MICROINSURANCE

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Abstract

In a global financial market dominated by innovation, with the declared tendency of unification and integration of financial markets, we notice that emerging markets are still looking for solutions to accommodate as many segments of the population as possible in a single market, the insurance sector being one of the most active and effervescent sectors in this perspective. In addition to the economic role of corporate insurances, we also meet the social one, without being confused with social insurance, which is the responsibility of governments and state authorities. Therefore, microinsurance is considered to be exactly at the boundary between the two, its stated role being to help and protect the low income population.

The purpose of this study is to present the concept of microinsurance and to highlight the differences between this type of insurance and the traditional insurances by presenting some guidelines regarding the positioning on the insurance market, as well as the most important features. The social role of this type of insurance is further emphasized, with details of the most common risks and the way they are presented in the form of ”*microinsurances*”.

Keywords: insurance, microinsurance, microfinance, distribution channels, traditional insurance

JEL Classification: A10, D53, G22

Introduction

”Poor people in the poorest countries are usually exposed to the greatest risks. Earthquakes, floods, drought, diseases, crime tend to hit the poorest. Vulnerabilities and poverty go hand in hand, but microinsurance promises to break a part of the cycle that links them.” [1]

”Microinsurance” is an increasingly used term when it comes to insurance with a low or limited insurance premium intended to serve a low income category.

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Microinsurance is part of the wider concept of microfinance, which includes a variety of ”micro” financial services for low income population. In fact, microinsurance is not very different from traditional insurance, except that it targets a different segment of population. However, this implies a completely different way of thinking about insurance: newer, simpler products, alternative distribution channels and an efficient concentration on operations.

Microinsurance products are viable alternatives to reduce the risk exposure of the population and ensure a stable environment favorable to social inclusion. Also viewed from the perspective of private sector actors, the creation of microinsurance products can be a mean of economic growth, the delivery process to target groups generating additional cash flow.

The interest in creating such products, the international organizations' forecasts regarding the future of microinsurances globally, with sometimes accelerated growth in emerging markets, market penetration strategies, have all pointed to the direction of enlargement, but also the need for the legal framework in which the entire activity can be carried out, with the primary objective of protecting the consumer and ensuring fair access for disadvantaged people to microinsurance products.

I. Definitions

A first definition was drafted by Craig Churchill in the first volume of the Compendium ”Protecting the Poor: A microinsurance compendium” in 2006:

”Microinsurance is the protection of low income individuals against specific risks in return for regular premium payments, proportionate to the probability and cost of the risk involved.”[2]

Without being considered complete and rather conceptual in nature, a detailed description is needed to make microinsurance operational. Thus, four main ways of defining the concept of microinsurance have been identified, which must be met cumulatively.[3]

1. Target group: The initial definition indicates that microinsurance is for people with low incomes. However, as there is no indication as to how to measure or determine that the low income group has been effectively reached, the definition could not be used effectively by insurers or supervisors.

Limitations: It is not realistic to expect insurers to assess whether the eligible policyholders are sufficiently poor to justify microinsurance.

2. Product definition: The most common operational definition uses product parameters based on the assumption that the capping of the insured amount and the premium will ensure product relevance for low income households. This approach is commonly used by regulators

[2] Craig Churchill, *Protecting the poor: A microinsurance compendium*, International Labour Office, Geneva, Munich Re Foundation, Munchen, Germania, 2006, p. 12.
[3] Craig Churchill, Michal Matul, *Protecting the poor: A microinsurance compendium*, Volume II, International Labour Office, Geneva, Munich Re Foundation, Munchen, Germania, 2012, pp. 8-10.

in countries already known and is relevant if their intention is to force or to attract existing insurers to develop products for the microinsurance market.

Limitation: Defining microinsurance based on premium ceilings and its benefits may be problematic if it inhibits innovation by limiting insurer options in product design. There are products that fall within specified parameters, such as a credit card or travel insurance, which, although having relatively small premiums, they are not intended for the target group.

