Micro-Insurance practice by Micro Finance Institutes (MFIs)

By Md. Quamrul Hasan

INTRODUCTION

Financing the poor is a risk, still Micro Finance Institutions (MFIs) have been involved in reducing and protecting poor household's vulnerability through micro-credit and savings program One of the risks comes from life and health risk of the clients, which ultimately makes the loan repayment uncertain. It is understandable that savings and emergency loans, address only relatively simple life cycle events and minor emergencies. Death and health insurance can prevent a family from sliding back to poverty. The concept of micro-insurance evolved out of these experiences gained over decades in micro finance.

According to the MFIs under this study, life insurance is the most widely available insurance in low-income markets. The lower frequency of death risks and the reduced complexity in managing life insurance make it a safer, easier form of coverage. Micro finance organizations venture into micro-insurance not purely, or even primarily, driven by a socially motivated agenda. MFIs are into it for a variety of commercial reasons, ranging from increased competition to limited sources of capital to diversifying risk to seeking new market opportunities.

Most of the MFIs under this study had several thousand clients, strong information-tracking capabilities, and a stable credit or savings portfolio before they developed insurance on their own. This paper focuses on product design, pricing, and delivery system of these organizations. I have, to the best of my ability, attempted to reflect the insurance schemes of various organizations accurately. Any misrepresentation or omissions are unintentional and solely my responsibility.

MFIs UNDER STUDY

All the organizations in this report provide some form of life insurance to their clients. The outreach of these products varies significantly, with the largest providers serving more than 5.5 million members and the smallest serving over 40 thousand.

It is worth noting that the substantial policyholder figures in Table 1 do not necessarily reflect a strong demand for life insurance on the part of low-income households. Five out of seven organizations studied provide their life insurance on a mandatory basis. Virtually all the policyholders purchase insurance as a condition of receiving a loan or maintaining an account.

Table 1
List of Micro-Insurers

Organization	Members
- Association for Social Advancement (ASA), Bangladesh	5.5 million
- Grameen Bank, Bangladesh	5.5 million
- Bangladesh Rural Advancement Committee (BRAC) , Bangladesh	4.0 million
- Delta Life Insurance Company Limited, Bangladesh	0.6 million
- FINCA, UGANDA	0.04 million

- Sarvodaya Economic Enterprises Development Services (SEEDS), Sri Lanka	0.2 million
- *Self Employed Women's Association (SEWA), India	0.2 million

*Though SEWA started as a social movement, it is now more like a MFI.

Motivation of MFIs to introduce insurance
Insurance protects households against those risks that they are unable to protect themselves through informal mechanisms, savings or credit. There is a degree of uncertainty among the various sources of vulnerability for low-income households, such as life cycle events, death, disability, loss of property, etc. There are occasional events such as epidemics, war, serious natural disasters that are all considerably more risky than life cycle events. The resulting losses or costs for each of these sources of vulnerability can vary from small to very large. As risks tend to get more and more uncertain, the losses increase and simple savings and loan activities may not be able to manage those losses (Hulme, 1999). MFIs have following motivation to experiment with insurance:

Social agenda: Insurance reduces the vulnerability of households and increases their ability to take advantage of opportunities. Also, insurance reduces the impact of household losses that could exacerbate their poverty situation.

Commercial agenda: Insurance enhances the stability and profitability of poor households. It reduces the impact of client-risks on loan and savings portfolios, generates additional revenue, and enhances services in comparison to competition. Insurance products can be linked with targeted savings and emergency credit.

Therefore, insurance is appropriate when there is an overlap of perspectives of both the member/borrower and the MFI.

TYPES OF COVERAGE

Designing micro-insurance product is a bit complicated due to high transaction costs, irregular income flows, and due to the difficulties in controlling moral hazard and adverse selection. Besides, households have limited understanding of insurance and there is a bias against insurers. Microfinance providers are themselves challenged by their need to achieve scale, the need for data and skills for actuarial analysis, reinsurance, investment opportunities and regulation.

Of all the products, term insurance is typically the most economical and the least complex form of life insurance. Term life insurance policies provide a predetermined amount of insurance coverage over a fixed period of time (the "term"). This may explain, at least in part, the popularity of term life insurance products among MFIs.

