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A BUSINESS CASE FOR MICROINSURANCE: AN ANALYSIS OF THE PROFITABILITY OF MICROINSURANCE FOR FIVE INSURANCE COMPANIES

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PREFACE

The primary goal of the International Labour Organization (ILO) is to contribute with member States to achieve full and productive employment and decent work for all. The Decent Work Agenda comprises four interrelated areas: respect for fundamental worker's rights and international labour standards, employment promotion, social protection and social dialogue. Broadening the employment and social protection opportunities of poor people through financial markets is an urgent undertaking.

Housed at the ILO's Social Finance Programme, the Microinsurance Innovation Facility seeks to increase the availability of quality insurance for the developing world's low-income families to help them guard against risk and overcome poverty. The Facility, launched in 2008 with the support of a grant from the Bill & Melinda Gates Foundation, supports the Global Employment Agenda implemented by the ILO's Employment Sector.

Research on microinsurance is still at an embryonic stage, with many questions to be asked and options to be tried before solutions on how to protect significant numbers of the world's poor against risk begin to emerge. The Microinsurance Innovation Facility's research programme provides an opportunity to explore the potential and challenges of microinsurance.

The Facility's *Microinsurance Papers* series aims to document and disseminate key learnings from our partners' research activities. More knowledge is definitely needed to tackle key challenges and foster innovation in microinsurance. The *Microinsurance Papers* cover wide range of topics on demand, supply and impact of microinsurance that are relevant for both practitioners and policymakers. The views expressed are the responsibility of the author(s) and do not necessarily represent those of the ILO.

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Executive Director
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CONTENTS

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1 > INTRODUCTION

The question "under what circumstances can insurance companies generate profits from microinsurance?" is important because in many markets insurers are showing an increasing interest in expanding into the low-income market. Insurers are beginning to recognise the future potential of this market and the longer term benefits of building a customer base in a new market segment. To maintain the involvement of commercial players in this market, microinsurance needs to contribute to the overall profitability of the insurer and generate value for its investors. Profits over time must be sufficient to compensate investors for the capital invested and the risks taken, in order to justify the investment required to support the development of the business.

This paper presents a case study analysis of the profitability of microinsurance provided by five insurers operating in different regions across the globe. The insurers selected for the case studies are sampled from differing environments, and approach the problems of commercial microinsurance in different ways. To bring consistency to the analysis, and to facilitate comparison between the cases, a framework for the assessment of microinsurance profitability was developed. The framework is based on three main drivers of profitability:

- generating sufficient income by reaching scale
- managing claims costs
- and managing acquisition and administration costs

How the insurers balance these three often competing aspects of the business is investigated through the case study analysis. Although the experiences in these case studies are unique, investigating the challenges and successes of these established microinsurance initiatives provides insights into possible approaches to improve viability for other players in the market.

Although this paper considers mainly the commercial viability and profitability of microinsurance business, there are other significant reasons why insurers target the low-income market. Most evident from the case study studies are social objectives to improve the quality of lives of the poor. Given the importance and prevalence of these social objectives, a complete review should factor an initiative's client value proposition. The question of profitability needs to be balanced with whether products provide value to the client because long-term sustainability depends on the value proposition. Unfortunately, this review was beyond the scope of this paper, and further research is needed.

Government regulation that requires or encourages commercial insurers serve low-income and rural communities is another reason for insurers to expand into this market. The insurers in the case studies from India, South Africa and the Philippines have been influenced by government policy on microinsurance to a greater or lesser extent. Donors have also played a role in expanding the involvement of insurers in microinsurance by funding research and pilot projects to smooth the entry for commercial players by reducing the investment required and the associated risks.

Despite the social motivations, it is important that microinsurance initiatives are viable to maintain the involvement of insurers and develop microinsurance into a globally sustainable industry. The experiences of the several insurers in the case studies indicate that microinsurance can be profitable. However, there are instances where the insurers experienced challenges in establishing a profitable initiative and have engaged in an iterative process of restructuring the initiative aimed at reaching profitability.

For the most part the insurers have not formally monitored the costs associated with developing microinsurance products and writing the business. As a result, it was difficult to assess the cost of the microinsurance business directly and assumptions had to be made around expense allocation. The expenses were allocated based on a proportional method, where the management costs of the relevant business segment or overall company were allocated to the microinsurance business based on premium volumes. It is possible that if the costs were more accurately allocated to the microinsurance products, expense ratios would be higher. As business grows it will become more important for the insurers to monitor expenses relating to microinsurance accurately to better understand the profitability and commercial viability of the business.

The framework is tailored to assess microinsurance initiatives run by traditional insurers. It therefore may not be relevant for assessing all microinsurance initiatives or for analysing profitability for other players in the supply chain (e.g. distribution channels). The framework was also adapted to suit the circumstances of the five participating insurers and will require cautious application to other companies.

The paper is organised as follows. Section 2 outlines the research methodology and selection criteria used for the cases. Section 3 provides an overview of the framework and drivers of profitability. Section 4 lays the context for the insurers, the insurance sector they operate in, and their microinsurance initiatives. Financial analysis and an examination of the drivers of profitability for each of the microinsurance initiatives are outlined in Section 5. Section 6 concludes with the main findings from the case studies and recommends areas for future research.

2 > METHODOLOGY

This section considers the nature of funeral insurance in more detail. What makes funeral insurance different from other types of microinsurance? What are the market's salient features?

The research used a case-study approach. Five insurers from different regions running microinsurance initiatives were selected based on the following criteria:

- The insurer is well established and has been selling traditional insurance business for a number of years
- The insurer has sold microinsurance products for at least three years
- The insurer has adequate financial information to analyse the profitability of microinsurance over time

Once the insurer was selected, the products to be assessed were chosen taking into account the following aspects:

- number of lives covered/policies issued (at least 50,000 lives covered)
- the period for which the schemes have been in operation
- availability of financial data for the period under review
- the consistency of product features over the review period

The research relied on the insurer's definitions of microinsurance markets. For Old Mutual, ICICI Lombard and Malayan, these products intended to comply with policy or regulatory definitions of microinsurance, whereas for CIC and ASR the products were based on a distribution channel that was expected to reach the low-income market.

A number of challenges were encountered in obtaining information from the insurers.

WILLINGNESS OF INSURERS TO PARTICIPATE

A number of insurers were reluctant to participate in the study as they felt that their information was commercially sensitive. Some insurers declined to participate all together, whilst others were willing to participate, but with limited disclosure of the financial information. Although this posed difficulties in compiling this research, it indicates that insurers view microinsurance as a serious business venture, vulnerable to competition.

ABILITY TO OBTAIN DATA

The quantitative information required for the financial analysis was difficult to obtain, even from willing insurers. Often the required data was unavailable because insurers did not monitor that particular aspect of their initiative. In some cases significant assumptions had to be made to do the financial analysis.

STAGE OF DEVELOPMENT OF INITIATIVES

Although a number of the insurers were reaching a large number of low-income lives, the portfolios were relatively small compared with the market and their history was relatively short. In some cases it was found that although the initiative had been operational over a long-enough period, financial monitoring had only been performed for a short period of time. In other cases, products had been altered significantly over time to take account of experience, and therefore the product in its current form only had a short history of financial information. Where difficulties were encountered in this respect, the qualitative information drawn from interviews with the insurers was relied on more heavily in the analysis. Figure 1 provides an overview of the framework developed to assess the profitability of microinsurance. The framework was developed using as a reference both the standard measures of profitability used in the traditional insurance market, as well as performance indicators developed by the CGAP Working Group (now the Microinsurance Network) in 2008. Both quantitative and qualitative measures were considered.