3. Provider: A third way to define microinsurance is based on the type of organization that can provide it. In addition to traditional insurers, microinsurance could also be provided by other types of companies such as funeral services, mutual societies, cooperatives and community organizations. This approach is used, for example, in the Philippines, where mutual societies have lower capital and technical requirements and can offer a limited range of products.

Limitations: definitions that focus exclusively on suppliers could hinder the expansion of microinsurance, since a number of institutional arrangements are needed to reach a vast and untouched market.

4. Distribution channel: a fourth approach, sometimes used by the insurance companies, is the definition of microinsurance according to the intermediary involved. For example, if the products are distributed by the microfinance institutions, by the retailers or by other organizations, then they could be considered microinsurance by the insurer.

The four concepts considered separately fail to describe completely a microinsurance, but together they create a comprehensive picture and draw guidelines for both insurers and regulators. Moreover, within an insurance company, it is necessary to distinguish between traditional insurance and microinsurance, by establishing for the latter one a distinct department with a clear definition of the duties and working procedures within this department. Also, the regulators and supervisors, in order to establish a coherent and functional frame that ensures a fair competition on the market, should regulate this activity according to the country's objectives and specifics.

The qualitative definitions of the *microinsurance* concept describe the products in relation to the client, client that has the following characteristics: low income, with a clear need for small premium, flexible payment schemes, contracting the insurance without completing papers or forms and innovative distribution channels. Also, the focus on consumer definition aims at staying focused on this segment of the population. The reference points given by the target group are accurate and distinguish between traditional insurance and microinsurance.

II. Introduction of "microinsurance" concept

The "*microinsurance*" concept is based on at least the following four characteristics, as shown by the specialized studies:

1. Simplicity / easy to understand*:* the microinsurance concept should be structured according to the type of insurance product, underwriting conditions, premium collection and complaint handling. This takes into account the lack of actuarial data and contributes to a better understanding of the products and their acceptance by the potential insured.

2. Price accessibility*:* insurance premiums and coverage are kept at a low cost in order to make products accessible to the target population. The grants provided by the authorities can also contribute to simplifying the access to microinsurance products. At the same time, when these grants are missing, there are a number of innovative financial options, among which we mention crowdfunding, a resource that uses an on-line platform, which represents an innovative alternative to microfinance projects, and which can be applied in some microinsurance projects.

3. Flexibility: *a*s the low income people's category is not a homogeneous segment, the microinsurance products require, in order to meet their needs in an efficient way, to be personalized and designed according to the needs of the target group. One example is the frequency of the payment of insurance premiums, which can be adapted to the needs of future policyholders.

4. Obvious utility: low income people generally face the following risks: death or serious illness of a family supporter, loss of crops or loss of households due to natural disasters and extreme weather phenomena.

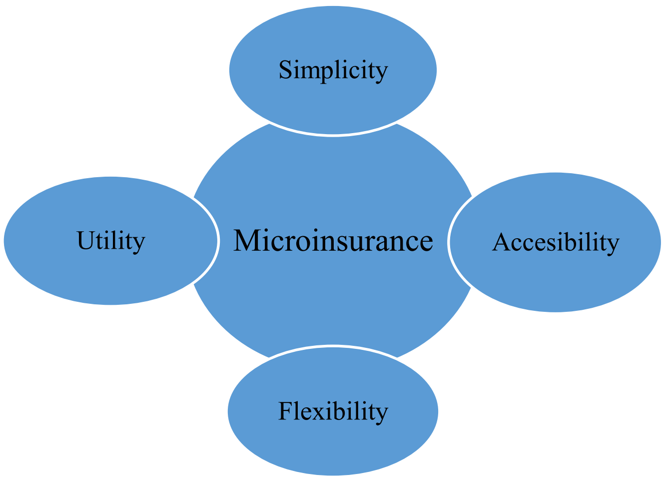

Figure no. 2.1 Microinsurance characteristics

Source: "Protecting the poor: A microinsurance compendium" Volume II, International Labour Office