Table 2
Insurance provided by MFIs

Product Type	**Organization**
Outstanding Balance Life Insurance with Additional Benefit	- ASA - FINCA, UGANDA - Grameen Bank - SEWA
Death and Disability Outstanding Balance Life Insurance	- SEEDS
Basic Term Life Insurance	- BRAC
Life Savings Insurance	- ASA
Endowment Life Insurance	- Delta Life Insurance Com.

Term Insurance has been modified to customize popular micro-insurance product like Outstanding Balance Life insurance and others. It is linked to loans that repay the outstanding balance on the loan if the borrower dies. This type of policy provides the most limited coverage but also tends to be the least expensive. For the borrower's surviving family members, this product cancels their obligation to repay the debts of the deceased, thereby reducing a small portion of the financial loss associated with the death. For the lending organization, the insurance reduces loan default rates and collections costs. Five following variations on the basic term life insurance concept were identified among the organizations:

Outstanding Balance Life with Additional Benefit
This product covers the outstanding balance on a loan and provides an additional one-time monetary pay-out to the policyholder's designated beneficiary. The pay-out is generally aimed at helping surviving family members cope with sudden death of the member.

The beneficiary of a deceased **ASA** borrower receives the full amount of the loan at disbursal, from which the outstanding loan balance is deducted. Thus, the additional benefit is determined by the amount of the loan that has been paid off at the time of death. For example, if a borrower takes out a Tk. 3000 loan and dies the next day, all of the insurance payment will be used to repay the outstanding balance. On the other hand, if a borrower dies with only a single payment left on his or her loan, the beneficiary will receive most of the Tk. 3000 in cash.

Under Loan Insurance Program of **Grameen Bank**, outstanding loan is paid off in case of death of a Borrower. This coverage is now extended to the Borrower's husband (96% Borrowers of GB are women) with additional deposits in the loan insurance deposit account. If husband dies, outstanding loan is paid off by insurance. **SEWA** provides two integrated insurance packages which includes death, sickness and loss of assets. The coverage is also available for member's spouse and children. Under scheme 1, life insurance provides Rs. 5,000 on natural death, Rs. 40,000 on accidental death and Rs. 15,000 on Spouse's death.

Death and Disability Outstanding Balance Life
These policies operate in a similar manner to the outstanding balance products described above; however, they also offer coverage if a borrower becomes disabled. The amount of coverage and the definition of disability vary by organization. **SEEDS**, in Sri Lanka, cover both temporary and permanent disabilities.

Although these policies venture into a riskier and more complex area of insurance by offering disability coverage, these organizations have limited their risk by limiting coverage to the size and duration of the loan. In this way, SEEDS avoid the complex pricing, monitoring, and claims-verification methodologies typically needed to provide complete disability coverage. The addition of disability coverage should, in theory, create greater risk of fraud (clients can more easily falsify a disability than a death), implying greater claims-verification costs than for the basic outstanding balance policies (Narayan, 1999).

Life Savings Insurance

Unlike the previous types of term insurance, life savings insurance is tied to savings rather than credit. The beneficiaries of life savings policies receive a pay-out when he or she dies. In addition to loan insurance, small business member of **ASA** deposits Tk. 10 per week as security deposit or premium for life insurance. In case of member's death, family would receive 6 times of the total premium paid by the member. If there is no claim, the member will receive the total deposited amount along with 4 % interest after 400 weeks of contributing to insurance fund. The same type of scheme is now offered to the spouse also.

Basic Term Life

This insurance is tied to neither credit nor savings. Policyholders pay a regular premium, usually annually, and if they die during the course of the coverage period, a predetermined fixed indemnity is paid to the beneficiary named in their contract. **BRAC** provides Tk. 5000 insurance coverage irrespective of the loan amount taken by the borrower, in addition outstanding loans of deceased are written off.

Endowment Life Insurance

Endowment life insurance is similar to term life in that each policy has a fixed duration, although endowment policies are on average set for longer periods than term life policies. The main difference between endowment and term life is that the former accumulates a cash value. In 1993, Delta Life began offering endowment life policies, in either 10 or 15 years durations, with Face Amounts ranging from Tk. 5,000 to Tk. 50,000.