The framework includes three main drivers of profitability: achieving scale, managing claims costs, and managing acquisition and administration costs. The two aspects at the base of the diagram cut across the drivers of profitability and form the necessary foundation for successful initiatives. A detailed description of the framework and the drivers of profitability is in Appendix A.

Figure 1: Framework for the assessment of the profitability of microinsurance initiatives

Scale: Selling and retaining large business volumes	Claims costs	Acquisition and administration costs
Defining and accessing the market	Pricing for the risk	Working with partners and groups
Providing valued benefits and meeting the needs of the market while maintaining premiums at a reasonable level	Managing anti-selection, moral hazard and claims fraud	Leveraging existing infrastructure
Incentivising distribution channels to sell and renew voluntary products	Use of reinsurance and managing claims volatility and co-variant risk	Simplicity and efficiency in distribution and administration systems
Building relationships with the market and servicing policies efficiently		
Organisational structure Monitoring experience		

This framework uses *excess of income over outgo* as shown in the revenue account as the measure of profit in the period. The amount of profit in a given period is an absolute measure and is therefore difficult to compare against the profits of other microinsurance initiatives or lines of business on its own. The framework therefore measures overall profitability of the microinsurance initiative relative to the premium income as depicted in Box 1.

Box 1: Measurement of profitability

$$\text{Gross Insurance Profit Ratio} = \frac{\text{Gross Insurance Profit}}{\text{Gross Earned Premiums}}$$

[Profit is also measured in terms of net insurance profit to net earned premiums (after allowing for reinsurance)]

If insurers want to have a better understanding of the value to shareholders generated by microinsurance business it is important to keep track of capital and other resources devoted to the microinsurance, and monitor the profits relative to these investments. The return demanded by investors is usually related to the perceived risk of the initiative.

Providing insights into the return on investment for the case studies was not possible due to a lack of data from insurers on the amounts invested in building the business. Some qualitative insights into the resources devoted to the business are given in the analysis section.

The following factors underlie the profitability of microinsurance business:

SCALE

Microinsurance initiatives need to achieve scale to cover the costs of building the business and other fixed costs. Low margins in microinsurance business often means that these initiatives need to generate larger policy volume to generate reasonable profit levels relative to other business. Scale is also needed to maintain a stable pool of risks; this in turn enables insurers to manage claims costs.

It is important not only to focus on selling large volumes of business, but also to retain customers. Monitoring new business relative to renewed business can be an important indicator in this regard. Levels of retention can be an indication of customer satisfaction and the appropriateness of the product.

CLAIMS COSTS

Claims costs are managed mainly through the design of the initiative, pricing for the risks, and managing the risks. Pricing the risks is a challenge because microinsurance involves new markets and products for commercial insurers. Insurers often rely on existing experience when pricing microinsurance products, and make adjustments over time based on the experience of the initiative. Risk management measures need to be built into the design of the initiative and the products. The insurer should also implement processes to mitigate underwriting and claim stage risks (e.g. anti-selection and claims fraud) as well as monitor these risks on a regular basis. Reinsurance can protect the insurer against poor claims experience.

ACQUISITION AND ADMINISTRATION COSTS

Many insurers work with groups and leverage existing infrastructure, within the insurer or of strategic partners, to control distribution and administration expenses. Insurers are also experimenting with alternative distribution channels such as retail stores and telecoms that provide access to an existing client base. Simplicity of products and efficiency in the processes and the design of the microinsurance initiative are important.

Two aspects of initiatives cut across the drivers of profitability:

ORGANISATIONAL STRUCTURE OF THE INSURER

It is important to understand how contextual factors and the specific circumstances of an insurer can influence the successes and challenges of a microinsurance initiative.

MONITORING EXPERIENCE

It is useful to assess the changes in the quantitative performance indicators as well as the underlying drivers of the profitability of microinsurance over time, as it allows for an understanding of the evolution of the product.

3 > CONTEXT AND SETTING THE SCENE

This section gives an overview of the five microinsurance initiatives and the environments in which they operate (see Table 1 for a summary of the initiatives).

3.1 CO-OPERATIVE INSURANCE COMPANY (CIC), KENYA

THE KENYAN INSURANCE MARKET

The insurance industry is underdeveloped compared to other sectors of the economy with insurance penetration remaining at around 2.6 per cent (2008) for the past few years. The majority of this penetration is attributable to compulsory motor third party insurance and compulsory government insurance and pensions from the National Health Insurance Fund (NHIF) and the National Social Security Fund (NSSF).[1]

Insurance activity in the low-income market has increased in recent years, with many traditional insurers showing interest in this market. A range of products have been recently introduced including health, credit life, personal accident and crop insurance.

CO-OPERATIVE INSURANCE COMPANY (CIC)

CIC is a large established insurer that is owned by over 1,000 co-operatives. It is the only co-operative insurer in Africa and is the eighth largest insurer in Kenya. CIC has been active in the low-income market for a number of years, administering a handful of products through its existing traditional insurance departments. Given its experience in the market and dedication to grow its microinsurance business, CIC established a microinsurance department in 2010.

CIC has benefited from its existing links with the co-operative movement in Kenya that have allowed it to easily form partnerships with many credit co-operatives to distribute microinsurance products.

CIC'S MICROINSURANCE PRODUCTS

Among the microinsurance products offered by CIC are a group credit life product, and a bundled product known as Bima ya Jamii (Insurance for the Community). Credit life is the oldest of CIC's microinsurance products, offered to microfinance institutions (MFIs) and savings and credit co-operatives (SACCOs) since 2002. The product is compulsory for all borrowers. It covers the borrower for the period of the loan and pays the value of the outstanding loan plus interest to the lender in the event of a borrower's death or disability. An additional payment to the disabled borrower or their surviving dependants of US$130 was introduced in 2010 for no additional cost.

The credit life product has been a means for CIC to generate profits in order to support the development of riskier microinsurance products, such as Bima ya Jamii, which provides a health, funeral expense, loss of income and personal accident benefit for the principal member and named dependants. Bima ya Jamii has been revised over time, mainly as a result of challenges experienced with the health component of the product. In the most recent (and most successful) version of the product, CIC outsourced the health benefit to the NHIF, which has more experience managing health insurance risk.