Microinsurance can be a social protection tool through its role of collecting risk mitigation measures, mainly through premiums, the basic feature being the fact that there is rather a horizontal redistribution of income between companies with comparable risk profiles, than a vertical redistribution, from the rich to the poor. At the same time, the "*micro*" prefix indicates that contribution rates are accessible to low income people with reduced benefits in proportion to the paid premiums. Ideally, the scheme's benefits package, registration conditions and trading formalities should meet the specific needs of the target group[4]. The term "micro" can be understood from three perspectives, according to a study published on the website www.microinsuranceacademy.org . A first approach is represented by the product's characteristics, the second refers to the financial situation of the customers, namely the ones with low incomes, and the third one is a characteristic of the process by which the schemes are created and managed.[5].

Microinsurance contracts are often the result of a "dialogue" between suppliers and target groups, while public social protection systems are often created through vertical processes (top-down).

The limitations of the potential of microinsurance are primarily linked to the fact that they are not a substitute for social transfer schemes, since microinsurance addresses vulnerability rather than severe poverty. Microinsurance schemes (in a similar way to social security schemes) are funded by the contributions of their members and are designed to mitigate the impact of any reduction in a member's revenue and any unexpected increase in his main expenditure. They are not a suitable tool for people who have difficulties in meeting their basic daily needs, not to mention provisioning for future social needs. Unlike fiscal transfer systems and social security systems - microinsurance systems can not (and do not have the purpose) to redistribute funds from wealthy members of society to the poor.

Another limitation is closely related to access to a microinsurance system, given that many households do not have such systems in their neighborhood. Although microinsurance schemes offer to people with low and fluctuating income, who often cannot access other types of social protection instruments, the possibility to mitigate their risks, they cover only a limited part of the population in those countries: many experts think that microinsurances will never reach a majority of the population, even in the most optimistic hypotheses (APUD: Roth et al., 2007).

A particular issue is that governments and donors (foundations in particular) can support the extension of microinsurance by providing advice and promoting the creation of sound basic conditions, but nevertheless the fairness of granting financial subsidies to these systems should be carefully considered because it would favor system customers at the expense of households that do not even have the chance to join. [6]

It has been found that microinsurance is better suited to cover certain risks / needs than others are. Experience shows that in life insurance and disability the problems tend to be the lesser. Ensuring extreme weather events is currently offered by several countries, although this is more difficult to design and manage. Micro-pension is also difficult to offer because it requires a high degree of trust of customers in suppliers, especially since benefits are paid after decades from the premium payments, not to mention the difficulty of the investment management provider to generate revenue which will make possible future pension payments.

[4] Ibidem, p. 49.
[5] David M. Dror, David Piesse: *What is microinsurance?*. The study can be found at: www.microinsuranceacademy.org/wp-content/files_mf/1406872143194603_MIN_BRO_CHAPTER_2_final.pdf
[6] Ibidem, p. 49.

Micro-health insurance also raises serious challenges. Micro-health insurance generally reimburses the costs of medical treatment to policyholders regardless of their income. This means that for a given indemnity package, the insurer expects to spend in average the same amount of benefits to all insured.

Despite these limitations, microinsurance can be a useful approach to social protection in some very different situations, as illustrated in the following figure. The role of the state in the use of microinsurance as a social protection instrument can be extremely important if certain principles, listed below, are respected. [7]

