, once informal microinsurance schemes are formalised, the opportunities for an insurer to grow its business may improve due to more professional management and marketing as well as possible regional diversification.

C. Facilitating new microinsurers

In a facilitative approach to regulation, microinsurance may be differentiated as a separate business line with its own regulation of portfolios, products and delivery (as is already happening in India, Peru and Mexico). Alternatively, a new tier of insurer could be created with a special microinsurance licence, such as the Mutual Benefit Associations overseen by the insurance supervisor in the Philippines.

D. Motivating insurance take-up on the demand side

This strategy could take two forms: firstly, the introduction of economic incentives, such as tax exemptions and subsidies; and secondly, market education and the promotion of an insurance culture in low income markets. The strategy could include the building of trust through consumer protection.

E. Integration of microinsurance policy into financial sector and other policies

Microinsurance often suffers from a lack of coordination among policy makers trying to facilitate cover for the low income populations. Many different government authorities can be involved, such as the agriculture ministry developing livestock and crop insurances, the health ministry with health insurance, fiscal authorities with their tax policies, the cooperatives authorities governing cooperative insurance, the banking supervisor who might restrict the ability of MFIs to act as agents for insurance, and of course the insurance supervisor. Often the lack of coordination between these policy makers causes conflicting approaches, and confusion in the markets. Clarifying the roles of the different parties and joining in a unified approach to microinsurance, such as through the Financial Sector Policies of Colombia and South Africa, can have an important positive impact on the rational expansion of microinsurance.

These five policy options may be integrated into regulations in different ways. Some countries, such as India and the Philippines, have specific microinsurance regulations, while other countries, such as Ghana, are integrating microinsurance policy into existing regulation.

CHINA: REGULATOR-DRIVEN MICROINSURANCE DEVELOPMENT

In one sense, microinsurance has a long tradition in China. The All China Federation of Trade Unions (ACFTU) provides limited coverage to around 30 million members for health, property loss, unemployment and other risks. In another sense, microinsurance is a recent development: According to China Today a farmer from Shanxi Province bought a life insurance policy from China Life Insurance on 3 September 2008, reportedly “the first microinsurance deal in rural China”.

Microinsurance development in rural China is mainly regulator-driven and often discussed in a social security context, a model sometimes labelled as “government support, peasant participation, commercial operation”. The vision of the China Insurance Regulatory Commission (CIRC) includes “a tailor-made, multi-level rural insurance system with wide coverage,” according to its chairman Wu Dingfu. He adds “CIRC will develop various customised property insurance, life insurance and other insurance products and encourage cooperation between the government and insurance companies.” CIRC’s policies include subsidies and the formation of new, specialised agricultural insurance companies.

A diversity of products are currently offered in pilot projects by many of the large insurance companies. They include health insurance, livestock insurance, credit insurance, migrant worker insurance and products for old-aged people. China Life Insurance Company covered 700,000 lives in such a pilot in one region and The People’s Insurance Company (Group) of China Limited (PICC), the biggest market participant, aims at covering 900,000 lives before 2012. Another example is the Sinosafe Insurance Company, which insured 400,000 student loans in 2008.

The vast size of the rural Chinese market, an estimated 800 million people, has attracted the interest of international insurers. Zurich Financial Services, for example, is engaged in microfinance initiatives in China. RMS, a Risk Modelling Agency, has developed a microinsurance product against earthquake losses that could provide cover for 55 million low income people for a premium of \$1.50 – and on a commercially sustainable basis.

Sources: China Today blog, China Daily, Munich Re, RMS, GTZ.

The question of how to regulate microinsurance raises a real policy dilemma. In the short term, excessive and premature regulation may stifle development of microinsurance markets. However, if there was no regulation at all, a longer-term consequence could be negative experiences for policyholders, which may set back insurance market development by years. In some instances, regulatory forbearance may be a facilitative strategy, but over time market participants will appreciate appropriate adapted regulation and its enforcement.

