MILK Brief #21:
Colombian Life Microinsurance: An emerging success story[1]

Executive Summary[2]

Life microinsurance in Colombia has been a growing and profitable business. MILK's research indicates that life microinsurance is contributing materially to both the top and bottom line of companies engaged in the sector. The experience of MAPFRE, the Spanish multinational insurer, reflects these trends with significant growth in its Colombia-based life microinsurance business, which in 2012 contributed 28% of top line revenues[3] for these lines of business and 20% of the bottom line net income for these same products. The success of life microinsurance in Colombia can in large part be linked to the broad engagement of the commercial insurance sector and innovative distribution strategies which employ utility companies and other alternative channels that themselves are highly engaged, incentivized and compensated to sell insurance and bill premiums.

Surprisingly then, after years of robust growth – 16% compounded annual growth rate (or CAGR) from 2008 to 2011 – the industry growth slowed in 2012 with only a 4% increase in overall life microinsurance premiums.[4] It appears that this leveling off reflects increasingly crowded and competitive distribution channels and a decline in funeral cover sales. In-kind funeral coverage was the industry's early lead product, which was regulated out of existence, forcing companies to turn to group life and personal accident to fuel growth. MAPFRE, which has singularly enjoyed the advantage of selling funeral cover after the rest of the industry was prohibited from doing so, lost this privilege in April 2013, and will now be challenged to make a similar adjustment. The reliance on the effective but expensive and increasingly crowded utility channel, another key driver of business success, is also a question mark. Early investments in large retail chain distribution channels, while intriguing, have yet to produce material sales results. In sum, the successful life microinsurance sector in Colombia is at a critical juncture. Intensifying competition, effective but expensive distribution and an evolving regulatory environment have raised questions about how the next five years will unfold.

Introduction

The MicroInsurance Centre's MILK project is studying four commercial carriers (MAPFRE, Royal Sun Alliance (RSA), Suramericana (SURA) and Solidaria, collectively the "study group") who are active in life microinsurance in Colombia. Our study period is 2008-2012 and the products we are studying are group life, personal accident, health and funeral cover ("study products"). In this brief, we highlight MAPFRE's results, which are illustrative of the emerging microinsurance market in Colombia but also reflect a unique position in the market.

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[1] This brief was written by Richard Koven and Xavier Martin (April 2013). The authors were assisted by Nick Winkleblack, who collected and analyzed the data for the paper.

[2] The MILK team appreciates the superb cooperation we received from Fasecolda (The Federation of Colombian Insurers), and Alejandra Diaz in particular, for their active assistance and for providing access to their microinsurance database, which is so critical to this project. We would also like to express our appreciation to MAPFRE, and Maria Eugenia Pacheco in particular, for their generous contribution of time and thoughtful insights.

[3] Premiums and other financial data herein are a composite of data reported by MAPFRE to MILK.

[4] Composite industry data is composed of a combination of data reported by MAPFRE to MILK and Fasecolda's industry data set.

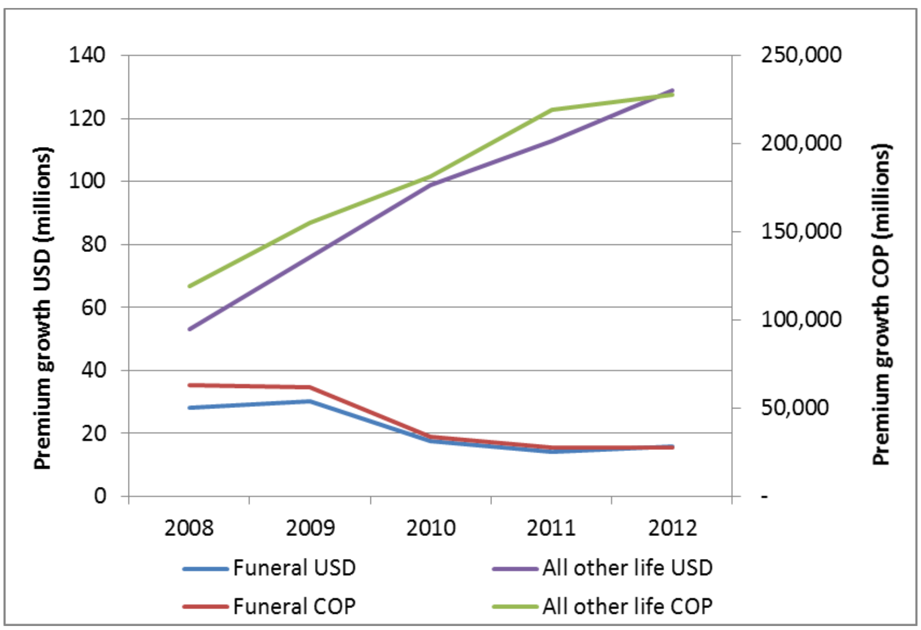
Colombia has a profitable life microinsurance sector[5] driven by commercial and cooperative insurers that team up with more traditional distributors such as MFIs and cooperatives, but also employ alternate distributors, such as utility companies and increasingly, large "big box" retailers. The target market is the economic segments 1, 2 and 3, which are the three lowest of six government-designated income strata in the country.[6] The MILK study group companies cover 68% of the life microinsurance market. Stand-alone microinsurers are not present in Colombia.