PRICING LIFE INSURANCE

In life insurance pricing, three components are important:
a) the methodology used for calculating premiums, b) the schedule used for collecting premiums, and c) the premiums charged relative to benefits provided.
All these factors affect both the ultimate success of the product in the eyes of prospective low-income policyholders and the prospects for financial sustainability of the providing organization.

Calculation of Premiums

The calculation of premiums is among the most important and complex aspects of providing insurance. Developed-market insurers rely on detailed, actuarial calculations to forecast expected mortality rates with as much precision as possible. Increased precision allows reducing margin for error and increases organizations' ability to offer policyholders more competitive prices.
The majority of the organizations studied calculate their premiums either by rule of thumb or through in-house actuarial expertise to gain access to the required expertise. **ASA**, in Bangladesh, developed a simple, but riskier, methodology to set premiums for its outstanding balance insurance. Rather than construct detailed calculations, ASA set a premium rate that management knew would be much higher than would be needed to cover claims and operating

expenses. The product was launched as mandatory coverage for all loans with a premium of 2 percent of the initial loan balance. As expected, ASA's clients quickly complained about the high cost of the insurance relative to the benefits. Anticipating this reaction, ASA's management gradually reduced the cost of the insurance over several years until clients stopped complaining. Premiums are now stable at 0.3 percent of initial loan balances (Matin, unpublished).

Although this approach was substantially simpler than that used by most of the other organizations, it also entailed a significantly higher risk for ASA. During the first several years of the program, ASA risked losing loan clients who became sufficiently dissatisfied with the high cost of the insurance. BRAC finances the insurance program through interest income earned from the micro credit program. It is estimated that 2 % of the total service charge on the loans (in average Tk. 5,000) covers the total expenses of the program. Taking into account of BRAC's average loan balance which is Tk. 3,500 and lump sum amount Tk. 5,000, the premium for the insurance coverage is Tk. 12 per thousand coverage amount.

The borrower of **Grameen Bank** (GB) is required to deposits 3 per cent of the original loan amount at the time of receiving loans under Loan Insurance Program. If a borrower dies, her entire outstanding amount is paid up by the insurance fund. In addition, her family receives back the deposit. This program is works as Money Back term insurance plan.

Scheduling Payments

For voluntary insurance products, clients are more likely to purchase a policy with a premium schedule that is in line with their household cash flows. In micro-insurance policyholders' premiums can be assessed in a single, up-front payment or divided into many smaller payments. Most MFIs assess premiums on an annual basis.

ASA and **FINCA Uganda**'s partner insurer American International Group **(AIG)** determine the total premium as a 0.5 percentage of the initial loan value and then divide this total equally across the duration of the loan. The advantage of these level premium systems is simplicity, for both the client and the organization. However, there is some conceptual dissonance. As clients progress through the loan cycle, they are paying the same premium for an ever reducing amount of coverage. For many, the practical concern for simplicity outweighed the argument for correlation between premiums and benefits (Sebagani, 2003).

SEWA allows its members either to pay premium annually or to open a Fixed Deposit Account. Under the later option, the interest accrued for the deposit is paid towards the premium every year; as a result a woman gets continuous insurance coverage throughout her membership with SEWA (McCord, 2001). Gono/Grameen Bima premiums of **Delta Life** are all assessed on monthly schedules, with level premiums over the life of the contract.

Premiums and Benefits

A life insurer's premium should be a function of three factors:
a) the risks covered by the policy, b) the insurer's expectations of claims losses and operating expenses, and c) the insurer's desired profit margin.

Since these factors vary, no single standard can be established for the premiums to be charged for a given level of coverage. If an organization discovers that its premium is substantially higher or lower than the others, that organization should be able to identify the cause of the difference in terms of differing coverage levels, mortality rates, operating costs, and/or profit expectations.

All the life insurance programs that shared their financial results are profitable, indicating that the premium rates presented are sufficient for each organization's specific context.