At the initial stages, regulators may wish to confine their activities to ensuring that no harm is being done to the development of a microinsurance sector. Supervisors may see benefits in closely observing

and evolving with microinsurance markets, both in their capacity and their regulatory practice. In the early stages of market evolution, a lack of regulation is rarely a limiting factor. In the long term, however, supervision will be an essential ingredient in the sustainable growth of microinsurance.

TEN 'EMERGING' MICROINSURANCE POLICY GUIDELINES

A recent publication by the Microinsurance Network and the Centre for Financial Regulation and Inclusion (CENFRI) makes ten recommendations for good microinsurance regulation in the form of emerging guidelines for policymakers, regulators and supervisors.

Policy guidelines

1. Take active steps to develop a microinsurance market.
2. Adopt a policy on microinsurance as part of the broader goal of financial inclusion.

Prudential guidelines

3. Define a microinsurance product category.
4. Tailor regulation to the risk character of the microinsurance product category.
5. Allow microinsurance underwriting by multiple entities.
6. Provide a path for formalisation.

Market conduct guidelines

7. Create a flexible regime for the distribution of microinsurance.
8. Facilitate the active selling of microinsurance.

Supervision and enforcement

9. Monitor market developments and respond with appropriate regulatory adjustments.
10. Use market capacity to support supervision in low-risk areas.

THE FUTURE: A BILLION CLIENTS IN 10 YEARS?

The MicroInsurance Centre estimates that over the next 10 years the microinsurance market could grow to one billion policyholders, a third of the potential market of 3 billion and seven times more than today's estimated market size. This shows the potential of microinsurance both as business and as outreach to low income groups. Assuming microinsurance will grow in this way, how should we tackle the critical challenges of such massive growth?

We begin with the short term future, and examine five areas:

- Product innovation: What products will emerge in credit life insurance, health insurance and agricultural insurance?
- Distribution models: Which partners - NGOs, community-based organisations, international reinsurers, donors, MFIs or governments - do we need to work with?
- Technological development: Which high tech solutions will work in low income markets?
- Insurance culture in low income markets: How can we assist potential customers to become familiar with insurance, and better understand low income markets ourselves?
- Changing risk landscape: Which factors - population growth, economic development, urbanisation, and climate change - will characterise this market in the future?

"We are currently at the crossroads for microfinance to become a fully fledged and recognised global industry service.

Microinsurance will follow microfinance."

**Peter Hoppler,
Swiss Re**

"Only the commercial insurance sector has the resources (financial and technical) to massify microinsurance outside of social security."

**Jim Roth,
LeapFrog Investments**

Table (iii): Strategies for overcoming key challenges for the growth of microinsurance

Clients	<ul style="list-style-type: none"> • Cultivating an insurance culture in low income markets • Satisfying unmet needs and demands for new risk management tools • Providing effective client education • Offering real value for money
Insurers	<ul style="list-style-type: none"> • Finding new business and distribution models • Building staff and management capacity • Enhancing efficiency by organisational and technological innovation • Managing and leveraging a paradigm shift to product and process simplicity • Identifying profitable schemes

Regulators

- Removing regulatory obstacles
- Adopting a market development agenda
- Incentivising commercial insurers to move into lower-income markets
- Developing systematic and comprehensive approaches to regulation

Environment

- Generating and using reliable insurance data
- Contributing to stable macroeconomic conditions
- Preparing for climate change and catastrophic risks
- Developing an infrastructure to facilitate catastrophic risk insurance approaches
- Implementing effective market education programmes
- Improving healthcare facilities

Source: Botero et al, 2006, The Microinsurance Compendium.

Product innovation

A 2005 survey by The Economist found financial services for low income communities to be either inaccessible or of “awful” quality. One noticeable change has been a greater diversity of interesting products.