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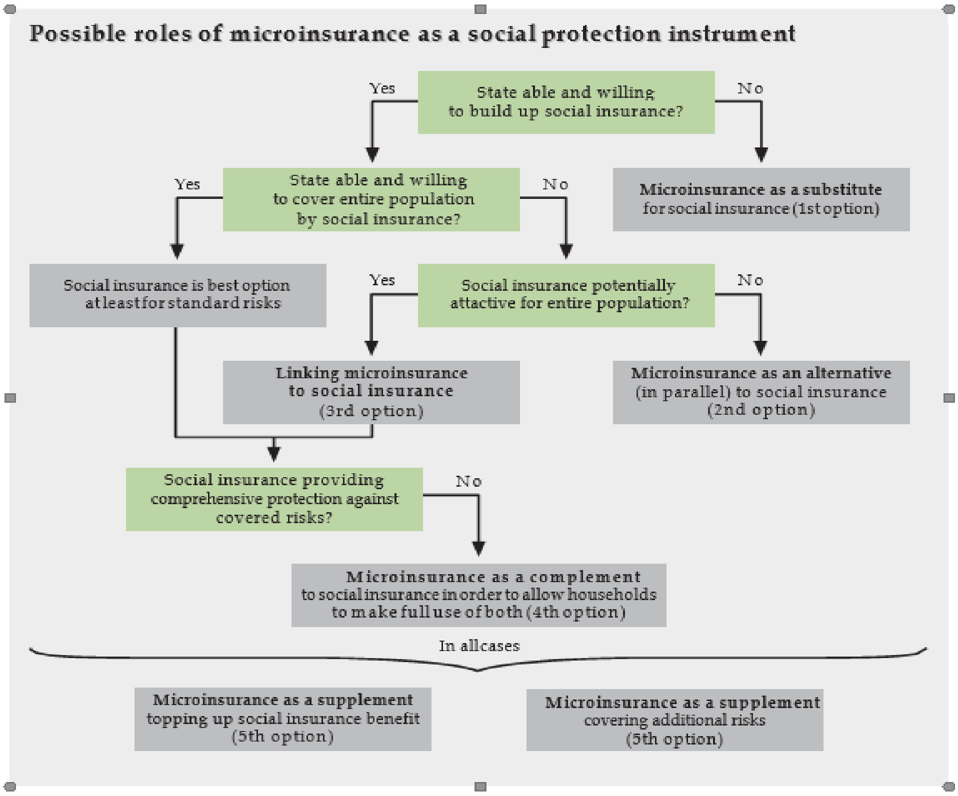

Figure no. 2.2 Social role of microinsurers

Source: Craig Churchill, Michal Matul, Protectingthepoor: A microinsurance compendium, Volume II, International Labour Office, Geneva, Munich Re Foundation, Munchen, Germany, 2012, p. 52

Overall, we can say that *microinsurance has the ultimate goal of ensuring social protection*, by reducing poverty and vulnerability by providing support to low income families in their risk management efforts. In addition, microinsurance schemes should not be evaluated solely on the basis of technical criteria, such as financial sustainability and cost-

[7] Ibidem, pp. 52-58.

effectiveness, but also on their impact on poor and vulnerable groups in society. The promotion of microinsurance should also be part of a systemic approach geared to protecting as many households as possible against as many risks as possible.

From a social protection point of view, it is essential to bear in mind that the benefits of microinsurance are often most effective when combined with other complementary social protection instruments such as social security or when they are included in a wider social protection framework. The positive impact of microinsurance systems makes its presence felt in four major directions. That is why we can talk about the *positive role of microinsurance products on a large scale*, with 4 roles identified by specialists.

The first one, but not the most important, is the *social protection*, followed by the *financial inclusion*, the *commercial development* and the *financial stability*.

Specialists have identified *four types of microinsurance product providers* that we find in most countries with such developed channels:

1. Donors (foundations) and NGOs: see the CGAP - World Bank Advisory Group to Assist the Poor[8] and Microinsurance Network[9], a multi-stakeholder global platform[10].