Impact of Actuarial Calculations

Organizations with the benefit of access to actuarial expertise in calculating their premiums appear to offer greater value for lower premiums, without jeopardizing the financial sustainability of the insurance program. FINCA Uganda, acting as an agent of commercial insurer AIG, offers the largest additional benefit (US$670 accidental death insurance plus coverage of the policyholder's spouse and dependents), yet its premiums are on par with those of ASA and significantly less than other organizations.

Table 3
Premium Rates of Life Insurance coverage provided by MFIs

Organization	Coverage (Death Benefit)	*Annual Premium rate (per 1000 coverage)
ASA	Write off outstanding loan and pays the balance of the Loan (Initial– outstanding loans) to the family.	Tk. 5.
Grameen Bank	Write off outstanding loan and the return of paid premiums.	Tk. 30
BRAC	Provides Tk. 5000 and Write off outstanding loan	Tk. 12
SEWA	Natural Death : Rs. 5,000 Accidental Death : Rs. 40,000 Hospital Expenses, Property loss Ins. etc.	**Rs. 7.5 (rate for normal death of the member)
SEEDS	Provides Death and Disability coverage.	Rs. 17.50
FINCA UGANDA	Write off outstanding loan and pays lump sum to the family.	$ 5-10

** for Normal Death Coverage of the member.*
***Rate collected from McCord (2001) paper.*

Mandatory Insurance

Most of the term life insurance providers in the study rely on mandatory insurance policies to reduce adverse selection. For these mandatory policies, the insurance coverage is an automatic condition of the loan or savings account. Mandatory coverage offers the providing organization two benefits. First, it reduces the risk of adverse selection within the client base, as all loan or savings clients must purchase the insurance regardless of their risk level.
Second, mandatory insurance allows the organization to achieve the scale required to feel reasonably confident that claims losses will track closely to expectations.
The disadvantages of this approach are that policyholders have no option to reject the insurance if they are dissatisfied with the coverage or the pricing; as a result, the provider lacks a feedback mechanism for judging whether clients' risk-management needs are truly being met. In essence, making an insurance product mandatory comes with the implicit responsibility of the organization to ensure that policyholders are at least minimally satisfied with the benefits of the insurance.

MARKETING

Insurance products are very different from the savings and credit products that are the primary focus of the majority of the organizations in the study. Insurance requires policyholders to make

ongoing contributions for an uncertain future benefit. In the case of term life, there is no tangible benefit to policyholders if they do not die.

Many organizations indicated that clients were slow to accept and understand why they should be interested in the insurance. In Bangladesh, ASA clients initially complained that the insurance premium was simply another form of obligatory "savings" scheme. The clients of FINCA Uganda were skeptical because in the past, other insurance companies, unrelated to FINCA Uganda or its partner AIG, had failed to fulfill their claims obligations. FINCA was able to turn this perspective around by making sure that their claims would be paid and in a reasonable time period (Weihe, 1997).

The unique nature of insurance relative to other financial services suggests that training will likely be required for providers' sales staff. However, the mandatory nature of most of the life insurance offered by the organizations has negated much of the need for credit or savings officers to learn how to sell insurance. Indications from Uganda and Bangladesh suggest that a lack of sales staff training can limit a product's success.

Delta Life has hired a dedicated, commissioned agent sales force from among its potential client base to sell its Gono Bima product. However, preliminary indications suggest that these agents receive limited training in how to sell the product, as many of their clients are friends or family who "…want to help the commissioned agent out…" (Matin, Unpublished).

ORGANIZATIONAL MODELS

Three different organizational models for delivering life insurance benefits were used by the organizations. Each model implies different responsibilities, skills and expertise, and different revenue and cost implications. Each model is described in more detail in the paragraphs that follow :

Full-service Insurers

It perform, start to finish, all the activities required in offering life insurance. They are responsible for all aspects of product manufacturing, sales, and servicing. This model is the most demanding on an organization in terms of the capacity, expertise, and investment required to make it work. As a result, it also entails the most financial risk for an organization; full-service insurers are wholly responsible for all insurance-related costs and losses. As compensation, full-service insurers retain all the income generated if a product is profitable.