Life insurance

A significant proportion of microinsurance in the developing world remains credit life insurance: around 30% on average. Many criticise the compulsory credit life insurance provided by MFIs on the grounds that it can be overpriced and aims to protect credit portfolios rather than give value to clients.

However, there are some more optimistic evaluations. Credit life insurance is generally cheap to distribute and can serve as a good starting point to familiarise clients with the concept of insurance. Moreover, better value for policyholders can easily be added to basic credit life products once they are introduced and prove profitable. For example, policy terms can be decoupled from loan durations and much higher coverage than just the loan balance can be offered.

Health insurance

“Among all the uncertainties and challenges faced by low income people in their day-to-day lives, most of the communities tell us that health is the top priority,” writes Francis Somerwell of Microcare, a health insurer in Uganda. Demand surveys in low income markets invariably confirm this observation. But the practical difficulties of health insurance are daunting. Claims handling is expensive because of the large numbers of cases. Access to healthcare and/or quality of healthcare may be poor in a particular country,

which limits the value of any health insurance provided. Other problems that are expensive to control are fraud, both by those insured and healthcare providers; as well as moral hazard and anti-selection.

Nevertheless, the demand and supply challenges have been a stimulus for innovation, and there are now a diversity of health insurance solutions, mainly in Africa. Prospects for success are unclear at this stage, but it is possible that as insurance improves access to healthcare for low income groups, the increased demand and more effective control of costs and fraud may lead to a “big push” in the quality and quantity of healthcare provided.

Agricultural insurance

Agricultural insurance is widely available for large producers in industrialised countries, although even in these countries, few such schemes have proved economically sustainable without subsidies. Agricultural insurance ranks second in many demand surveys. Small producers in developing countries want it mainly to cover loss of crops, livestock, plantations and farm equipment. Challenges for insurers include the high cost of distribution, the high costs of loss assessment and claims handling, and difficulty in controlling fraud and moral hazard. Local schemes struggle with correlated risks, such as droughts, that affect whole regions and therefore most clients. Nevertheless some isolated success stories exist, most of them subsidised.

Index insurance

Index insurance or parametric products appear to be promising solutions for some of the challenges of agricultural insurance, particularly weather-related risks. Once a product is calibrated, there is no need for individual assessments of insured values and risks, and in the case of claims, no adjustment procedure. The index, measuring for instance too much or too little rainfall, determines the payments.

Reinsurers have invested heavily in the development of index solutions, often in collaboration with research institutes and primary insurers. IFC of the World Bank Group has initiated a Global Index Reinsurance Facility and Swiss Re has declared “agricultural risk solutions” a top priority. A large diversity of index products are currently being tested in pilot stages.

Reactions to some of these products have been mixed. One perceived drawback is basis risk: the possibility that a particular policyholder or group of policyholders will not receive payment despite having suffered damage. Distribution options are being tested, including distribution through lenders, group policies for large cooperatives and associations, and index insurance for public sector entities or a government as a whole.

INDONESIA: INDEX-BASED FLOOD INSURANCE WITH A CREDIT CARD SIZED POLICY

Inhabitants of certain areas of Jakarta are being offered flood insurance in the form of a card valid for one year. If water levels at a given gauge rise above the “trigger” of 9.5 metres, holders of the card can claim a payment of 250,000 Indonesian Rupiahs (\$26). The premium is 50,000 Indonesian Rupiahs (\$5.2). As an index product, the flood insurance requires neither assessments of flood risk, nor of property values, nor a claims adjustment procedure in case of damage. Coverage can be increased by buying several cards.

The product, launched in May 2009, was developed by GTZ, Munich Re (reinsurer), and Asuransi Wahana Tata (insurer and risk carrier).



Source: Munich Re, Asuransi Wahana Tata.

PHILIPPINES: TYPHOON INDEX CROP INSURANCE FOR RICE FARMERS

Under this index insurance, payout to a policyholder is triggered if their farm lies within the path of the typhoon. The sum paid out depends upon three factors: coverage, distance from the typhoon path and wind speed. Premiums are at 8-10% of production cost.

