MILK Brief #32:
Colombian life microinsurance: the business case for Solidaria's distribution partners[1]

Executive Summary

As a follow up to our study of life microinsurance in Colombia (MILK Brief 21 – Colombian life microinsurance: an emerging success story) the Microinsurance Centre's MILK team returns to this intriguing market to study the business case for life microinsurance at various stages of the value chain. Our analysis focuses on Solidaria and its distributors, all cooperative institutions in Medellin, which distribute credit and group life products.

We found that Solidaria had robust profitability on two of its three partnerships; the third was terminating, requiring run off reserves which made it somewhat unprofitable. For the distribution partners, each made solid profit margins. However, it is not clear how material these profits are relative to the scale of the distributors' overall businesses, and therefore Solidaria must rely on other intangible benefits to support the business case for its partners.

Introduction

In the 2013 review of four commercial carriers, the MicroInsurance Centre's MILK project team determined that 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 and that 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.

MILK also found that after years of robust growth, industry expansion slowed in 2012, with only a 4% increase in overall life microinsurance premiums. It appears that this leveling off reflects increasingly crowded and competitive distribution channels and a decline in funeral cover sales, which were affected by recent changes in the regulation of this product that limit the capacity of insurance companies to provide competitive coverage. 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.

With this update we explore the business case further and expand our analysis to include pieces of the broader value chain, including an in-depth look at three different microinsurance distributors working in partnership with the insurer Solidaria. We begin with the assumption that to be financially sustainable in the long term, a microinsurance program must provide value at each stage of the chain: for insurers, distributors, and end clients.

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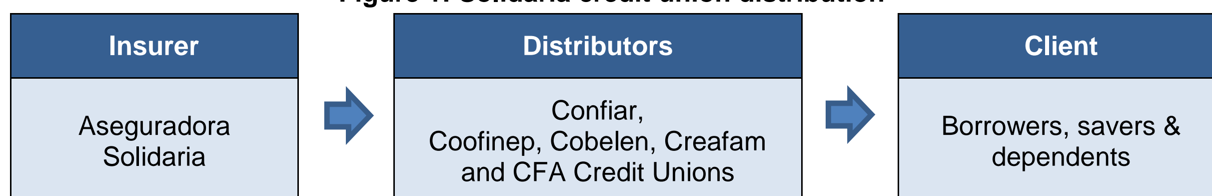
[1] This MILK Brief was prepared by Richard Koven and Xavier Martin (April 2014).

For **distributors**, we examined premium and commissions along with direct and allocated costs associated with distribution activities for select products. For the **insurer,** Solidaria, we calculated the profitability of each distribution partnership.

Distribution Study: Objectives and Methodology

The objective of the study is to determine the costs and benefits of distributing the Aseguradora Solidaria (Solidaria) microinsurance products through partnerships with credit unions (Figure 1). The study looks at the profitability of both Solidaria and the associated credit unions in three of the partnerships that Solidaria has through its Medellin branch. Medellin is the capitol of Antioquia, the first region in which Solidaria developed this kind of partnership, and Solidaria's Medellin branch is the branch that most contributes to this line of business. The period covered by the study was January 1, 2013 to October 31, 2013.

Figure 1: Solidaria credit union distribution



Aseguradora Solidaria

"Microinsurance has been in the DNA of Solidaria since we began our activities."
-Mónica María Arroyave, Aseguradora Solidaria

Solidaria is a cooperative insurer based in Bogotá with national reach via 40 field offices, including offices in all of Colombia's major cities. Founded in 1964 by CUNA Mutual, an international mutual insurance company specializing in financial services for cooperatives and credit unions, Solidaria is a nonprofit organization with an extensive network of alliances with businesses, cooperatives, credit unions and associations. Since the 1980s, Solidaria has been linked with different Colombian cooperatives and cooperative employee welfare funds, focusing on products for these organizations. In 2004, the funeral service company Los Olivos became the majority partner in Solidaria, holding 76.2% of the company.