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[1] FinAccess National Survey 2009

Table 1: Overview of microinsurance initiatives

	Products	Target market	Distribution and administration	Structure
Co-operative Insurance Company (CIC), Kenya	- Credit life: compulsory credit life - Bima ya Jamii: voluntary bundled health and life insurance cover Credit life shows large profits from inception Challenges with growth for the voluntary product	Members of microfinance institutions (MFIs), savings and credit co-operatives (SACCOs) and other self-help groups Large MFI and SACCO membership in Kenya	MFIs, SACCOs and other groups Leveraged existing relationship with these groups	Planning to set up a separate microinsurance business unit
Old Mutual, South Africa	Burial Society Support Plan: group funeral cover Funeral cover is popular in South Africa, but this is a highly competitive market	Members of burial societies, funeral parlours and savings clubs Challenges with small group sizes	Salaried agents who work with groups are responsible for the selling and servicing of policies Costly distribution model	Set up the Foundation Market business unit to focus on the low-income market
ICICI Lombard, India	- Manipal Arogya Suraksha: group-based health insurance - Index-based weather insurance: crop cover based on rainfall index (Bundled with credit) The government created awareness for index-based insurance Challenges with the profitability of the health insurance product	Community groups in western coastline of India Clients of MFIs, rural banks and other credit providers	Network of health care providers MFIs and other credit providers First mover advantage is important in establishing relationships with these groups	Microinsurance products are managed under business units organised by product line. There is no separate microinsurance business unit.
Aseguradora Rural (ASR), Guatemala	- Life cover: death and disability cover - Student cover: life policy with additional health cover Both products have been profitable since their launch	Clients of BANRURAL (rural bank)	BANRURAL network of bank branches Leveraged infrastructure of the parent company BANRURAL	Microinsurance products are managed under the life insurance business department
Malayan Insurance, Philippines	Life cover with additional benefits (e.g. fire assistance)	Clients of pawn shops, rural banks and lending intuitions, co-operatives and NGOs	Pawn shops, rural banks and other credit providers Leveraged partner's large footprint in the low-income market	Managed by the Retail Underwriting Group Plan to move management of microinsurance business to subsidiary in 2011

Bima ya Jamii, like the credit life product, is sold through SACCOs and MFIs. However, it is not compulsory for all members of the MFI or SACCO. CIC relies on the MFIs and SACCOs to sell the product to their customers. This structure posed challenges for CIC, with partner remuneration needing improvement to incentivise higher levels of sales. CIC has recently engaged an agency to assist in managing sales at the MFI and SACCO branches. The agency is responsible for training the MFI and SACCO sales clerks on the workings of Bima ya Jamii, provide consumer education at the point-of-sale, and provide customer support on behalf of CIC (both for the partner and the policyholders).

3.2 OLD MUTUAL, SOUTH AFRICA

THE SOUTH AFRICAN INSURANCE MARKET

Traditional insurance provision in South Africa is highly developed, and is comparable to developed nations both in terms of size and sophistication. However, the low-income market is underserved. As a result, there have been increased efforts in recent years, both in the public and private sectors, to improve the provision of insurance in this market. A variety of insurance products are now available to low-income South Africans, the most dominant of which are voluntary funeral products provided by both formal (e.g. insurers) and informal providers (e.g. burial societies and funeral parlours). The funeral insurance market is highly competitive. Insurers have used a range of distribution channels to reach the market from the traditional agent model, to partnering with church groups, retailers, burial societies and funeral parlours. Products are also sold through banks.

OLD MUTUAL

Old Mutual is the largest and oldest life insurer operating in South Africa, offering a wide range of products across all income segments in South Africa.

Old Mutual sells a significant amount of their business through its Retail Mass Market business unit, which targets clients in the middle to low-income groups. This business unit contributes considerably to Old Mutual's growth and profitability. Success of the Retail Mass Market unit led to the creation of the Foundation Market business unit in 2008 to develop products exclusively for the low-income market. The Foundation Market business unit was set up separately from other business units to provide the initiative with sufficient attention to allow it to grow and eventually contribute substantially to Old Mutual's profitability.

OLD MUTUAL'S MICROINSURANCE PRODUCTS

The Foundation Market currently has one established group funeral product and is devoting significant resources to build other distribution channels and products. These other products were at an early stage of development at the time of this study and therefore could not be analysed.

The funeral insurance product provides a cash payout on the death of a covered life. It covers the principal member with the option to add immediate family members and is distributed through burial societies and funeral parlours using salaried agents. Once a burial society or funeral parlour opts to take the cover, the cover becomes compulsory for all members who each pay a monthly premium. Burial societies and parlours can select from a range of sums assured,

with the selected cover level applicable to all members, and therefore the same premium payable by all members on a monthly basis. Both the product design and distribution model are common in the South African market.
Due to existing cultural norms, the product is popular and therefore relatively easy to sell. However, the use of salaried agents to distribute the product is expensive. Additionally, burial societies tend to be small and therefore scale has been difficult to achieve. Another challenge has been the large number of competitors in the market, which has meant that the high start-up costs of the product could not be fully reflected in the product premiums. The Foundation Market unit has however benefited from access to technical skills and infrastructure from other business units, which has helped keep overheads low. Old Mutual is prepared to provide this support until the business unit becomes profitable and can sustain its own expense base.

3.3 ICICI LOMBARD, INDIA

THE INDIAN INSURANCE MARKET

Prior to 2001, the Indian insurance industry was wholly state-owned. Following the opening of the industry to private players in 2001, significant growth has been experienced, with insurance penetration rising steadily over time. The insurance regulator issued Microinsurance Regulations, which require insurers to sell a certain proportion of their business to low-income earners. Additionally, the government subsidises insurance premiums for poor households. Microinsurance in India is mainly sold through partnerships with MFIs, NGOs and other community-based organisations. A wide range of products are available to the poor, including credit life, index-based weather insurance, health and livestock insurance.

ICICI LOMBARD

ICICI Lombard was established in 2001 when the Indian insurance market opened to privately owned operators. Today, it is the largest private sector non-life insurer in India, offering a full range of retail and commercial products. ICICI Lombard's microinsurance business mainly originates from group-schemes sold through partnerships with large and reputable NGOs and MFIs, as well as government-funded schemes. In 2008, the Indian government introduced a national health insurance fund known as Rashtriya Swasthya Bima Yojna (RSBY). ICICI Lombard has focused on successfully procuring RSBY bids from various districts, and this is a major part of their microinsurance strategy going forward.

ICICI LOMBARD'S MICROINSURANCE PRODUCTS

Among the many microinsurance products underwritten by ICICI Lombard is an index-based weather insurance product that ICICI pioneered in 2003 with a leading MFI, BASIX. The product is sold to farmers throughout India through credit providers. The government also plays a significant role in promoting sales by subsidising the product premiums, which are relatively high, by upto 80 per cent for farmers applying for agricultural credit. The product provides a payout in the case of low rainfall, as well as excess rainfall, at the option of the insured. Payouts are progressive once rainfall in an area falls short or is in excess of a predetermined threshold limit. The weather product has benefited from government campaigns to build awareness of weather insurance as index-based insurance has gained better acceptability among the policymakers.

ICICI Lombard also underwrites a health product known as Manipal Arogya Suraksha Yojna, ("MAS") which is offered to low-income families in the coastal districts of the states of Kerala, Karnataka and Goa. This product provides a hospitalisation benefit and additional cover for 30 days prior and 15 days post hospitalisation for the principal member and their immediate family and is sold on a group basis to community groups (or clusters) such as churches, temples and self-help groups. This product was developed in conjunction with the Manipal Group, a diversified enterprise engaged in areas of healthcare and education. This group has ownership of 11 hospitals, at which the benefits under the health product can be redeemed. Administration of the product is shared between ICICI Lombard and the Manipal Group. Manipal Foundation, a Corporate Social Responsibility Team of the Manipal Group is engaged closely with the scheme in identifying the poor households who cannot afford to pay premiums for this scheme. This foundation provides premium subsidies in varying proportions to families who cannot afford the premiums.