The product is marketed by MicroEnsure, a microinsurance agent, which has also led its development. Malayan Insurance Co. is the underwriter, Paris Re the reinsurer. Data for the index is provided by the Japan Meteorological Agency. Banks, MFIs, Cooperatives and farm suppliers sell the policies.

A pilot, launched in Spring 2009, offered policies to about a 1000 farmers. MicroEnsure hopes to have 2000 to 3000 policyholders by the end of 2009 and up to 3.5 million joining over the next three years. “Now that climate change is disrupting the usual weather patterns and threatening the country’s food security, farmers are more in need of insurance protection against the elements,” explains EG Manuel of Malayan Insurance Co.

Sources: MicroEnsure, Malayan Insurance, Yuchenco Group, BusinessWorld online.

Innovating the microinsurance value chain

The distribution model for bringing simple insurance products to low income groups is usually a partnership between an insurer who carries the risk and a distributor with established relationships with a large number of clients (for example the MFI Compartamos in Mexico with over 800,000 low income borrowers). How efficiently this model evolves depends on governments, regulators and donors and on further capacities being available in the market.

Meanwhile interesting new options are being explored in several countries:

Insurance as a commodity

Can simplification be pushed so far that insurance becomes a commodity that can be sold by almost anyone? Index insurance solutions are advances in this direction. Another example has been a personal accident product distributed as a policy printed on fertilizer bags in India by Iffco-Tokio.

Unorthodox delivery channels

Any institution with access to low income clients may sell insurance provided local regulations allow this. Funeral parlours in South Africa and elsewhere sell funeral insurance. Life insurance is sold from internet kiosks in India. Vendors sell livestock index products in Mongolia. An insurer in Eastern Europe plans to have property products delivered by tax collectors. The future will see significant expansion of microinsurance through a vast array of such unorthodox delivery channels.

Reinsurance for local mutual schemes

According to Ralf Radermacher of the Micro Insurance Academy, “Mutual schemes ... must be able to cede risk to reinsurers and to obtain the necessary capacity building. This allows the advantages of small groups to be combined with an insurance necessity: pooling on a large scale”.

The advantages of such schemes include social control of adverse selection and fraud, as they are locally based and share risks informally among their members. However correlated risks, such as droughts or epidemics, may overstrain their capacities. The linking of small, local, mutual schemes to primary insurers in the formal sector will present an opportunity, particularly if these schemes are pressurised by insurance supervisors to move to the formal sector.

Classical reinsurance

For small schemes, the benefits of working with reinsurers, apart from the reinsurance itself, would include capacity building, risk management support and collaborative product development. Reinsurance can help microinsurance schemes to expand both in risks covered and in product

“Disadvantaged people, whose lives are disproportionately impacted by catastrophes, can be served in a commercially sustainable way.”
Pane Stojanovski,
RMS

diversity. In Colombia, for example, Munich Re has effectively developed microinsurance products with its partner Suramericana to create flexible products that even took clients away from the mutual insurer. MicroEnsure, a microinsurance agent and broker working in a number of countries, has strong links with reinsurers to cover index and other products. The role of the reinsurer will become much more important to microinsurance as products increase in complexity.

Insurance for the lowest income population

The lowest income population may be covered by implicit or explicit insurance provided by governments and other organisations, such as health insurance and social security in the widest sense. The consensus, however, is that commercial insurance will not reach the lowest income population (those in the bottom 10% to 15% of the economy). This may change in the future as governments focus more clearly on this constituency. A recent example has been the government of Georgia, who recognised that they were unable to effectively cover the health care needs of the low income communities in their country. Therefore Georgia quantified the poverty level of its citizens, and paid premiums to commercial insurers to cover the lowest income 25% of its population.