Group Term Life is currently the predominant product in the Colombian life microinsurance sector with Personal Accident second.[7] Unlike in many other countries, credit life is not a lead product in Colombia. In fact, credit life cover is not even considered to be "microinsurance" by the Federation of Colombian Insurers (Fasecolda).

According to Fasecolda's data, having previously accounted for 49% of all life microinsurance premiums in 2008, the sale of funeral cover (with payment of the benefit in funeral services rather than in cash) was limited by recent regulation[8] which gave preference to pre-paid plans offered by funeral parlors. Fasecolda now reports that funeral cover is only 10% of all premiums. The insurers have argued, unsuccessfully, that they are better equipped to offer funeral coverage, as they are regulated entities with required levels of capital and with formal reserves to offer clients secure coverage. Insurers also claim to offer value to clients through these in-kind funeral products; MILK Brief #8 on the value to clients of MAPFRE's in-kind funeral policy suggests this to be the case.[9]

As a result of the legal restriction barring funeral services as insurance benefits, funeral coverage premiums declined 94% industry-wide since 2008. Meanwhile MAPFRE, which was granted an exemption from the regulation until April 1, 2013, has enjoyed an advantage over other insurers in providing funeral coverage, jumping from a 24% share of total market in 2008 to a 93% share in 2011 before leveling off in 2012.

Figure 1: Micro funeral premium growth vs. all other micro life premium

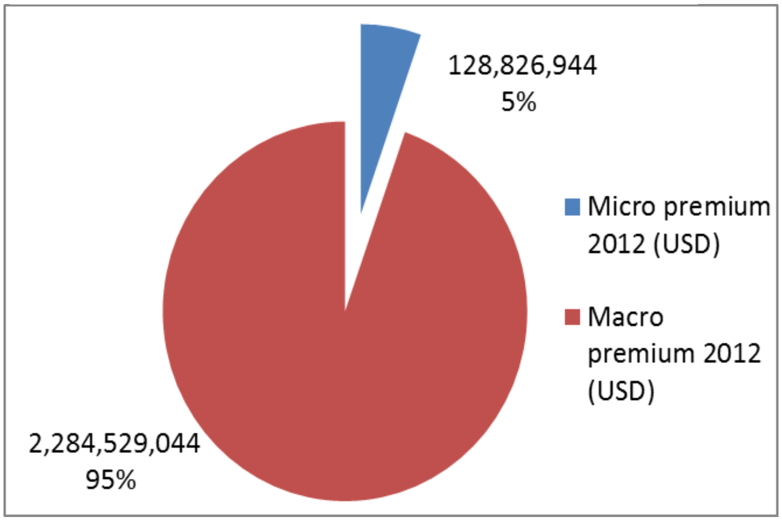


As demonstrated in Figure 1, despite the industry-wide decline of funeral coverage, the life microinsurance industry in Colombia has maintained significant growth, driven primarily by the rise in Group Life insurance and Personal Accident insurance premium.

Beyond the restriction on funeral cover, there is no direct regulation of microinsurance in Colombia. There are no government or donor

[5] For the purposes of this study the life insurance sector in Colombia includes individual life insurance, group life insurance, health insurance, personal accident insurance and funeral coverage, as these products are all regulated as life insurance.
[6] Strata 1, 2, and 3 represent "lowest income", "low middle class", and "middle class", respectively.
[7] McCord, et al. Forthcoming. Landscape of microinsurance in Latin America and the Caribbean. Washington, DC: Inter-American Development Bank.
[8] Diario Oficial 47.411, Ley 1328 de 2009 (Julio 15), Artículo 86, Parágrafo 3. http://www.elabedul.net/Documentos/Leyes/2009/Ley_1328.pdf
[9] Barbara Magnoni and Derek Poulton. 2012. "MILK Brief #8: 'Doing the Math' - Cashless Funeral Microinsurance in Colombia." Appleton: The MicroInsurance Centre.