3.4 ASEGURADORA RURAL, GUATEMALA

THE GUATEMALAN INSURANCE MARKET

A large proportion of the Guatemalan population in both the low and middle income groups are excluded from formal financial services.[2] The insurance market in Guatemala is relatively small, with 17 insurers in total covering the life and non-life markets. Insurance penetration in the country is low at 1.2 per cent[3] and has remained relatively stable over the past few years.

Few insurance companies in Guatemala have ventured into the microinsurance market, with only three showing significant activity. Competition is therefore limited.

ASEGURADORA RURAL (ASR)

Aseguradora Rural is a small insurer, established in 1999 to operate in both the life and non-life markets. It is fully owned by BANRURAL, a large local bank focused on extending financial services to the rural population of Guatemala. ASR's strategy is aligned to that of BANRURAL, with the focus being the provision of insurance to the rural market.

ASR has launched four microinsurance products to date. ASR's microinsurance business has experienced significant growth since its inception and in 2009 accounted for 28 per cent of ASR's total gross premiums. The microinsurance business is administered under the traditional insurance operational structures within ASR. There is however a team allocated to managing the relationship between ASR and BANRURAL's agency network, which currently distributes all of ASRs microinsurance products.

ASR'S MICROINSURANCE PRODUCTS

This study considers a life product and a health policy sold to students. The life product constituted approximately 90 per cent of ASR's total microinsurance gross premiums in 2009. It was ASR's first microinsurance product, providing

[2] Source: World Bank data - Web pages: http://data.worldbank.org
[3] Source: Superintendencia de Bancos de Guatemala - SIB. - Web pages: www.sib.gob.gt

life, funeral and disability cover. A range of annual premium and benefit levels are available to choose from, with different plans available for the 15-50 years age group and the 51-64 years age group. To purchase a policy, the client needs to be an account holder of BANRURAL, although it is not compulsory for BANRURAL's clients to purchase the product.

ASR's student policy provides a death and disability benefit for principal members and a health benefit for financially dependent minors. The product benefits include:

- For the minor person, healthcare services provided by ASR's partner healthcare network (EPSS) or reimbursement of health expenses in a different healthcare centre in case of accident, ambulance service in case of accident, daily rent for hospitalisation in case of accident or disease, and medical assistance 24 hours a day.
- For the parent or tutor, cover in case of death deriving from a natural or accidental cause and cover in the case of permanent and total disability.

A range of premium and benefit levels for both the student and principal member components are available. Similar to the life product, policyholders are required to have an account with BANRURAL, although the product is not compulsory for all account holders.

ASR spends a significant amount of time managing BANRURAL's role in the distribution of the product and has encountered challenges incentivising the bank's agents to sell the product.

3.5 MALAYAN INSURANCE, PHILIPPINES

THE FILIPINO INSURANCE MARKET

The Filipino insurance industry is small but growing, making up 1.2 per cent of GDP in 2006. Approximately 5.4 per cent of the adult population are covered by a microinsurance product.[4]

Insurers are starting to target the low-income market and are offering a range of products: whole life; accident, burial and medical benefits plans; asset protection for microentrepreneurs hit by fire, lightning, flood, typhoon or earthquakes; and weather-index crop insurance.

In addition the government developed the "National Strategy and Regulatory Framework for Microinsurance" to promote growth in the microinsurance sector while protecting consumers by requiring retail sellers of insurance policies to either register a mutual benefit association (MBA) or partner with a regulated insurer.

MALAYAN INSURANCE

Malayan Insurance, the largest general insurer in the Philippines, has been active in the low-income market as part of an expansion strategy into new markets. It relies on three distribution channels to service the low-income market:

- National pawnshop network with more than 1,200 branches provide personal accident insurance with fire assistance

[4] Microinsurance in the Philippines Presentation, National Credit Council Department of Finance, 2009

- Rural banks and lending institutions provide consumer and retail lending to livelihood projects and microenterprises through 78 branches nationwide
- Co-operatives and NGOs provides weather-index, life and fire insurance

4 > FINANCIAL ANALYSIS AND DRIVERS OF PROFITABILITY

This section investigates the overall profitability of these microinsurance initiatives by exploring the factors underlying their financial viability as outlined in the framework above.

The analysis uses a combination of performance indicators derived from financial information and insights gained from the interviews with managers at the insurers. The financial analysis is based on financial and product information received from the insurers, including financial accounts, internal reports on policy information and claims, and marketing material. In many cases only summarised information was made available and hence most of the insights on financial analysis were obtained through workshops with management. These insights are particularly helpful in understanding the financials and identifying elements of the initiative that may be contributing to the profit or creating losses for the business.

The profitability analysis is based on the premiums received and claims reported in each year and an allocated amount of expenses. In instances where expenses were not tracked separately for the microinsurance products, they were allocated proportional to the premium income for the broader business units. It is possible that this would underestimate the cost of some of the microinsurance initiatives where expenses are disproportionately higher than the corresponding premium income.

As the analysis is based on case studies of five insurers, the study emphasises individual approaches and experiences of each insurer and drawn comparisons and general insights into the drivers of profitability where appropriate.

4.1 OVERALL ASSESSMENT OF PROFITABILITY

For microinsurance initiatives to be viable business propositions, they need to make a contribution to overall profitability of the business relative to their risk and the investment of capital and other resources required. Table 2 shows the insurance profit gross of reinsurance costs for the products investigated in the case study:

Table 2: Gross insurance profit[5]

Insurer	Product	2007	2008	2009
CIC	Bima ya Jamii (Accidental death and disability bundled with National Health Insurance)	60%	51%	27%
	Credit Life	69%	66%	66%
ICICI Lombard India[6]	Manipal Arogya Suraksha (Health insurance)	(30%)	(30%)	(32%)
	Weather Insurance (Index-based weather insurance)	(35%)	5%	1%
Old Mutual South Africa	Burial Society Support Plan (Funeral insurance)	(20%)-(25%)	(25%)-(35%)	0%-5%

[5] Details of the calculation of the performance indicators used in the financial analysis is found in Appendix B.

[6]All the figures for India in the financial analysis section are for the financial year 1 May to 30 April

ASR Guatemala	Life Cover (Accidental death and disability)	85%	46%	67%
	Student Cover (Accidental death and disability)		67%	56%
Malayan Philippines	Microinsurance business (Mainly accidental death and disability)	47%	35%	47%

CIC

Data and assumptions

The allocated amount of expenses for Bima ya Jamii were based on the direct expenses determined by CIC with an addition of a proportion of the group life expenses allocated to this product, based on assumptions made by the researchers. No expenses were allocated individually to the credit life product.

When estimating the allocation of expenses, it was assumed that microinsurance should be factored into the expenses of the group life business where most of the business is managed. Expenses were attributed to the microinsurance business in proportion to the premium income of each initiative. This assumes that the expenses for a type of business managed by the group life department relates to the premium volume for each type of business. CIC may find that actual microinsurance expenses are different (possibly higher) to these expense allocations. Such a detailed expense investigation was beyond the scope of this case study.