Technology

Communication and information technologies have had unforeseen impacts in developing countries. In 2009 The Economist, in its Mobile Money Survey, concluded: “new uses for mobile phones could launch another wave of development”. Jeffrey Sachs, director of the Earth Institute at Columbia University stated in the same report that he considers mobile phones to be “the single most transformative tool for development” by facilitating business: phone calls may substitute for costly travel, text messages may supply farmers with weather forecasts, and market information is easily passed on.

“Technology does two key things that help drive the development of financial services: it cuts costs, and bridges physical distance.”
World Resources Institute

Subscriptions for mobile phones in developing countries have grown from a few hundred million at the beginning of the century to three billion in 2008, and in Africa there are on average 40 mobile phone subscribers per hundred people. The spread of the internet is lagging behind mobile phones but is showing similar growth trends.

What will this mean for microinsurance? A pointer to the future is the way one insurer in Eastern Europe is developing an SMS-based fast claims handling procedure in health insurance, which works as follows: a doctor who verifies a claim sends a text message to a server, with codes for the patient and the required treatment. The automated response to the physician includes an authorisation to withdraw the insurance payment from an ATM. The system is designed to provide cash in case of a medical emergency to the

patient as fast as possible, leaving the claims handling paperwork for later. Similar solutions can be internet-based, sending money to a mobile phone, or directly to a healthcare provider.

The internet, mobile phones and chip cards have the potential to reduce costs and increase the outreach of microinsurance throughout the supply chain. Agents and clients will submit applications electronically, policies will be automatically generated and distributed online, and electronic/automated premium payments will all further increase efficiency. Tata AIG in India already provides online information, application forms and premium calculators for its microinsurance products. Additionally, Microcare in Uganda provides online client registration and application forms.

A significant benefit in the move from paper-based to electronic processing is the quick generation of detailed data, which allows for better mortality and morbidity studies, better pricing and broader understanding of the risk within a particular market. If used effectively, it offers the potential to create products that are better fitted for a market.

Who would have predicted credit card sized insurance policies or the widespread use of mobile phones for payments and banking ten years ago? Clearly if microinsurance is to reach massive numbers, technological innovation will make it happen.

Insurance culture

Microinsurance demands cultural change by all involved. Insurers need to understand their low income clients as much as the potential clients need to understand insurance. Non-commercial delivery channels have to become familiar with their commercial partners, and vice versa.

Michal Matul of the Microinsurance Innovation Facility at the ILO explains some of the barriers: “In most of the developing countries, low income clients think they do not need insurance, they do not trust insurers, they do not understand fully the risk-pooling concept, and strongly believe insurance is just for the rich and that they do not have enough resources to pay for it.” In the experience of Francis Sommerwell of Microcare “it takes a lot of time before ... people will trust a product. However once you have a successful and trusted product, word of mouth and testimonial marketing work effectively.”

TAKAFUL: AN ISLAMIC INSURANCE SYSTEM

Takaful, meaning “joint guarantee” in Arabic, is an insurance model that complies with Islamic law. Its central principles are mutual assistance based on voluntary contributions and collective risk bearing. Interest rates, gambling, uncertainty and profits from the losses of others are avoided as they are deemed to be un-Islamic. In practice, a Sharia board oversees the scheme, which includes the

investments of premiums and savings. Growth rates for the Takaful market were estimated at 25% for the period 2004-2007, according to Swiss Re.

Microtakaful products, sometimes referred to as Sharia microinsurance, can increase the outreach of insurance to low income groups, who may hesitate to buy conventional insurance out of religious considerations.

INDONESIA: PAYUNG KELUARGA (FAMILY UMBRELLA)

Allianz Life Indonesia offers a microtakaful life insurance that is distributed via MFIs to its lenders and primarily provides coverage in case of the death of a family breadwinner. According to Jens Reisch, CEO of Allianz Life Indonesia, the product is the first of its kind sold by an international insurer. Similar products being planned include health insurance and property coverage against natural disasters.

Sources: Allianz, Swiss Re (sigma 5/2008).