Solidaria has been a pioneer in Colombia in the field of microinsurance and is one of the major players in this market segment, with a market share of 9% in 2012. Solidaria was created to offer insurance coverage to low-resource populations and has the largest number of insured risks in the country. Most of Solidaria's clients are from income strata 2 and 3, which the government defines as the low- and low-middle classes. The wealthy strata (5 and 6) are not well represented because most of Solidaria's products are designed to offer coverage and premiums especially suited for low- and middle-income populations. Although Solidaria has some clients from stratum 1, this segment is also not very well represented due to the challenges associated with reaching the poorest of the poor. A detailed breakdown of Solidaria clients by income is not available because Solidaria does not keep information about the income of its clients; however, the focus of Solidaria on low- and middle-income populations has been in place for decades. In fact, Solidaria pioneered the penetration of sectors traditionally excluded from the insurance market, such as taxi drivers, with whom they have been working for over 15 years.

Personal Accident and Group Life covers are the two largest lines for Solidaria, both by premiums written and lives covered (see Figure 2 and Figure 3). These are two of the most common products sold in the life microinsurance market in Colombia. In Figure 4, we can see that at USD 2.02 and USD 2.43 per month, these products are affordable for the poor. Both are group products designed for sale by a sponsoring entity that can collect premiums and facilitate policy renewal via automatic debit or another form of payment.

Figure 2: Solidaria premium by product type, January - April 2012 (USD)

Product type	Premium (USD)	% of total
Personal accident	3,078,756	52%
Group life	1,922,833	33%
Unemployment	698,560	12%
Funeral	177,594	3%
Home	10,806	0%
TOTAL	**5,888,549**	**100%**

Figure 3: Solidaria covered lives by product type, as of April 2012

Product type	Covered lives	% of total
Personal accident	1,523,100	64%
Group life	792,887	33%
Unemployment	30,096	1%
Funeral	28,905	1%
Home	132	0%
TOTAL	**2,375,121**	**100%**

Figure 4: Solidaria monthly average premium by product type, April 2012 (USD)

Product type	Avg. monthly individual premium (USD)
Personal accident	2.02
Group life	2.43
Unemployment	23.21
Funeral	6.14
Home	81.87
TOTAL	**2.48**

Distribution Strategy

Solidaria does not have its own retail sales force, but rather it partners with various distribution channels to sell its insurance products (see Figure 5 and Figure 6 below). The cooperative, or “solidarity” channel as they call it, is of great importance for them. There are 3,300 cooperatives with which Solidaria maintains agreements for the distribution of insurance products. In Colombia there are a total of 10,000 cooperatives and employee welfare trusts countrywide. As a result the cooperative channel has the advantage of being diverse (e.g. funeral cooperatives, transportation cooperatives, financial cooperatives, etc.), allowing Solidaria to reach a diverse and geographically wide-spread client base that would otherwise be difficult to serve.

Solidaria has explored other channels for the distribution of microinsurance, including a partnership with the electricity provider in San Jose de Cucutá, which is the capital of the state of Norte Santander. Other insurers have had success with this type of arrangement, such as Mapfre, which partners with Codensa, the utility company in Bogotá. The utility channel is an alternative to reach the large informal sector. The public service companies have a trusted relationship in place and a means of premium collection, two critical assets for microinsurance distribution. According to Solidaria, this channel will continue to develop as it sees the participation of these companies in the distribution of insurance products as an opportunity.

While some companies have used door-to-door sales in conjunction with the utility channel, Solidaria considers this approach to be both expensive and ineffective. When Solidaria attempted this method, it sold 35,000 policies in the first year; however, the renewal and collection rates where problematic and were dragging down the success of the sales channel, as the effective costs of covering door-to-door sales were unsupportable. In Figure 5 and Figure 6 we can see that the large majority of Solidaria's premiums and covered lives come through the group and cooperative channels.

Figure 5: Premiums by channel, January – April 2012 (USD)

Channel	Premiums (USD)	% of total
Group plans (employers, associations, utilities, etc.)	3,638,363	62%
Cooperatives	1,499,161	25%
Welfare funds	344,837	6%
One-to-one sales	315,199	5%
Banks	48,477	1%
MFIs	42,512	1%
TOTAL	**5,888,549**	**100%**

Figure 6: Covered lives by channel, as of April 2012

Channel	Lives covered	% of total
Group plans (employers, associations, utilities etc.)	1,651,022	70%
Cooperatives	519,372	22%
One-to-one sales	129,660	5%
MFIs	47,719	2%
Welfare funds	25,815	1%
Banks	1,533	0%
TOTAL	**2,375,121**	**100%**

Solidaria believes that its distribution strategy is successful when the partner sees the value of insurance for their members and understands how the credit unions themselves can benefit from a relationship with Solidaria, beyond the level of commissions paid. Of course, automatic debit from savings accounts is key to the success of the model. The relationship with credit unions and employers that can remit premiums makes this possible.