Profitability assessment

Both of the CIC microinsurance products investigated in this study are profitable. The credit life product is more profitable than the bundled health insurance product and is the most profitable of all the products investigated in the case studies. CIC used its experiences in credit life to learn about the market. The profitability of credit life supported the expansion into other insurance microinsurance products like the bundled health product.

The bundled health insurance product was loss-making until it was re-launched as Bima ya Jamii with the health insurance component underwritten by the NHIF. The following keys to the profitability of the CIC microinsurance products were identified:

- Partnering with a large number of MFIs and SACCOs
- Compulsory nature and high margins of credit life product
- Bundling life benefits with the more popular health benefits
- Outsourcing the risk of the health cover to the NHIF
- Leveraging the infrastructure of the distribution channel and paying low fees for selling and servicing business
- Challenges with business volumes of Bima ya Jamii due to a lack of incentives for individual sales staff
- More accurate monitoring of expenses for Bima ya Jamii led to decline in the profitability levels

ICICI LOMBARD

Data and assumptions

ICICI Lombard restructured its operations in 2008. Since then, there has been no separate business unit for microinsurance or rural and social sector business. Both of the business units where the two microinsurance products are housed are also responsible for products sold to market segments outside of the microinsurance market.
Actual administration costs and non-commission acquisition costs relating to microinsurance were not available from ICICI Lombard. In addition, researchers were provided with budgeted, rather than the actual expense amounts. But, given ICICI Lombard's policy of strict adherence to expense budgets, there is little scope for variation between the budgeted and actual costs. The expense allocation method assumes that the cost of writing the business is proportional to the premium income.
There is no reserving for the index-based weather product due to the structure of the product. Premiums earned and claims incurred are equivalent to written premiums and paid and reported claims. The financial analysis for the index-based weather insurance is based on gross of reinsurance premium results . ICICI Lombard was unable to disclose the net of reinsurance premium and claims information for the weather insurance product, as this would disclose commercially sensitive information about their reinsurance programme for the product. For consistency, the figures show the gross of reinsurance results for both products.

Profitability assessment

There have been challenges to the profitability of both the ICICI Lombard microinsurance initiatives. The index-based weather insurance product appears to be just breaking even before reinsurance is taken into account. The MAS health insurance product has been consistently generating negative returns, due to high claims ratios. ICICI Lombard has introduced measures to improve the claims experience of the health insurance business, but the effect of the interventions has yet to be seen in the profit ratios. The following keys to the profitability of the ICICI Lombard microinsurance products were identified:

- Partnering with a large number of credit institutions for the weather insurance product and the health care provider network for the MAS health insurance product
- Compulsory nature of weather insurance product for all members of the group
- Using long standing relationship of the health care provider with the community as well as using the insurer staff to encourage enrolment for the health insurance product
- Claims risk challenge both products, protected by reinsurance for weather insurance which is a key reason for ICICI Lombard being able to provide this cover
- Mutually beneficial relationship with the distribution channel, facilitates lower fees for services and access to infrastructure
- Managing microinsurance together with traditional insurance business on a product line basis facilitates access to the resources of business unit and allows expenses to be subsidised by the business unit as a whole
- Support from government and the healthcare network to create awareness for these products

- Combining social objectives with insurance in order for premium to be subsidised by government for the weather index product and by the Manipal Foundation for the health product

OLD MUTUAL

Data and assumptions

Old Mutual's practice in the traditional insurance market is to collect sufficient information on each client in order to monitor the experience of the portfolio of clients. Such business practices follow through into the Foundation Market's business. Expenses are monitored and allocated to each product within the Foundation Market's portfolio, allowing for accurate pricing.

The data received from Old Mutual was fairly comprehensive, providing details of the reserves for the product as well as management expenses allocated to the product. Since reserving is relevant for the burial society product the financial ratios are based on an earned premium and claims incurred basis. The allocations of the management expenses were used in assessing the profitability of the initiative.

Profitability assessment

Old Mutual's group funeral product had been loss making since its launch in 2003, and has only in the last year managed to break even due to interventions to manage claims ratios. The following keys to the profitability of the group funeral products were identified in the case study:

- Measures to reduce number of loss making groups on the books are starting to improve the poor claims experience
- Salaried agent delivery model is expensive relative to premium volumes generated, this issue is exacerbated by small group sizes
- Setting up a separate business unit for the Foundation Market to focus on expanding insurance into the low-income market, but still having access to resources from other business units in the insurer

ASR

Data and assumptions

ASR has not kept separate records of expenses related to its microinsurance initiatives. The company does not analyse claims and expenses specifically for microinsurance in its monitoring and performance management system. Expenses are managed at company level and any deviation against the budget objectives is analysed. Claims are monitored for damage business line and life and accident business line and deviation from the historical or budget objectives are analysed.

The analysis of the profitability for each year is based on the premiums received and claims reported in the year, an allocated amount of expenses, reserves and investment income. The claims expenses were identified for each product and for the consolidated microinsurance business respectively.

The marketing expenses and training expenses are managed at company level and were distributed based on gross premium. The expenses related to promotion activities on the field were directly identified for the microinsurance products an allocated based on gross premium.

The allocated amount of sales incentives corresponds to a proportion of life products amount allocated based on the number of policies sold. The rewards, bonuses and administration expenses were allocated based on the gross premium.

The reserves for unearned premiums correspond to technical reserves calculated as a percentage (given by the law) of gross premiums for each business line. The outstanding claims reserve, corresponding to claims reported but not paid at the end of the year, was identified for each individual product. There is no reserve for claims incurred but not reported, as the law does not allow it.

Profitability assessment

The microinsurance initiatives of ASR have shown good annual profits since the inception of the business in 2007. Both products analysed achieved comparable level of profitability. The Life Cover product is major contributor to the overall profitability due to the sales volume it generates. The following keys to the profitability of the ASR microinsurance initiatives were identified in the case study:

- Providing simple products that have not previously been widely available in the market
- Using limited underwriting and exclusions to manage claims risks
- Partnership with the parent bank with a vast footprint in the low-income market
- Paying no fees for access to the infrastructure and the services provided by BANRURAL

MALAYAN

Profitability assessment

The microinsurance initiatives of Malayan Insurance have been profitable after the initial investment in business in 2004. The following keys to the profitability of the microinsurance initiatives were identified:

- Providing simple accidental death and disability products with additional cover (e.g. fire) that is valued by the target market
- Partnership with the pawn shops, rural banks and credit providers with a vast footprint in the low-income market
- Making changes to the cover over time based on experience (e.g. removing the 'Unprovoked murder and assault' from product sold through pawn shops)

4.2 SCALE

Microinsurance is a business that needs to reach high volumes to generate profit and justify resources required to build the business. This can be a challenging task in the low-income market and insurers use strategies to achieve scale like working with aggregators, tapping into existing demand, and offering compulsory products.

COVERED LIVES AND PREMIUM VOLUMES

The level of scale reached by a microinsurance initiative is often measured in terms of covered lives and premium volumes.