The development of an insurance culture involves both understanding and trust. It needs a careful combination of marketing, market education and a process of allowing clients to experience the tangible positive effects of insurance. In order to have a sustainable impact, market education efforts require perseverance. A variety of channels are needed to reach target groups, taking into account literacy levels. Many of the following suggestions are already being tested:

- Governments providing financial education as a public good
- Politicians or celebrities advocating and explaining insurance
- Associations of insurance companies promoting insurance in joint projects
- Donors, international organisations and NGOs providing financial literacy campaigns (TV, videos, radio, music, games and even street theatre are being tested)
- Associations, employers and other organisations buying group policies for their members
- Governments introducing compulsory insurance as a way of generating positive experiences
- MFIs selling compulsory credit life insurance, in part to familiarise clients with the concept
- Provision of health insurance and other social security programmes to the very poor
- Provision of aid to the very poor in the form of insurance rather than distribution in cash or in kind
- Insurers and reinsurers sharing their experiences in low income markets through publications and conferences
- Mutual insurance schemes and community based organisations spreading the experience of risk pooling
- Researchers studying the different financial education campaigns and microinsurance products to find out what works best

Success in market awareness will depend on perseverance and a good blend of initiatives. This will undoubtedly take time, but the initial signs are encouraging.

The changing risk landscape

Economic growth, urbanisation and climate change are transforming the global risk landscape, and thus the markets for insurance. Some of these changes will increase the demand for microinsurance, but others may well decrease it.

Economic growth and urbanisation

Growth and urbanisation should lead to expanding microinsurance markets as wealth increases and more people are exposed to financial services. At the same time the huge concentrations of people in megacities such as Lagos, Mexico City and Mumbai will change the patterns of disaster risk. Research by Lloyd's, for example, suggests that China may become a "peak zone" for insurers' catastrophe exposure as the density of values exposed to disaster risk and insurance penetration increases with economic growth.

Climate change

The insurance sector actively engages in discussions and policy making about the impact of climate change. An example is the 2009 Lloyd's publication "Climate Change and Security" which examines the impact of climate change on several key security-related issues. Similar research and analysis is published by others. An initiative with wide backing in the insurance sector is ClimateWise, a collaborative effort to "respond to the myriad risks and opportunities of climate change". Another is the Kyoto Statement of the Geneva Association, whose signatories commit to a "major and concerted role in the global efforts to counter climate risks".

Global climate change will mean an increase in the magnitude and frequency of extreme weather events. One of the ways suggested to mitigate the consequences of floods, droughts and storms in developing countries is through developing microinsurance schemes, with index solutions currently attracting most attention. Increased desertification, in combination with the rise in extreme weather events, is likely to result in gradual adaptation, including structural changes in agriculture and large-scale resettlements.

These changes will seriously affect the developing world, and microinsurance has been proposed by some, such as the Munich Climate Insurance Initiative (MCII), as part of the solution. Another view is that, where adaptation is necessary, the provision of subsidised insurance may actually hinder adaptation, and that technical assistance and other forms of support would be more effective. Insurers need to be careful and responsible in the midst of considerable uncertainty. As Richard Ward, chief executive of Lloyd's, has said: "Microinsurance needs to be offered in conjunction with the United Nations Framework Convention on Climate Change to promote development in sustainable areas, rather than vulnerable places that may have to be abandoned in future due to the effects of climate change."

GIRIF AND INDEXRE: DONOR INTERVENTION LEADS TO A PUBLIC PRIVATE PARTNERSHIP

In 2007, the International Finance Centre of The World Bank Group, the EU, and PartnerRe entered a partnership to set up the Global Index Reinsurance Facility (GIRIF). This project, currently stalled, has involved the formation of a new commercial reinsurance company, IndexRe, specialising in weather index and catastrophe insurance products and promoting parametric risk solutions in the developing world.