Figure 2: Life microinsurance* premiums as a % of total market premiums in Colombia (2012)
*including group life, personal accident, health, and funeral

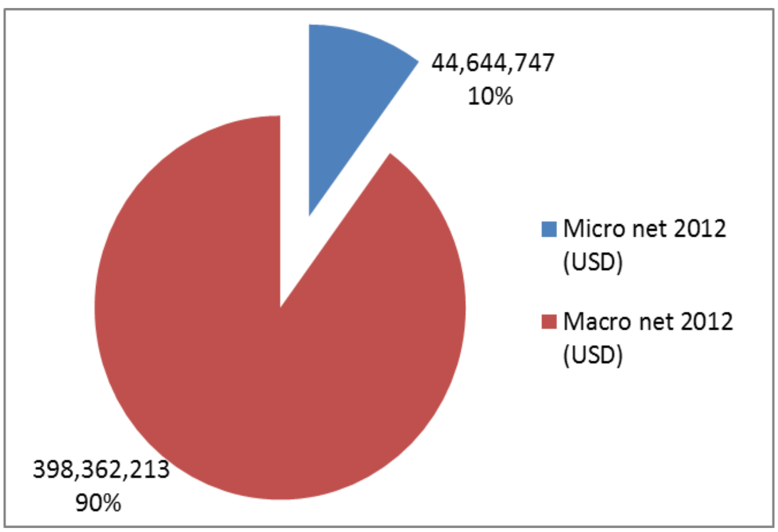


subsidies present in any of these programs. A debate is ongoing about the merits of more extensive regulation. In particular, some argue that limiting commissions for distribution would make it easier for insurers to achieve sustainability or profitability while keeping prices accessible for low-income clients, but others note that such regulations might also dis-incentivize distributors from working in this space. In any case, the insurance regulator of Colombia stated that the Ministry of Finance is not inclined at this time to intervene in what it perceives as a growing and healthy sector. The development of new distribution channels will, in theory, engender a competitive dynamic which then should have a self-regulating effect on the cost of distribution.

Over the last five years the cumulative growth of the life microinsurance sector has been significant, and as of 2012 it produced material contributions to the top and bottom lines for the study group companies study products. (See Figures 2 & 3)

Microinsurance in Colombia is treated (for the most part) like affinity group mass marketed programs (See Box 1). Brokers are sometimes present in the value chain and typically earn 10% to 15% commission. However, utility companies are the top distribution channel and often sign multi-year contracts for fees in the range of 10% to 35% of anticipated premium volumes. The activities of these utility partners go far beyond what brokers typically do, and they have extensive involvement along the insurance value chain (see Figure 4 below). Insurers appear to compete for distribution channels, or "sponsors" as they are considered in Colombia, based on commission levels. Sponsors understand the leverage they have, leaving some insurers to complain about the pressure for high commissions. The number of insurance companies using utility channels for distribution grew from two

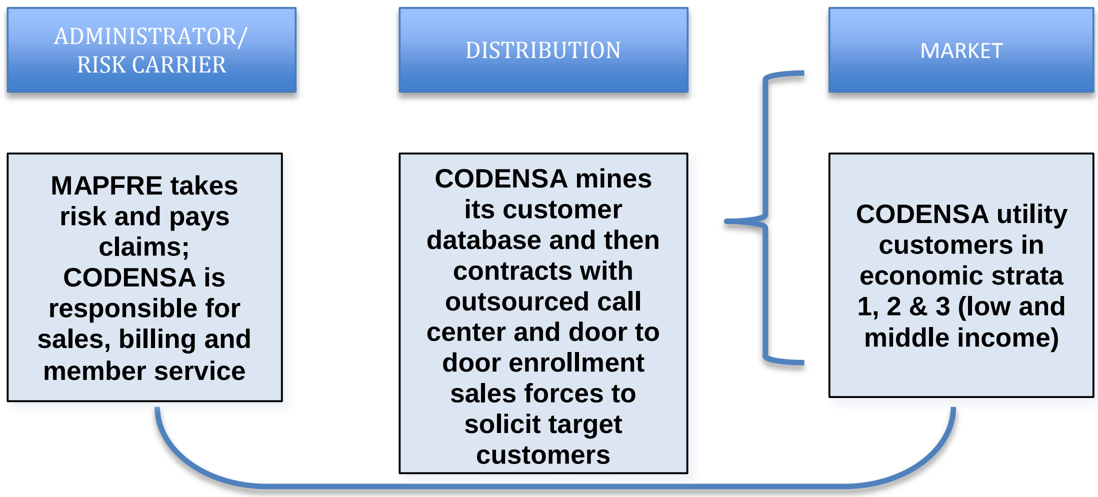
Figure 3: Life microinsurance* net income as a % of total industry profits in Colombia (2012)
*including group life, personal accident, health, and funeral



"Colombia's economy has grown significantly in the last decade, creating new consumers for insurance. We are fortunate that our insurance industry has been innovative in creating new products and new channels to capture this growth opportunity."
– Juan Pablo Arango, Deputy Superintendent for Financial Supervision, Colombia

to six during the study period. There is a high degree of variability in the total cost of maintaining these channels (including fees paid to the channel plus internal cost to support the channel), ranging from 20% to 50%. Utility distribution relies heavily on door to door client acquisition by outsourced sales forces, adding another dimension to the value chain, and additional costs.