Table 3: Premium volumes and covered lives

Insurer	Product	Gross Written Premiums			Covered lives		
		2007 US$'000	2008 US$'000	2009 US$'000	2007	2008	2009
CIC	Bima ya Jamii[7]	27	137	142	3 625	17 461	18 872
Kenya	Credit Life[8]	2 196	2 356	3 919	159 047	170 725	256 762
ICICI Lombard	MAS health insurance	539	1,008	1 323	318 334	511 456	550 194
India	Weather Insurance[8]	1 383	4 637	20 490	43 278	108 819	259 958
Old Mutual South Africa	Group funeral		N/A[9]		400 000-450 000	400 000 - 450 000	500 000-600 000
ASR	Life Cover	2 143	2 603	4 789	42,184	75 004	123 429
Guatemala	Student Cover		36	175		3 984	20 554
Malayan Philippines	Microinsurance business	815	1 246	1 913	4 113 975	4 334 887	5 009 089

Although the case studies show a substantial number of covered lives, microinsurance premiums are relatively small compared to premium volumes for traditional business (at 3 per cent or less for all the initiatives except CIC's credit life and ASR's life cover[10]). Microinsurance product lines will need to expand significantly before they make a tangible impact on the business of the insurer as a whole.

Growth in credit life for CIC and the life product for ASR have led to these products making up a significant proportion of the gross premium volumes of the life business of these insurers (25 per cent and 37 per cent respectively in 2009). At ASR, the growth in the microinsurance business exceeded the expectations of the insurer. ASR attributed the boost in sales to a new Commercial Direction strategy and the establishment of a department in charge of the relationship with the distribution channel. ASR developed and implemented a new marketing and promotion methodology and an incentive system to focus on the microinsurance initiatives.

Old Mutual has not reached sufficient policy volumes to cover distribution costs. ICICI Lombard's health product has not gained sufficient penetration within groups to counter anti-selection. ICICI's weather insurance product has not

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[7] The low policy volumes for the Student Cover and the Bima ya Jamii product is partly explained by the fact that these products are relatively new, having been launched in 2008 and 2007 respectively.

[8] Compulsory products bundled with credit.

[9]Old Mutual was unable to disclose premium volumes as this represents competitively sensitive information to the insurer.

[10] This information is not available for Malayan.

reached sufficient geographical spread to enable the insurer to retain more of the premiums and rely less on reinsurance.

GROWTH IN PREMIUMS

A number of products investigated show substantial growth trends. These trends, coupled with the large size of the untapped market, indicate opportunities for growth in these markets. Table 4 shows the growth in premium volumes over the past two years.

Table 4: Growth in premiums, covered lives and renewal rates

		Growth in Gross Written Premiums		Renewal Rate	
Insurer	Product	2007-2008	2008-2009	2007-2008	2008-2009
CIC	Bima ya Jamii	412.4%	3.7%	6%	30%
Kenya	Credit Life[11]	7.3%	66.3%	78%	81%
ICICI Lombard	MAS health insurance	87.2%	31.3%		N/A
India	Weather Insurance	235.2%	341.9%		N/A
Old Mutual South Africa	Group funeral	2.0%	(18.0%)	50%	60%
ASR Guatemala	Life Cover[12]	21.5%	84.0%	64%	87%
	Student Cover		389%		68%
Malayan Philippines	Microinsurance Business	53%	54%		N/A

Growth in the premium volumes for the CIC credit life product and the ICICI Lombard weather insurance product is supported by the increase in the number of partner savings groups and credit providers as well as high levels of retention of existing partners.

The main challenges in growth have been experienced by CIC with Bima ya Jamii and Old Mutual with the group funeral product. The policy volumes and retention levels for Bima ya Jamii are below the level targeted by the insurer, partly due to the lack of active selling to individual group members. For group funeral products, Old Mutual has undertaken an exercise to reduce the number of loss making burial societies on the books over the past three years. As part of this exercise Old Mutual increased the premiums for burial societies where the business was loss making. This resulted in a many of these schemes failing to renew cover, resulting in a decline in business volumes.

[11]The renewal rate for the credit life product is based on the number of partners.

[12] Premiums for the life cover did not increase in line with the covered lives due to a decrease in the average premium.

The experiences of the various insurers provide insights into factors underlying the growth in business volumes and the achievement of scale.

Working with partners and existing groups to access the market

All of these insurers work with aggregators like MFIs, SACCOS, NGOS, health service providers and burial societies to access the market. Their experiences illustrate the following benefits of working with partners to reach scale in the low-income market:

- Working with a partner with a wide-footprint of branches or access points allows the insurer to develop a large, diversified customer base. ASR benefits from access to 4 million BANRURAL customers and Malayan's partnership with pawnshops provides access to a large segment of the low-income market.
- Working with partners allows the insurer to leverage the infrastructure of the partner to access the market as part of the existing activities of the market (e.g. making repayments on the loan to the MFI). This reduces costs for the insurer and the customer. ASR leverages the large presence of BANRURAL in the country (around 750 points of sales covering 80 per cent of the national territory).
- It is easier to achieve scale where products are compulsory and bundled with other financial products provided by the partner (e.g. credit from MFIs). Compulsory cover for all group members or selling the policies in bulk is used for CIC's credit life product, ICICI Lombard's weather product and Old Mutual's group funeral product.
- The partners' existing links to the market and relationship of trust can facilitate expansion into the market. ASR uses the good image of the bank to promote its microinsurance. ICICI Lombard works with the trusted Manipal Group that has been involved with the communities for a long period of time. The benefits of working with a partner that has a long standing relationship with the community is seen in the higher enrolment and retention rates of the Rural Maternity and Child Welfare cluster, which is a captive cluster of the Manipal Group. Very few client dropout from these cluster, and when they do, the Manipal Group contacts each member to ascertain the reason for dropout and to persuade them to continue with the scheme.

Insurers were able to build successful partnerships by employing the following strategies:

- Leveraging existing relationships through working with partners that form part of the same financial services group created a competitive advantage for CIC, ICICI Lombard and ASR.
- First-mover advantage to lock in the relationship with the partners and maintaining these relationships by delivering efficient service was shown to be important in the longer running initiatives of CIC and ICICI Lombard.
- Creating mutually beneficial relationships with partners, where the insurer is able to negotiate lower fees with the partner. The credit life and index-based insurance products directly benefits the partner by protecting the loan from default in the event of the death or crop failure. ICICI Lombard's health insurance product offers the health care provider a tied client-base where treatment is covered by the insurer.

- Building and maintaining good relationships with partners through good service levels and the satisfaction of individual clients. High retention rates of partners of between 80 per cent and 100 per cent seem to indicate that most of the insurers in this case study appear to have achieved this (as seen in Table 4).
- Old Mutual's distribution model requires agents to sell business in and around the community in which they live. This facilitates a relationship of trust between the agents and the clients to whom they sell their products. This was an important factor in their growth, especially in the case of burial societies, which are community-centred. While Old Mutual has been able to reach a large number of lives using this model, the policy volumes do not support the costs of the salaried agents and there are other players in the South African market that have reached higher policy volumes using partnership distribution models e.g. through church groups and retailers.
- All the insurers have been involved in building the capacity of partners. Insurers assisted partners to set up infrastructure and systems to allow for efficiency in processes and ease of the flow of information between the insurer and the partner. Twenty percent of the donor support received by CIC was used to build the relationships with partners and build the capacity of partners in microinsurance.