The GIRIF Trust Fund (GTF) is the second element of the project. Its role is providing technical assistance, capacity building and market development for index insurance solutions. The focus will be on Africa, the Caribbean and the Pacific, all regions that are highly exposed to weather-related and earthquake risks.

The World Bank Group is involved in various partnerships with similar objectives, including the Commodity Risk Management Group (also involved in the GIRIF project), the development of a Turkish Catastrophe Insurance Pool (earthquake risk), and various agricultural insurance pilot projects, such as an index-based livestock insurance in Mongolia.

Source: International Finance Centre, MicroInsurance Centre KfW 2007.

The bottom line: can microinsurance make profits?

Government and donor-sponsored schemes will remain essential for initiating market developments, providing social security schemes and assistance to the very poor. But mainstreaming microinsurance, beyond sponsored pilot programmes will have to be market-driven. Profits have to be the key driver for microinsurance growth that reaches a potential three billion clients, and there are further business benefits:

Diversification

Expanding business activities into new markets, new risks and new products are necessary for portfolio diversification, and this applies to investments in microinsurance for a traditional insurer based in developed countries. A microinsurance strategy can provide a sound basis for future growth as it means diversifying into new regions with different exposures to natural disasters, into economies of different demographic structures, and into new products such as weather index insurance.

Reputational benefits

Engagements in microinsurance show a commitment to corporate social responsibility. They add value to brand names in both traditional and new markets, and help justify initial investments in microinsurance. There is little doubt that microinsurance improves the lives of its clients. As the International Association of Insurance Supervisors (IAIS) has stated: "In absolute terms, many microinsurance initiatives launched

"The vast demographic coverage facilitated by [an] innovative and robust model has enabled us in diversifying region specific, occupation-specific risks and reach a wider clientele."

**ICICI Prudential,
India**

by governments, insurers and other organisations to protect the lives, health and assets of the low income persons have made a tremendous impact”.

A laboratory for innovation

The challenges of microinsurance demand radically new solutions in products, procedures and technology. The small transaction sizes in microinsurance products require highly cost-efficient processes, from sales and premium collection to claims handling. The resulting innovations can be implemented in traditional business lines, with substantial gains in efficiency. Some multinational insurers, including Allianz and Zurich, have stated this as a reason for entry into microinsurance.

Market intelligence

Moving into new markets with a microinsurance initiative provides practical insights into business environments, regulatory practice, and unknown economic and political structures. Research and business in unfamiliar markets through microinsurance programmes may prepare the ground and build the experience with staff for traditional insurance activities in these markets.

First mover advantages

Many of today’s microinsurance clients will be the middle class clients of tomorrow, part of the “Burgeoning Bourgeoisie” in developing countries described in The Economist’s special report of February 2009. Satisfied clients will remain with their microinsurance provider, spread the word and demand more products as they move into the middle class and appreciate the benefits of traditional insurance.

“The potential is now so strongly perceived that all life insurance companies – old and new alike – operating in the country have started their own microinsurance products.”
Delta Life, Bangladesh

In summary

Although microinsurance is unlikely to ever be the major focus of more than a few insurers, many insurers have found microinsurance to be profitable if they operate simply and efficiently on all levels, respond to market needs, and access large numbers of low income people.

Investments in microinsurance have diverse returns that evolve over time: reputational gains in the short term, knowledge in the medium term and growth in the long term. If we view insurance as a sector in which knowledge is a decisive resource, then microinsurance can be viewed as a driver of local learning and ultimately economic growth.”

CONCLUSIONS

Those with the least ability to adapt are being affected most by climate change, population growth and rapid urbanisation: there has never been a greater need to protect these communities.

Governments are increasingly recognising this and contributing to insurance schemes in developing countries. We expect this trend to grow following the climate change negotiations at Copenhagen. Policymakers understand that insurers and reinsurers can only provide material cover in the long term if they can develop profitable business models. Whilst microinsurance so far has focused on life assurance, opportunities for property, agricultural and livestock cover exist.