Figure 4: MAPFRE value chain



Observation & Analysis

For the study products, life microinsurance in Colombia grew at a compounded annual growth rate (CAGR) of 14% (COP) for the study period 2008-2012. This compares with a CAGR of 8% (COP) for the entire life industry in Colombia. In 2012, life microinsurance premium represented 5% of the total premium earned by the entire life industry, based on the products studied. More impressively, MILK estimates that life microinsurance's contribution to net income for the sector in 2012 was 10%. In other words, **without life microinsurance,** the entire life industry would have had on average **10% lower profit** than experienced in 2012.

In 2012, the industry covered 8.9 million lives with microinsurance, up from 8.2 million in 2011.[10] The companies we spoke with reported that typically the majority of covered lives (in life insurance) are on micro programs. At the same time micro premiums are a much lower percentage of overall company premiums. That said, MI premium is not inconsequential:

As Table 1 indicates (see below), all companies in the study group other than SURA have material and even dominant (in the case of RSA) microinsurance books of business. Each company reported growth in premiums during the study period and three of the four indicate MI is profitable. Loss ratios for life microinsurance in Colombia are lower when compared to loss ratios in the overall life sector, with Fasecolda reporting an average loss ratio of 32% in life microinsurance for the five year period 2008-2012, as compared to a 56% loss ratio for the overall life line of business.

Microinsurance is a relatively young industry in Colombia with most companies entering between 2001 and 2009. Still, there appears to be room for continued growth. RSA, for instance, entered the field only in 2009, yet has achieved 34% market share by 2012.

[10] McCord, et al. Forthcoming. Landscape of microinsurance in Latin America and the Caribbean. Washington, DC: Inter-American Development Bank.

Table 1: Life microinsurers in Colombia – Microinsurance as % of total company premium for life microinsurance products studied (Group Life, Health, Personal Accident, and Funeral), 2012

Company	Year MI Operations Started	2012 Total Premiums (USD MM)	2012 MI Premiums (USD MM)	Percent MI Premiums	MI Market Share at 12/31/2012
RSA	2009	60.0	40.0	67%	34%
MAPFRE	2001	108.7	30.7	28%	20%
Solidaria	2005	31.2	14.1	45%	9%
Sura	2004	714.6	7.5	1%	5%
TOTALS		914.5	92.4	10%	68%

MAPFRE[11]

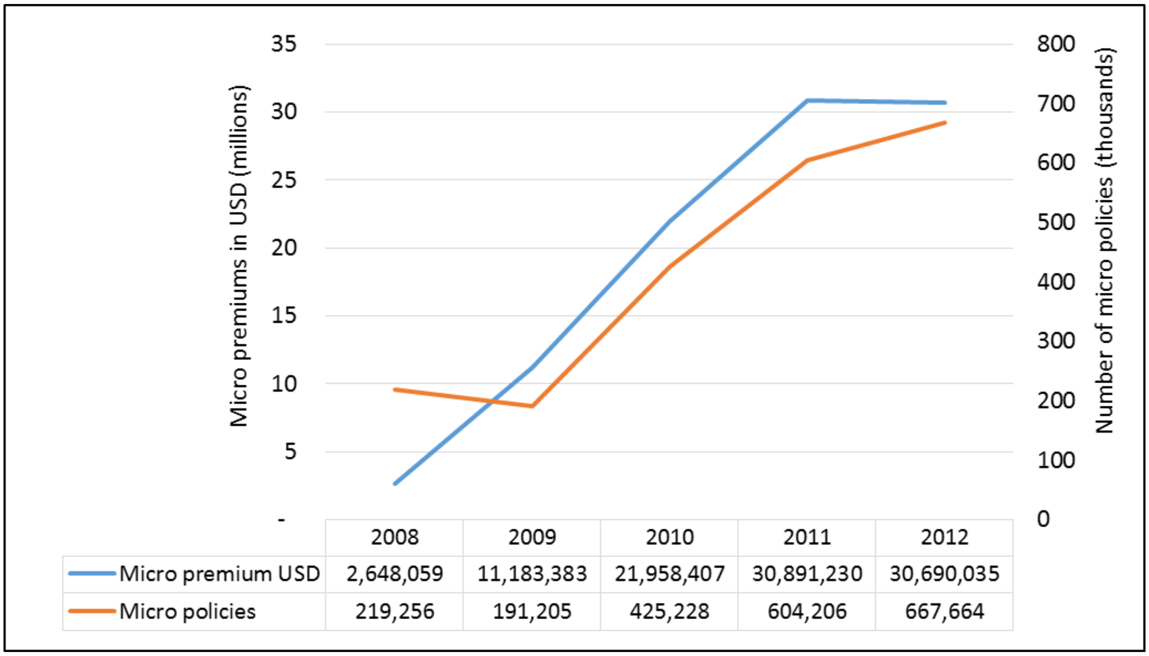
MAPFRE has been active in the Colombian insurance market for twenty years and in the life microinsurance segment since 2001. MAPFRE Colombia is the Colombia affiliate of the Spain-based multinational group MAPFRE, which offers insurance and reinsurance in more than 40 countries. MAPFRE Colombia's activities are carried out via two entities: MAPFRE Seguros Generales de Colombia S.A. and MAPFRE Colombia Vida Seguros S.A. In 2009, MAPFRE Colombia became a top performer in the microinsurance products market, reaching more than 1.5 million insured clients. As of 2012, MAPFRE has a 10% market share of the entire life insurance market and a 4.7% share again for the entire industry for the products we studied. At the same time, its life microinsurance market share in 2012 was 23% for the products studied. Much of its growth can be ascribed to the success it had as the first to market in partnership with a public utility.