Affordability and competitiveness of premiums

Setting premiums at a level that is appropriate for this market is critical. There is often a tension between providing benefits demanded by the market, premium affordability and maintaining financial viability. The insurers in the case studies handled the issue of affordable premiums in the following ways:

- For the life cover and weather products, the insurers deal with the issue of affordability of premiums by offering products with limited benefits.
- Old Mutual and ASR introduced a range of benefit level options to allow customers to select an affordable price point, while the cover level is still of value. For Old Mutual this was in response to a finding that a number of burial societies were lapsing as they were forced to select options where premiums were too expensive.
- Flexibility in premium payment options is important. ASR allows for monthly, quarterly or annual payment of premiums. On the other hand CIC indicated that the requirement of the payment of the premium on an annual basis for the Bima ya Jamii product has been a challenge.
- Competitiveness of premiums is an important issue in the group funeral insurance market in South Africa. The level of premiums is often a key consideration in the selection of an insurer for the larger funeral parlours and burial societies. Old Mutual has had to maintain premiums at a lower level than would support the fixed costs of the initiative until business volumes reach a commercially viable level in order to keep premiums competitive. This fiercely competitive market was not highlighted in the other case studies, but may become more of an issue as more players enter the various markets.
- The tension between providing benefits demanded by the market, premium affordability and maintaining financial viability is illustrated by the experience of the CIC with the bundled health product. CIC expanded benefits on the bundled health insurance product based on suggestions by partners, which led to the

business making large losses. This prompted CIC to enter into the relationship with the NHIF. In addition the NHIF proposed significant premium (50 per cent) increases in 2010. This may affect the affordability of the bundled Bima ya Jamii product.

- Regulation can affect how premiums are set, as seen in the experiences of Malayan and ICICI Lombard (see Box 2)

Box 2: Regulatory implications for premiums

For Malayan and ICICI Lombard external factors like regulated maximum premiums for microinsurance business and premiums subsidies played an important role. Malayan's microinsurance products must meet the regulatory requirements for microinsurance in the Philippines, where a maximum premium levels are proportion of the disposable income of various segments of the low-income market.

In India, the need for affordability of premiums is addressed through premium subsidies rather than pricing interventions. These premium subsidies allow the products to reach market segments that would be excluded because of affordability issues. The advantage to ICICI Lombard of expanding the potential target market for products demonstrated the benefits of aligning with social objectives, where there are benefits to the community beyond insurance cover (e.g. improved health of the community).

Products and benefit design

Insurers in the case studies developed products with generic benefits that appeal to a broad customer base. The advantages of this can be seen in the level of scale reached by the CIC credit life product, ICICI Lombard's index-based weather insurance product covering the two main crops in India and ASR's life cover. In contrast the MAS health product is designed to target a specific segment of the market; the target market is limited to the geographical areas in which the health care provider operates. These constraints limit the overall market, but allow the insurer to develop cover that is more tailored to the needs of the community.

Old Mutual has tapped into existing demand for funeral cover in South Africa. A significant segment of the low-income market uses informal mechanisms as well as formal insurance cover for funeral expenses. A disadvantage for Old Mutual is that this market is highly competitive, where other players have more experience.

There is a high level of demand for health care services in the low-income market. CIC and ICICI Lombard have taken advantage of this in linking insurance to a health care provider that has a reputation for providing quality services. CIC has partnered with the public National Health Insurance Fund (NHIF) to provide the health benefit component of the bundled Bima ya Jamii product. This partnering arrangement offers unique benefits to CIC, in that the insurer is able to increase the appeal of the product by including the health benefit, but the risk is carried by the NHIF. ICICI Lombard has worked with the Manipal Group to provide insurance cover through its hospital network. The challenges of achieving sufficient scale for voluntary products are seen in the low policy volumes of both these products. For CIC the policy volumes are only 63 per cent of the targeted policy volumes set by the insurer after three years, and for ICICI Lombard enrolment rates are below the target of 60 per cent, for the majority of clusters.

These insurers all get input from the partners and community groups at the inception stage and over time on possible improvements to the benefit design.

- CIC approaches the potential partner MFI or SACCO with the product idea, so that the partner can give input as to whether sufficient demand for the product exists. The product is then piloted with the partner, and on showing success rolled out to other partners.
- ASR benefits from BANRURAL's agents' knowledge about customers. ASR gets input from BANRURAL when developing a new product in order to evaluate whether the product meets the demand needs.
- The Manipal Group has a long-standing relationship with the community that has helped ICICI Lombard develop health insurance that meets the needs of the market.
- Old Mutual has relied on insights into the needs of market from its social responsibility initiatives[13], since it does not have the benefit of gaining insights through working with a partner.
- Customer inputs are a major component of the product development process of Malayan.

Although the analysis of the factors underlying retention of business indicated that providing benefits that were seen as providing value by the customer is important, the value of products to customers was not explicitly assessed as a measure for the success of the initiative.

Incentives to sell and retain business

ASR and Malayan implemented incentive programmes for the agents of their partners. ASR saw an increase in premium volumes after the implementation of a programme that provided incentives to the sales staff at an individual as well as team level.

Old Mutual structured its incentive packages for salaried agents to focus on servicing existing schemes as well as selling new business. Old Mutual agents receive rewards based on the quality of the business that they sell based on the claims ratios of the groups that they sign up.

The importance of incentivising sales of individual products is seen in the challenges experienced by CIC in reaching targeted policy volumes and retaining business with the Bima ya Jamii product (see Box 3).

[13] The Foundation Market has strong ties to Old Mutual's corporate social responsibility initiatives including a consumer education programme and a Masisizane Fund that provides loans to small and medium enterprises. Old Mutual has used its experience with these initiatives to gain an understanding of the market and generate leads for marketing.

Box 3: Creating a dedicated sales force

CIC's Bima ya Jamii product was initially sold by staff at the MFI or SACCO. There were no incentives for individual sales staff and selling insurance products was not the core responsibility of the staff. Sales of insurance products were therefore not prioritised resulting in low premium volumes. CIC is addressing this issue by introducing an agency force responsible for the sale of individual products and introducing commission for the agents. Individual incentives increase costs of distributing the products but seem to be necessary to reach the required policy volumes.

Client satisfaction and building relationships with the community

Client satisfaction and maintaining high levels of service is important to maintaining business volumes.

- Old Mutual makes a commitment to pay the claim within 48 hours of receipt of all documentation. The agent assists the beneficiary in gathering and submitting the necessary documentation. Maintaining customer satisfaction through the additional services provided by the agents are important in the competitive South African funeral insurance environment.
- The quality of the treatment provided by the hospital network is important for ICICI Lombard's health insurance product and the cashless benefit allows for a more efficient claims process.
- Old Mutual and ASR provide initial and on-going training for agents on products to keep service levels to customers of a high standard. This training has cost implications for the insurer and is one of the reasons that the salaried agent model has been an expensive strategy for Old Mutual.
- ICIC Lombard investigates reasons for cancellations of the health insurance product. ASR conducts surveys to evaluate the client satisfaction after the sale of the policy and monitors on-going customer satisfaction and reasons for cancelation of policies.
- Consumer education and awareness programmes can be used to build the relationship with the community. The health awareness campaigns run by the Manipal Group help to maintain a trusted relationship with the community.