Partner–Agent Model

Two organizations are involved in the provision of the life insurance. The partner, typically an established insurer, is responsible for product manufacturing. FINCA Uganda, and SEWA act as agents for established insurers and are responsible for both product sales and servicing.

The division of responsibilities, benefits, and costs under this model allows each party to focus on doing what it knows best. Aviva Life Insurance Company and AIG, the established insurance companies that have partnered with FINCA Uganda and SEWA respectively already have actuarial expertise and financial resources to develop and support an insurance product. However, they lack an infrastructure to distribute and service policies efficiently for low-income households.

In this model, the MFI helps overcome this obstacle by serving as the insurance agent. Through its village bank network, for example, FINCA Uganda has pre-existing channels for efficiently

conducting financial transactions in low-income communities. This network is also well positioned to verify claims as they are received from policyholders' beneficiaries. In this model, the strengths of one party offset the weaknesses of the other.

In developed insurance markets, agents typically receive commissions from their partners to help cover the cost of sales and servicing. The purpose of their insurance programs of FINCA Uganda was to provide a valuable service to their existing loan clients and to support their existing credit business, rather than to earn a profit outright from their insurance operations. As a result, it does not receive a commission from its respective partner organization. Instead, FINCA Uganda justify the cost of their insurance programs through the reduced default rates and collections costs in their lending business and the intangible marketing benefit when potential clients recognize the value of having the insurance protection (Sebageni, 2003).

Group Policyholder Model

Organizations interested in delivering insurance benefits to their clients do so without taking on any of the costs or responsibilities of insurance provision. Instead of selling policies to its savings clients, collecting premiums from individual customers, and verifying claims, MFI purchases a group life insurance policy from a local insurer. As a group policyholder, MFI is not responsible for any sales or product servicing activities; it simply pays premiums and forwards applications for claims to Insurer just as any policyholder would. The difference in this case is that the claims MFI submits are on behalf of its clients, rather than on its own behalf. MFI does not charge its clients directly for the insurance; premium payments are funded from the organization's general account.

Organizations preferring not to burden themselves with the risks of offering insurance are more likely to prefer group policyholder models. Organizations interested in maximizing the financial gains from their insurance products are more likely to prefer the full-service insurer approach. As an organization gains more experience with insurance, it may opt to change its organizational model and take on more activities like SEWA.

OBSERVATIONS AND CONCLUSION

This study described the salient features of micro-insurance of seven different organizations that are insuring against risks faced by low income households. Following are the findings:

Protection for MFIs

Some insurance coverage more clearly benefits the organization offering the insurance than the policyholder, while other forms of coverage are designed in the interests of the policyholder. Basic outstanding balance insurance is the primary example of the former.

Although the beneficiaries of policyholders are relieved of the obligation to repay the outstanding loan, many MFIs write off loan losses due to death regardless of the availability of insurance. Thus, the primary "beneficiary" of such insurance is the lending organization, which receives compensation for loans that otherwise would have been written off. But in a competitive environment, organization-focused insurance may become a liability for an MFI. As clients, when given the choice, may prefer less costly uninsured loans from a competitor to insured loans made more expensive by premiums.

Additional benefits offer coverage that is increasingly focused on the needs of the policyholder rather than the organization. For MFIs, it is important to question the primary purpose in

developing a life insurance product. Is it to protect the MFI (against loan default, for example), or is it to reduce the impact of a death on clients and their families?

Table 4

Loan Insurance scheme of Grameen Bank (GB)

Following information is based on data from MicroBanking Bulletin (MBB) and Grameen Bank web site as of Jan. 2003 - Jan 2004 :

- **Organization Model :** Full-service Micro-insurer
- **Outstanding Loan:** Presently 1638 crore.
- **Micro Loan Disbursement :** In average Tk. 13 crore per month
- **Loan Repayment Period :** Normally Loans are for 1 year period.
- **Balance in GB's Loan Insurance Fund :** 50 crore, expects to grow 20 % each year.
- **Claims Paid :** Tk. 5 crore, **Claims Ratio :** 10 % of collected premium.
- **Administration : C**mputerized Accounting and MIS in most of the Branches.
- **Insurance Coverage :** Outstanding loan plus Return of Paid Premium(s) on Death.
- **Annual Premium Rate for Insurance Coverage:** GB requires Borrowers to deposit 3% to the Loan Insurance fund. So the premium rate comes to Tk. 30 per thousand of coverage.