> "We didn't realize we were doing *microinsurance* when we started. We are focused on mass marketing and targeting underserved segments of the population." -MAPFRE

Consistent with the industry trends, MAPFRE's life microinsurance premiums and numbers of policies grew significantly during the study period 2008-2012 (see Figure 5 below). In 2012, life microinsurance was 28% of MAPFRE's total life premium for the products studied and contributed 4% of net income earned company wide. Management reports that the line has been profitable every year. The goal is to grow the business at a rate of 15% per year in terms of premiums. However, 2012 was a disappointing year, as the retrenchment in the funeral cover business led to no growth in the top line revenue for MAPFRE's microinsurance segment. While the growth of the Group Life sector mostly offset this retrenchment for MAPFRE, as it has industry-wide since 2009, the prospect of losing the funeral product to regulation altogether is a discouraging one. MAPFRE enjoyed the advantage of having the singular ability to offer funeral cover these past several years. With that advantage gone and with other insurers now teaming up with public utilities, MAPFRE must shore up its competitive positioning to maintain its significant market share.

[11] Data sourced from Fasecolda and MAPFRE.

Figure 5: MAPFRE life microinsurance segment

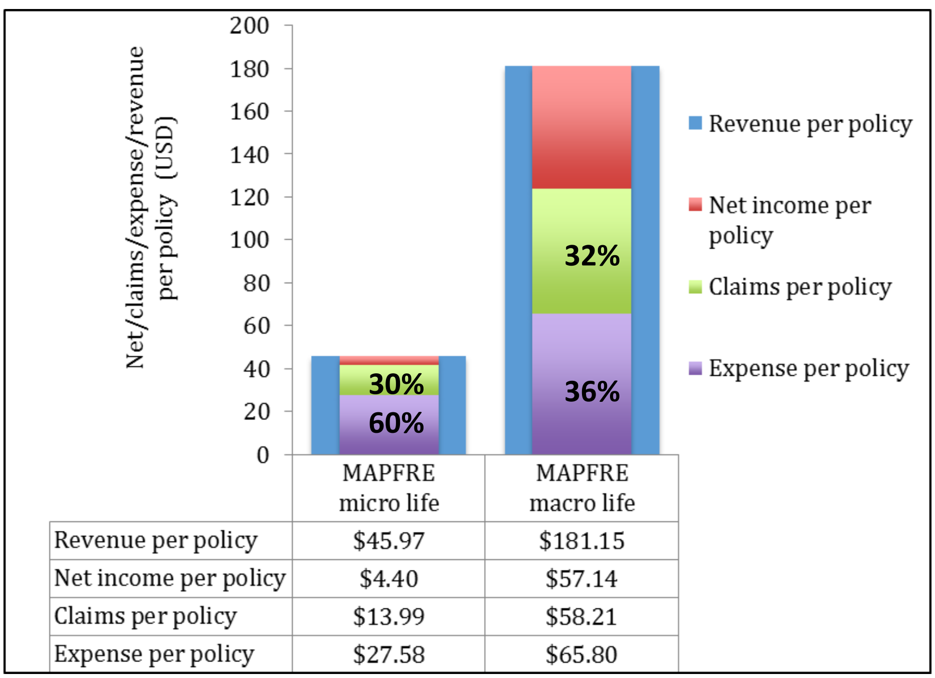


	2008	2009	2010	2011	2012
Micro premium USD	2,648,059	11,183,383	21,958,407	30,891,230	30,690,035
Micro policies	219,256	191,205	425,228	604,206	667,664

As expected, life microinsurance premiums are substantially lower per policy (75% lower) than all similar life policies MAPFRE sells. Figure 6 below shows that life microinsurance expenses, including distribution, administrative, and claims costs per policy, while higher as a proportion of the premium than for traditional policies, are still balanced in a way that supports profitability.

MAPFRE's success can be tied to its innovative, market-leading distribution strategy. MAPFRE was the first insurer to employ the utility distribution channel, and its relationship with CODENSA (see below) has been a driver of its microinsurance success. Although MAPFRE has other distribution partners, such as retailers and MFIs, 70% of its microinsurance premium is sold through CODENSA. Funeral cover has been the primary product but personal accident and group life insurance are also sold through this channel. Although available to all households, these life insurance products are designed and priced for low income people.