Distribution Costs

Solidaria negotiates an individual commission agreement with each distributor, but in general the distributor keeps about 10-15% of the premium in exchange for the use of their network. To this 10-15% we added the payment of incentives to sales officers within the cooperatives who sell the insurance products. On average, the payment of incentives to the sales force represents between 3-6% of the premium. As a result, taken together the channel keeps about 15-20% of the premium.

"We see credit union as partners. To make microinsurance profitable you need to develop a strategy that involves a high level of commitment for both Solidaria and the Credit Union. We work together to design publicity, trainings, goals for the sales team…We develop strong alliances with our partners"

-Rosa Osa Evira Henao, Solidaria

In the cooperatives sales channel, 65% of the policy sales are made through the intermediation of the staff of the cooperatives, while 35% are made by Solidaria staff, typically to the cooperative itself (e.g. portfolio cover) rather than to individual members. In other, larger channels, the proportion is reversed (40% of sales are made by intermediaries and 60% are direct.)

Solidaria maintains profit and loss statements for each product in order to evaluate the profitability of each of its initiatives. Claims cost is critical to profitability and also factors into how much premium may be allocated to distribution costs. Currently, Solidaria has a target average claims ratio of 40-43%. For some types of insurance, like personal accident, the claims ratio is considerably lower (e.g. 23%). As of the beginning of 2012, the results were 31% on a composite basis for all products (see Figure 7).

Figure 7: Claims ratio by product type, January - April 2012 (USD)

Product type	Claims value (USD)	Claims ratio
Group life	907,673	47%
Personal accident	720,044	23%
Unemployment	85,374	12%
Funeral	77,194	43%
TOTAL	**1,790,285**	**31%**

Distribution Cost Study

MILK studied Solidaria's distribution partnerships in Antioquia, the region where Solidaria began developing its partnerships with credit unions and where Solidaria continues to concentrate most of its microinsurance business. Solidaria has partnerships with five credit unions (Confiar, Coofinep, Cobelen, Creafam and CFA) in Antioquia; MILK made a detailed cost study of three of these – Confiar, Coofinep and CFA.

The Confiar, Coofinep and CFA Distribution Partnerships

The three financial cooperatives that we profile here are all based in Medellin. Confiar[2] (founded 1972), Coofinep Financial Cooperative[3] (founded 1962), and the Financial Cooperative of Antioquia (CFA)[4] (founded 2000) have a combined credit portfolio of almost USD 400 million. Both Confiar and Coofinep are profitable partnerships for Solidaria. CFA, however, did not prove to be a profitable distributor for Solidaria, and the relationship was finalized at the end of 2013. All three cooperatives profited from their partnerships with Solidaria.

Confiar, the largest of the three cooperatives in terms of portfolio, serves more than 100,000 clients and has a credit portfolio of USD 230 million, more than double that of CFA (USD 101 million) and nearly triple that of Coofinep (USD 60 million).

If we look at the two cooperatives that remain in partnership with Solidaria, Confiar and Coofinep, we see that both are quite profitable for Solidaria, with 18% and 10% claims ratios, respectively. Confiar has almost 10,000 policies in force, producing a ten-month premium volume of USD 285,000 (Figure 8). The considerably smaller Coofinep has almost 3,200 policies in force, producing a ten-month premium volume of USD 120,000 (Figure 9). Solidaria pays distribution and intermediaries fees to both – 20% in the case of Confiar and 10% in the case of Coofinep. Solidaria enjoys a 36% profit margin from Confiar and 54% from Coofinep (after taking fees and the direct and overhead expenses into account).

[2] Confiar was founded by a group of 33 workers from the Sofasa Company.
[3] Coofinep was founded by 28 workers and employees of Public Companies of Medellín.
[4] CFA emerged in the year 2000 as the result of the fusion of two cooperatives – Donmatías and Coobancoquia.