Actuarial Pricing of Money Back Term Insurance in comparison to GB's premium rate:

Segment	**Mortality Table 1980 CSO**	**Expenses (% of Premium)**	**Interest Rate**	**Premium Rate** (per thousand)
1	100 %	50 %	5 %	Tk. 5.15
2	150 %	75 %	5 %	Tk. 15.62
3	200 %	50 %	5 %	Tk. 10.35
4	200 %	75 %	5 %	Tk. 20.92
5	200 %	82 %	5 %	Tk. 29.28

Grameen Bank charges **Tk. 30** per thousand of coverage amount.

The above rates would be even lower if calculation is based on declining loan balance which is more appropriate for this type of insurance. GB's insurance coverage is bundled with micro credit loan on mandatory basis using its existing micro credit infrastructure, so there is no extra/additional cost for providing insurance to its Borrowers. Overall expenses ratio of GB is only 14.89 % (in 2004).

Over-Priced Premium Rate

The premium rates determined by most of the MFIs under study were not based on actuarial study and mortality experiences. All studied MFIs except ASA, SEWA and FINCA UGANDA are charging simply excessive premium. In the context of Bangladesh, premium rate of Grameen Bank is well above the actuarially sound rate whereas ASA's premium is quite reasonable. Such a variation in premium rates among them while operating in the same socioeconomic environment with healthy life fund is quite perplexing. In fact, ASA is charging the lowest premium among all the MFIs under this study.

FINCA Uganda and SEWA in partnership with AIG and Aviva respectively provides high coverage with minimum cost, since they can avail the expertise of their partner commercial Insurers.

Parter-Agent - the Best Model

Based on this study, "Partner–Agent" model comes out to be the most preferred model for micro-insurance. Following are some significant characteristics of this Model:

- This model allows the organizations involved to focus on what they know best. In a partner–agent relationship, the commercial insurer is not attempting to reach an unfamiliar clientele while the MFI is not attempting to develop products without the required expertise and financing.

- Partnership leverages the existing resources within both organizations, which can result in a reduced initial investment in both time and money. Established insurers often have actuarial capacity available that can develop a product for a low-income market. MFIs with just one micro-insurance project may not require dedicated actuarial resources that are either expensive or time-consuming.

- Although some studied micro-insurers (e.g. ASA) have developed successful insurance products without any formal actuarial expertise, the evidence from FINCA UGANDA and SEWA suggests that products developed with the insurance expertise of a partner can offer greater benefits at a similar cost to the policyholder.

- This model would help generating additional revenue in the form of commissions and Profit share on the sale of the insurer's policies. Acting as a sales agent, the MFI or local organization takes on none of the insurance risk, but is able to provide the benefits of insurance to its clients or members.

- Insurance sector is generally highly regulated. However, none of the organizations acting as agents are being affected by any government regulations. NGOs and MFIs may be intentionally excluded from standard insurance regulations because of their social missions or because they only insure their own loan clients. However, this Model would eliminate virtually any legal restriction if ever, any question arises in the future in regards to the legality of Full-service Micro-insurance provided by MFIs.

Creating social protection for poor people is a complex task. Even though, micro-insurance is still a new and evolving area for experimentation and research, experience provides some useful

lessons and highlights where further innovation, change, and experimentation are needed. It is too early to predict the impact micro-insurance will have on low-income households and the organizations that work with them. However, the examples presented here indicate promise and possibility in furthering the development of micro-insurance. At last, but not the least, MFIs should not make commercial gain by providing micro-insurance coverage to the poor people, rather they should help them to get out of poverty by charging them the minimum actuarially viable premium. In closing this study, it is fitting to quote a phrase from Old Testament: “If you lend money to one of my people among you who is needy, do not be like the moneylender; charge him no interest.” (Chapter 22, verse 25).

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