Figure 6: MAPFRE 2011 micro vs. macro life insurance



	MAPFRE micro life	MAPFRE macro life
Revenue per policy	$45.97	$181.15
Net income per policy	$4.40	$57.14
Claims per policy	$13.99	$58.21
Expense per policy	$27.58	$65.80

Although premium billing and collection are tied to the utility billing, the insurance offer is entirely voluntary. Sales are made using outbound and inbound call centers as well as door-to-door sales. Sales increased in 2007 when outbound calls were initiated and more so in 2009 when door-to-door sales were undertaken. Now almost half (48%) of sales result from door-to-door efforts with most of the remainder (50%) sold using outbound call centers. Since 2007, the CODENSA channel has produced sales of over 500,000 policies with a penetration rate of 25% (% of policies to power meters).

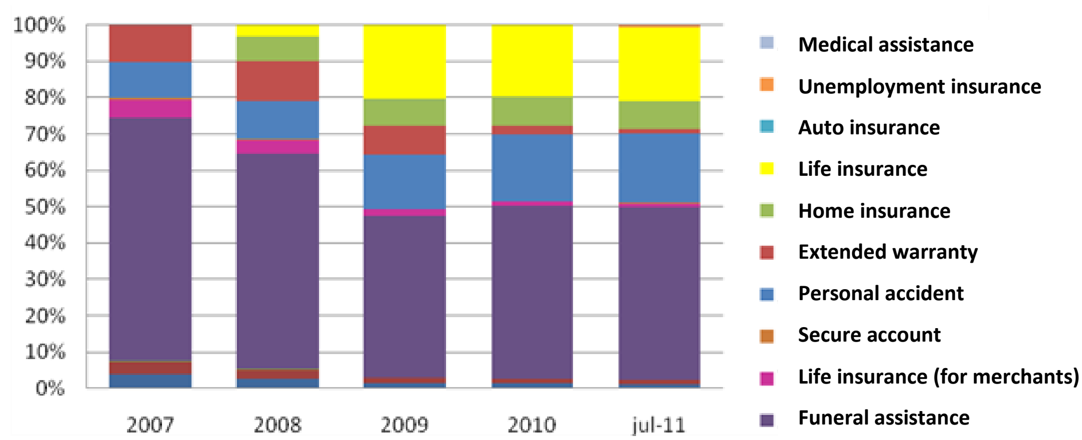
MAPFRE's perspective on the CODENSA channel is that it is an unusually effective one, producing more premiums than any other. CODENSA specifically produces a higher premium per policy than the MFI channel (although this may also be a function of the higher premiums associated with funeral cover). Not surprisingly then, the utility channel, while more effective, is significantly more expensive to MAPFRE than the MFI channel. Management estimates that the cost of acquisition through this channel is approximately USD 40 and can be amortized for 24-30 months. In its 2010 paper on alternate microinsurance distribution channels in Colombia, Cenfri noted that the profitability of the sector was highly dependent on renewal rates since the cost of distribution was quite high.[12] Lapse rates are presently manageable at 1.9% per month but have been increasing over time. CODENSA has intensified conservation efforts to assure that lapse rates do not increase further.

CODENSA

CODENSA is the largest electrical energy distribution company in Colombia. It serves 2.2 million residential customers in the city of Bogota and in other nearby municipalities in the department of Cundinamarca. In 2001, CODENSA created CODENSA Hogar (home), a division dedicated to the provision of complementary services for electrical energy customers. Payment for these services is included in the monthly electricity bill. Initially, CODENSA Hogar focused its efforts on facilitating access to credit for the purchase of home appliances. A short time after it entered the credit market, CODENSA Hogar moved into the insurance market.

As of yearend 2012, CODENSA had 520,000 active insurance policies. Its leading product is a funeral cover which now represents approximately 50% of the insurance sold through CODENSA. Following the funeral product in importance are group life, home and personal accident microinsurance policies. Other, less important, insurance products in terms of volume are health, medical aid, dental, unemployment, and traffic accident insurance products (see Figure 7).

Figure 7: CODENSA: Participation by type of insurance product (by number of clients)



[12] Cenfri/ILO. 2010. Case Studies on the use of Alternative Models of Distribution for Microinsurance in Colombia.