2. Investment funds: Leapfrog, J.P. Morgan, Swiss Re etc.

3. Brokers specialized in microinsurance products: microensure[11] or planetguarantee[12]. Microensure is a subsidiary of Opportunity International, operational in countries like Philippines, India, Indonesia, Uganda, Kenya, Tanzania and Ghana. It launched a range of innovative products on the South African market such as: index-based agricultural insurance, life insurance, health insurance, or invalidity insurance that can be signed by those who contract mobile telephony services.

4. Risk providers: met in countries like South Africa, Kenya, India, Philippines. As an example, we can take Old Mutual Group[13] who created a funeral insurance product for South Africa, distributed through a supermarket chain.

Microinsurance products are less restrictive in terms of eligibility requirements, are designed for irregular revenue streams, with flexible payment schemes and low premiums, have a transparent and easy process for claim and complaints and are characterized through the accessibility of the registration. Also, the design of the microinsurance products aims at adapting the design, distribution, customer service and promotion strategy to the profile and needs of low income customers.

The table below is suggestive in highlighting the correspondence between the main features of traditional insurances and microinsurance products:

[8] http://www.cgap.org
[9] https://www.microinsurancenetwork.org
[10] Stakeholder = english word in business field meaning „ interested parties"
[11] https://microensure.com
[12] http://www.planetguarantee.com
[13] https://www.oldmutual.co.za/about-us/about-the-old-mutual-group

Table no. 2.1 Main Features Traditional Insurance vs. Microinsurance

Traditional Insurance	Microinsurance
- **Limited eligibility with standard exclusions**	- Generally inclusive, with few exceptions
- **Regular premiums payment requiring bank transactions**	- The premiums provide customers with irregular cash flows, cash payments or possible alternatives
- **Ussualy at least 12 months**	- The covered period may be shorter - 4 months
- **Screening requirements may include medical examination**	- Limited healthcare statement
- **Age / risk price**	- Community / Group prices
- **Agents / brokers are primarily responsible with sales**	- The distribution channel can manage the entire customer relationship, including premium payment, collection and claims
- **Markets are mostly familiar with the insurance**	- The market is largely unfamiliar with the insurance

Source: adaption after http://www.impactinsurance.org/; https://www.frankfurt-school.de/en/home.html

The table above shows the differences between the two insurance concepts on the main attributes used in creating a product: risks, coverage, premiums paid, benefits, terms and conditions. These differences determine the design of the microinsurance product and highlights its main features.

III. Conclusions

Starting from the definition of microinsurance, which has a broader meaning and includes both qualitative aspects of the microinsurance concept as well as quantitative factors to describe what microinsurance policy is, we can create a product design by pointing the features presented above.

Also, the focus on consumer definition aims at staying focused on this segment of the population. The benchmarks are accurate and distinguish between traditional insurances and microinsurance.

Conceptual clarifications (eg specificity level of who is targeted / population target and what kind of parameters a microinsurance product must have, distribution channels, etc.) helps regulatory authorities and / or supervision to promote regulatory policies aimed at introducing, implementing or supervising microinsurances.

Finally, we can speak of a high interest from both international bodies, insurance companies and businesses / associations with various forms of functioning and organization (NGOs, IFNs, Mutual Societies, etc.) for access to financial and insurance services of very low income population categories and for the protection of consumers of such services in case of risk. Equally, the need to protect poor populations against risks is as high as possible, with very low incomes preventing access to traditional insurance products. Strategies, targets, and actions applied by certain developing countries to provide certain types of risk on severely depressed population segments can be considered good practice examples for a much larger scale implementation of a coherent, accessible and easy to understand insurance system.

References

[1] Craig Churchill, *Protecting the poor: A microinsurance compendium*, International Labour Office, Geneva, Munich Re Foundation, Munchen, Germany, 2006.

[2] Craig Churchill, Michal Matul, *Protecting the poor: A microinsurance compendium*, Volume II, International Labour Office, Geneva, Munich Re Foundation, Munchen, Germany, 2012.

[3] www.microinsuranceacademy.org

[4] https://www.oldmutual.co.za/about-us/about-the-old-mutual-group