Figure 8: Confiar channel financial results

	Accumulated from Jan. to Oct. 2013 (USD)	Per policy (USD)
Premium	285,434	28.63
Claims	52,360	5.25
Claims ratio	18%	
Distribution fee 15%	42,815	4.29
Intermediary fee 5%	14,272	1.43
Overhead 21%	61,654	6.18
Direct expenses 4%	11,201	1.12
Profit	103,133	10.34
% Profitability	36%	
Policy count	9,970	

Figure 9: Confinep channel financial results

	Accumulated from Jan. to Oct. 2013 (USD)	Per policy (USD)
Premiums	120,210	37.65
Claims	11,855	3.71
Claims ratio	9.9%	
Distributor fee 10%	12,021	3.76
Intermediary fee	none	
Overhead 21%	25,244	7.91
Direct expenses 6%	6,751	2.11
Profit	64,339	20.15
% Profitability	54%	
Policy count	3,193	

We took two steps to determine the cost of insurance distribution for the cooperatives (Figures 10 and 11). First, we calculated direct marginal personnel expenses resulting from insurance distribution, yielding a cost of just 3.7% of commission earned for Confiar and 5.6% for Coofinep. We then added a portion of the remaining overhead based on business volume including loans and deposits. Using this approach, insurance expenses – including direct and overhead expenses – were 33.4% of commission (Confiar) and 52% of commission (Coofinep), leaving ample margin for profit in both cases.

Figure 10: Confiar distribution costs

Description	Basis	Annual Cost (Jan-Oct, USD)	% of gross commission
Solidaria 2013 commission	15% X 2013 premium	42,815	
Direct costs		(1,590)	-3.7%
Commission less direct costs		41,225	96.3%
Allocated costs		(12,730)	-29.7%
Profit on Solidaria commissions		28,495	66.6%

Figure 11: Confinep distribution costs

Description	Basis	Annual Cost (Jan-Oct, USD)	% of gross commission
Solidaria 2013 commission	10% X 2013 premium	12,021	
Direct costs		(668)	-5.6%
Commission less direct costs		11,353	94.4%
Allocated costs		(5,579)	-46.4%
Profit on Solidaria commissions		5,774	48.0%

The third partnership profiled here has not proven profitable for Solidaria and has been terminated. CFA had over 11,000 policies in force, producing a ten-month premium volume of USD 307,000 (Figure 12). From Solidaria's perspective, the channel was not profitable, with an incurred claims ratio of 79% (paid claims plus IBNR). Solidaria paid a total of 12% in distribution and intermediaries fees and made a loss of 9%, including these fees, as well as direct and overhead expenses.

Figure 12: CFA Channel financial results

	Accumulated From Jan. to Oct. 2013 (USD)	Per policy (USD)
Premium	307,426	26.62
Claims	(188,561)	16.33
Claims ratio	61%	
IBNR 18%	(34,695)	3.00
Distribution fee 12%	(36,891)	3.19
Overhead 21%	(66,404)	5.75
Direct expenses 3%	(8,752)	0.76
Profit	(27,877)	(2.41)
% Profitability	(9)%	
Policy count	11,549	

Using the same methodology described above to calculate the cost of insurance distribution for CFA (Figure 13), we found its direct costs were 4.6% of commission earned and total insurance expenses were 47% of commission – making the relationship profitable from CFA's perspective.

Figure 13: CFA distribution costs

Description CFA	Basis	Annual Cost (Jan – Oct, USD)	% of gross commission
Solidaria 2013 commission	12% X 2013 premium	36,891	
Direct costs		(1,708)	-4.6%
Commission less direct costs		35,183	95.4%
Allocated costs		(15,706)	-42.6%
Profit on Solidaria commissions		19,477	52.8%

Observation & Analysis

As we have seen, two of the three channels studied produce profit for Solidaria, and all three channels themselves earn a profit on the distribution of Solidaria's insurance. However, upon further analysis, each of the three yields insights into the business case.

Confiar is a profitable channel for Solidaria despite having the highest distribution cost in the group. In this case Solidaria is competing with Allianz and other carriers, such as SURA and Mapfre, for access to the channel. Confiar does not offer exclusive distribution arrangements and thus insurers are competing for the channel and as a result will pay more commissions.