> "We are not just a broker. CODENSA is actively engaged in the insurance process end to end with intensive involvement in product development and the direct oversight of the marketing and sales process. We believe this level of engagement, which comes at a cost, is the key to our effectiveness as a distributor."
> - David Ricardo Rodríguez Maldonado, CODENSA Hogar Division Chief

Initially, CODENSA opted for a sales strategy wherein information about insurance products was included in electricity bills. In parallel, it contracted the services of a call center that used CODENSA's home energy customer database to offer insurance products. In 2009 CODENSA introduced a door-to-door sales channel, which currently employs some 170 salespeople. Sales efforts are focused on persons in income strata 1, 2 & 3 (the lower income strata) who can be identified based on place of residence. The outsourcing of call center and sales functions is accomplished on a competitive tender basis and gives CODENSA access to cost-effective, professional resources over which it extends very careful supervision. Perhaps a victim of its own success, CODENSA has had to confront intensifying competition. In response, MAPFRE and CODENSA have increased contributions to the common marketing fund from 5% to 8% of premium while reducing commissions paid to CODENSA. Benefits have also been enhanced and premium rates increased by 7% from 2011 to 2012 and then 8% more to 2013.

The abilities to bill customers directly for contracted services and to use an extensive customer database have served as the principle competitive advantages for CODENSA and as the basis for its success. Today, CODENSA Hogar generates 6% of CODENSA's profits. Of this 6%, microinsurance products represent 30% of the profitability of CODENSA Hogar.

No outside brokers are currently used to intermediate this arrangement, however, both door-to-door sales and call centers are outsourced to independent vendors. CODENSA receives a percentage of premium and other fees for its distribution and premium billing & collection efforts. MAPFRE has made a significant investment in the channel, which produces sales of about 15,000 policies per month, and recently secured an eight year exclusive agreement with CODENSA.

Box 1: Is this microinsurance?

Colombian insurers use a mass market approach to microinsurance, employing alternative distribution channels which make products broadly available, and not just to the poor. Because the channel is not confined to the poor as, say, an MFI channel might be, some observers have questioned whether the Colombian phenomenon is actually “microinsurance.” MILK believes that it is microinsurance because (a) the products are designed and priced for the poor and (b) they are sold through channels that while not exclusively available to the poor are accessed mostly by them.

First, to put this issue in context, Colombia ranks 83rd worldwide in GDP per capita at USD 10,247 (International Monetary Fund, 2011) placing it squarely in the middle of the global economies. Mexico, where MILK has also studied microinsurance, ranks somewhat higher (63rd) at USD 14,653 per capita, while the Philippines (128th) USD 4,080 or India (130th) USD 3,663 where microinsurance is prevalent are considerably less well-off economies.

In Colombia, overall life microinsurance premiums average approximately USD 22 per year. For some microinsurers like MAPFRE, average premiums climb to USD 50 per year. These are significantly higher premiums than we observe in Asia or Africa. However, importantly, average premiums reported for microinsurance are 8 to 12 times less per covered life than traditional insurance plans sold in Colombia, reflecting a price differential suitable to this target market. At USD 22, premiums are 1.3% of the established poverty level of USD 1,716 annual income per household.

Secondly, of the two broad-based distribution channels that distinguish Colombia, the public utility channel produces just over 50% of all microinsurance premiums, while the retailer channel, at this time, produces only 1% -2% of premiums. While both channels target the poor, the utility channel, the dominant channel, can document this, since in Colombia the population is divided into income strata which can be determined in large part by address – easily available in the utility company databases. The great majority of the population (89 percent) lives in strata one, two, and three, and on that basis, even if not by other criteria, is considered poor (Bushnell and Hudson, 2010).

Lastly, the data reported in this paper are based on a definition of microinsurance established by Fasecolda, based on an industry adopted standard definition, which specifies maximum sum assured and product design and distribution characteristics:

> *“Insurance products that offer protection to low-income people and their assets against specific threats, and further characterized by meeting the following requirements simultaneously:*
> - *Be designed, in their conditions and procedures, considering the target population.*
> - *Be commercialized through adequate channels to be accessed by the low-income population.*
> - *Have a bimonthly (every two months) premium equal or less than 1/12 of 1 SMMLV (approximately COP 23,600 (USD 13) per month in 2012)*
> - *Have an insured value equal or less than 135 SMMLV (Approximately COP 76.5 million or USD 42,000 in 2012)*

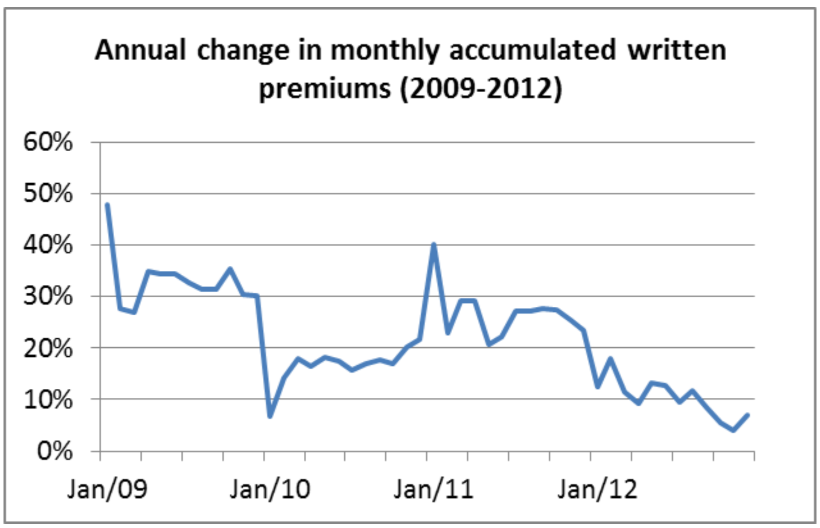
For the Latin American and Caribbean landscape study undertaken for the IDB (see McCord et al., 2012), microinsurance products / programs were screened using premium to GDP per capita ratio of 1%. For Colombia the highest qualifying premium for life microinsurance was USD 77, placing the industry average premium of USD 22 used in this paper well within the criteria. In sum, since all the products reported in this paper conform to these established definitions, MILK is therefore *comfortable that these products are in fact microinsurance.*