Many communities already have existing coping strategies for risk, but they can be made more efficient.

Some are basic, simply to avoid taking risks at all, others might include self insurance through savings or sharing a risk with a wider community. Where these are working well they should not be disturbed, but in many cases they can be made more efficient. Risk pooling, via mutual schemes or commercial insurance, will lessen the financial impact of loss of livestock, crop failure or the death of family members, and can help keep whole communities out of the poverty trap.

Demand for insurance should not be taken for granted. The perception of insurance in the developing world is often negative and an innovative approach to market education and incentives is called for.

Many people in the developing world are not familiar with the concept of insurance. Insurers must build trust through innovative approaches, including literacy campaigns and plots in TV and radio programmes, to explain the benefits of insurance. Alongside developing market education other incentives, such as tax exemption, subsidies, and even compulsory cover, will be required to generate demand.

Pilot microinsurance schemes have paved the way for huge potential growth in insurance over the next 10 years.

Most markets in the world remain untapped by insurers. It is estimated some 1.5 to 3 billion insurance policies are waiting to be sold to a rapidly growing market in the developing world. Business growth of over 10% p.a. has been observed in developing countries recently and some believe that a seven fold increase is possible over 10 years.

Insurance innovation and new, less conventional partnerships are essential first steps to a truly global insurance market.

Lloyd's is renowned for insurance innovation and the market was involved in the founding stages of the Caribbean Catastrophe Risk Insurance Facility which brought governments and industry together to payout claims quickly following a hurricane, using indices from risk models. Other innovative approaches to insurance, involve mobile phones or chip cards to provide policy details and therefore reduce distribution costs. Takaful insurance, which is beginning to grow in the London insurance market, has been described as "Sharia Microinsurance" as it respects Islamic laws. Partnerships with NGOs, aid agencies, governments and companies can all be used to reach the people that need the cover, and keep distribution costs down. If innovative approaches are required, Lloyd's can expect to play a key role in driving development.

There will be significant benefits to (re)insurers who establish an early position in this emerging market.

Establishing business in developing countries will provide an opportunity to gain a foothold in profitable, new and rapidly expanding markets. This will enable (re)insurers to diversify their business portfolios away from traditional markets and first movers are likely to gain a significant advantage by building trust with all stakeholders. In addition, reputational benefits may arise from doing business in developing countries.

Regulators and policymakers must balance the need to protect customers with encouraging industry innovation and growth.

Products designed for the developing world must be tailored to their specific needs. Similarly, insurance regulations developed for traditional insurance markets will need to be adapted for developing countries, so they both protect local communities and encourage insurance markets to grow.

FURTHER READING

On the basics of microinsurance

Protecting the poor: a microinsurance compendium Craig Churchill editor, ILO, 2006

The landscape of microinsurance in the world's poorest 100 countries The MicroInsurance Centre, 2007

Scaling up index insurance: what is needed for the big next step forward MicroInsurance Centre, 2007

On microinsurance regulation

Facilitating an appropriate regulatory and supervisory environment for microinsurance USAID

Microinsurance NOTE 8, USAID, 2008

Issues in regulation and supervision of microinsurance IAIS and CGAP Working Group on Microinsurance, 2007

Making insurance markets work for the poor: microinsurance policy, regulation and supervision

CGAP Working Group on Microinsurance, 2009

On the future of microinsurance

Visions of the future of microinsurance, and thoughts on getting there USAID Microinsurance Note 9, 2008

The next 4 billion: Market size and business strategy at the base of the pyramid World Resources Institute and International Financial Corporation, 2007

Agricultural microinsurance: global practices and prospects The MicroInsurance Centre, 2008

The fortune at the bottom of the pyramid: eradicating poverty through profits CK Prahalad, 2004

FOR MORE INFORMATION

For more information on insurance in developing countries and microinsurance, please email 360@lloyds.com