Elsewhere, MILK has noted that competition is healthy for microinsurance and helps to rationalize pricing (See MILK Brief 14). Competition for Solidaria comes from multiple sources: insurance is sold in supermarkets, through public service companies and directly by insurance companies as in partner-agent models such as with Confiar. Yet we do not see the expected downward pricing pressure for Solidaria nor in Colombia generally. Our observation is that this is a distributor-driven market where insurers offer higher and higher commissions for access to channels. In MILK's prior research in Colombia (MILK Brief 21), we have seen the utility channel become saturated but remain expensive, with a total cost of over 40% of premium. The supermarket retail channel is even more expensive, with commissions as high as 50%, but does not as of yet yield much volume. Seen in this light, the credit union channels that Solidaria is using are relatively cost efficient.

Confinep is the smallest channel we examined, but it is also profitable for Solidaria despite producing less premium volume. Here, the distribution costs are only 10% and the claims ratio is quite low, supporting substantial profitability for Solidaria. Solidaria has found that smaller channels can be effective distribution partners. At first, Solidaria partnered only with entities with a minimum of 30,000 members but has since learned that it can work with channels as small as 7,000 – 8,000 people. More than the size of the channel, Solidaria seeks alliances with clients / partners with the capacity to work in close partnership to establish sales goals and processes as well as effective premium collection processes.

Solidaria makes a significant investment in setting up new distribution partnerships. Beyond the commissions paid to the partner, Solidaria assumes the following additional costs:

- Commissions paid to an intermediary, if any
- Sales incentives for internal staff
- Publicity (banners, flyers)
- Stationary (printing policies, etc.)
- Training
- IT development
- Human resources (Solidaria personnel in the institution)

Especially when dealing with a smaller channel like Confinep, it is critical for Solidaria to have confidence that it will get the commitment from the channel to follow through and reach the sales goals. Management believes that sharing roots as a cooperative has been an important factor for success for Solidaria. Since they "speak the same language," as Mónica Maria Arroyave suggests, "these strategic alliances and integration with cooperatives like Confinep are more likely to be successful. The alliances with credit unions are based on a strategy that involves a much higher level of commitment to clients than with the bank channel (Bancaseguros). It does not just simply involve inserting a representative from the insurer. There is shared investment in publicity, training, and goals for the sales team."

In addition to the profits the cooperatives earn in commissions for the use of their networks, their employees receive economic incentives for sales. The image of cooperatives is also reinforced when there is a claim and they handle the resulting compensation.

In terms of the lack of profitability for CFA, claims have been increasing over time and Solidaria feels that it does not have adequate access to the sales force to make the necessary adjustments. As a result the partnership with this channel is ending after 2013. Solidaria is including a provision for run off claims that it expects it will have once the partnership ends; it is this IBNR of 18.4% that makes it unprofitable. In the other cases this IBNR is not included, as the partnerships are ongoing. Without this provision for future claims the CFA channel would have had a 9% profit margin, which while less than the other two channels, still reflects profitability.

Conclusions

Looking at Solidaria's distribution channels in the Antioquia province of Colombia we find an unambiguous business case for the credit union partners as well as solid profitability for the insurer in two of the three examples. The fact that these products are commercially viable may be unsurprising to some, but our analysis also reveals nuance around when, how, and to what extent these programs are profitable to different players in the value chain.

While profitability is undeniable, materiality or relevance to the distribution partners is an issue. Solidaria asks for a significant commitment from the credit union. To understand better how the payoff might be viewed by the credit union, we compared their overall profitability to the profits earned from selling insurance. In Figure 14 below we see that those profits are quite small (≤ 2%) relative to the total. In this case Solidaria must then rely on either (a) the indirect benefit the coop perceives from the insurance program and / or (b) the affinity that Solidaria has by virtue of sharing cooperative movement roots with its partners.

Figure 14: Distributor profit from microinsurance distribution vs. overall profitability (USD)

	CFA	COOFINEP	CONFIAR
Total profit	993,837	2,476,727	2,435,861
Profit from microinsurance	19,477	5,774	28,494
% of overall profit	2.0%	0.2%	1.2%

We agree with Solidaria's analysis that their ability to make their microinsurance program workable in small scale channels is a product of the affinity within the channel and the collaborative relations with the cooperatives. We also learned that Solidaria succeeds by providing significant support and resources to the channel to spur sales rather than relying on the channel to go it alone. However, we wonder if the lack of materiality of the profits earned by the channel will prove to be an issue in the future.

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.