Conclusion

MILK views the life microinsurance industry's five year track record in Colombia positively from a business case perspective. The sector's growth and profitability are unmistakable. We note that in Colombia life microinsurance was not birthed from MFIs selling credit life, as it was in many other countries. Rather, in Colombia the microinsurance industry springs from commercial and cooperative carriers employing innovative distribution channels. The example of MAPFRE demonstrates how microinsurance appears to contribute materially to these firms' top and bottom lines. MAPFRE's use of the utility channel, which other insurers have emulated, makes clever use of tie-in sales (pay the utility bill and buy insurance), yet the coverage is truly voluntary (no utility can cancel a customer's power because they do not pay their insurance premiums). In most other countries, life microinsurance has had at least some mandatory base cover. In this way the story in Colombia is again an exceptional one.

Nonetheless, the Colombian life microinsurance market leveled off in 2012 after years of robust growth. Fasecolda has identified a slowing trend that has been developing for several years (see Figure 8 below). MILK believes that this slowing relates not to market saturation; there are many millions of low income Colombians still without insurance. Rather access to (a) sales of funeral cover and (b) untapped and uncrowded distribution channels, which drove early explosive growth, are no longer available. In this sense the Colombian life Microinsurance industry has reached an early stage plateau. We will be curious to see the moves the industry makes to keep its product portfolio and distribution channels vital.

Figure 8: Microinsurance growth rates in Colombia (source: Fasecolda, 2013)



As we continue to study life microinsurance in Colombia we will actively review some developing trends and issues:

- Will distributors (e.g. utilities) begin to compete with each other in the microinsurance space? If yes, will distribution costs, which are now high, come down? Such competition may be emerging. For instance, the utilities Gas Natural and CODENSA have overlapping service areas and both offer insurance. There are also telephone companies showing an interest in microinsurance.

- Will investments that insurers are making in large retailers like Exito and Carrefour begin to pay off?

- The insurance regulator has been largely hands off to date; would new regulation, particularly around distribution channels and funeral cover, encourage or discourage further development?

- Intensive sales efforts driving up penetration rates and increased insured amounts attract new customers with prices adjusted moderately upwards. Will lapse rates increase and become problematic? Companies are beginning to employ traditional techniques to control lapses including sales force monitoring, training and incentives, but the effectiveness of these efforts remains to be seen.

- Additional new regulation on call centers requires authorization from the consumer before receiving a call. How much will this inhibit sales?

Lessons from this study are provided in Table 2 below, and factors considered to be particularly important in the Colombian context are shown in bold.

Table 2: Business case factors

Business Case Factors	Observations
PROGRAM AGE	Life microinsurance programs in Colombia have grown quickly and become increasingly profitable over time.
SCALE	**Life microinsurance programs in Colombia are built on existing commercial insurance operations and have the advantages of scale that, for instance, a standalone microinsurance startup would not have.**
BUSINESS MODEL	Both commercial and cooperative models appear to serve as good platforms for growing and sustaining life microinsurance programs. There are several types of partners – retail, utility, MFI and others. Unlike other countries, MFIs have a rather limited role as microinsurance distributors, producing only 7% of microinsurance premium volume in 2012.
PRODUCT	Group life and not credit life is driving the growth of microinsurance in Colombia.
DISTRIBUTION	**Mass marketing through alternative distribution channels such as utilities has been very successful and an important driver of business case.**
SUBSIDY	No subsidies are present for life microinsurance in Colombia.
COMPETITION	Limited competition between intermediaries was noted.
MANDATORY VS. VOLUNTARY	Most of the mass marketed programs MILK studied in Colombia are voluntary enrollments.

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Microinsurance Learning and Knowledge (MILK) is a project of the MicroInsurance Centre that is working collaboratively to understand client value and business case in microinsurance. Barbara Magnoni leads the client value effort and Rick Koven leads the effort on the business case. Contact Michael J. McCord (mjmccord@microinsurancecentre.org), who directs the project, for more information.