4.3 CLAIMS COSTS

The risk of higher than expected claims can be significant for microinsurance, especially where companies are expanding into new products and target markets where there is little previous experience on which to base assumptions on expected claims. The ratio of the claims to the premiums can give an indication as to whether claims are higher than assumed by the insurer when the product was priced.

Table 5: Gross claims ratios

Insurer	Product	2007	2008	2009
CIC Kenya	Bima ya Jamii	4%[14]	7%	15%
	Credit Life	5%	8%	5%
ICICI Lombard India	Manipal Arogya Suraksha	110%	109%	110%
	Weather Insurance	115%	75%	77%
Old Mutual South Africa	Burial Society Support Plan	90%-100%	80%-90%	65%-75%
ASR Guatemala	Life Cover	2% [14]	38%	32%
	Student Cover		11%	31%
Malayan Philippines	Microinsurance Business	13%	27%	18%

The case study analysis shows that claims experience is closely linked to the type of product and the profile of the target market.

- The low claims ratios for the compulsory credit life product in Kenya is consistent with compulsory credit life business.
- The claims ratios are also relatively low for the life products with limited benefits found in the Bima ya Jamii product, life cover and student cover products from Guatemala and the microinsurance initiatives of Malayan.
- Managing claims ratios for health products is a common challenge in microinsurance. High claims costs do not appear to be related to a specific region, insurer or initiative. The difficulties in managing the cost of claims are clearly demonstrated by the loss making experience of the health insurance product in India. ICICI Lombard has implemented measures to improve claims ratios by increasing premiums, negotiating lower treatment fees with the healthcare providers, encouraging enrolment and managing anti-selection. However, to date the effects of these efforts has only been seen in the largest cluster group. Similar experience was seen in the previous bundled life and health insurance product provided by CIC to MFIs and SACCOs. CIC re-launched this product as the Bima ya Jamii product and outsourced the health risk to the NHIF.

Insurers employed the following measures to manage claims costs:

Pricing for the risk

Credit life and basic accidental death and disability products are easier to price than health products. This has been the advantage for CIC, ASR and Malayan. Both CIC and ICICI Lombard have experienced challenges with the claims experience of the health insurance products, which was exacerbated by tensions between demands for higher levels of cover and maintaining the affordability of premiums.

[14] The Bima ya Jamii product and the ASR microinsurance products are relatively new initiatives having been launched by the insurers in 2006 and 2007. The small claims ratios in the first year are most likely due to unfamiliarity with insurance and delays in claiming. As business volumes grow over time, it is expected that the claims ratio will stabilise to reflect the risk profile of the lives covered.

To price the products, insurers generally used existing experience in similar products from the traditional insurance market and made adjustments for the low-income market. Old Mutual and ICICI Lombard experienced challenges with this approach (see Box 3). Claims experience with the group funeral insurance and the MAS health insurance product did not reflect initial estimates. International standards in pricing index-based insurance were used to price the weather product, for which ICICI Lombard received support from the reinsurer.

Box 4: Re-pricing risk

Old Mutual's claims ratio has been higher than the target of 60 per cent since inception, at close to or above 100 per cent in 2006 and 2007. This is partly due to the profile of the market, where mortality experience was higher than expected in the initial pricing based on other market segments.

Old Mutual adjusted the pricing for the BSSP and introduced differential pricing among groups. It actively monitored the claims and adjusted premiums on an ongoing basis, providing discounts for good claims experience and increasing premiums in the case of poor claims experience. These efforts resulted in the claims ratios declining from above 100 per cent to between 65 per cent and 75 per cent. Though these efforts resulted in a decline in premium volumes, they have resulted in the retention of better quality business.

Implementing claims control measures

Insurers need to balance between setting up sufficient controls to manage risks and maintaining efficiency and low acquisition costs. Insurers utilise similar techniques to manage claims risks as used for traditional insurance business, such as:

- Anti-selection can be a significant risk to the insurer and should be managed in the design of the product. This is particularly important as microinsurance products are generally not underwritten and repudiation of claims should be minimised to maintain the confidence of the low-income market. The risk of anti-selection on an individual basis is less of an issue for the credit life product as the product is compulsory and the benefit is used to pay the outstanding loan. Also there is little room for anti selection in the weather insurance product as claims are triggered by fixed events relating to rainfall that are beyond the control of the insured. For the ASR life cover product the risk of anti-selection is managed through limited selection criteria. Exclusions at the claims stage are used in the case of the student cover product. Old Mutual uses product features like a six-month waiting period and the compulsory nature of the product for all group members to manage anti-selection. The claims experience of the group funeral product seems to have been adversely affected by anti-selection by groups with poorer claims experience. Old Mutual introduced differential pricing between groups based on the claims experience of the group to curb the problem. Anti-selection is a significant risk in health insurance business and has been a serious challenge for the MAS health insurance product. ICICI Lombard has attempted to control the risk of anti-selection by targeting a minimum enrolment rate of 60 per cent for individual groups. Few groups have reached this target. In addition distribution of the product through the health care provider may exacerbate the effects of anti-selection as the health care providers are likely to have more contact with families that use health care services more frequently. Efforts by ICICI Lombard to improve enrolment rates have not yet shown signs of reducing claims ratios.

- Moral hazard and claims fraud are managed by working with partners and distribution agents. Old Mutual and CIC rely on group and community leaders as well as partners to validate claims for most products. There are, however, risks if the partner fails to validate claims properly. Old Mutual, ASR and ICICI Lombard for the health insurance product have implemented systems at the insurer to check the validity of claims. The risk of moral hazard and claims fraud is high in health insurance business. To manage the risk of claims fraud for the health product, ICICI Lombard only works with the Manipal network of healthcare providers to provide treatment for policyholders. Treatment protocols are closely monitored by the claims team at ICICI Lombard. The cashless nature of claims process limits the incentive for collusion between the healthcare provider and policyholder for making false claims. Moral hazard and claims fraud are not an issue for weather insurance, as the benefit payments are triggered by weather events that can be independently verified.
- Co-variant risks and reinsurance: Benefit levels for microinsurance products are small, so The risk of large individual claims is therefore not an issue. Also business volumes for microinsurance initiatives represent a small proportion of the overall business volumes of the insurer for all of the products investigated. Most insurers are therefore not concerned about covariant risks. The insurers investigated in this case study have therefore not purchased reinsurance to mitigate claims risk above the minimum amounts required by regulation, with the exception of ASR and ICICI Lombard for the weather insurance product (see Box 4). Despite the low benefit levels, high levels of claims due to the accumulation of small claim amounts remains a risk in microinsurance business. This is seen in the experience of Malayan where the higher claims ratio in 2008 is partly attributed to losses due to Typhoon Frank.

Box 5: Reinsuring weather risk

The risk of an accumulation of claims due to adverse rainfall conditions is significant for the index-based weather insurance product. ICICI Lombard makes use of a multi-layered reinsurance programme to protect the company from large losses on the weather portfolio. The protection provided by this reinsurance programme is the main reason for ICICI Lombard being able to provide the weather insurance product and it is key to the success of the business line. However, this protection comes at a cost of passing profits onto the reinsurer. With the increasing volume of weather insurance, ICICI Lombard will be in a position to retain a larger portion of the risk of this business.

Monitoring experience and adjusting premiums over time

The insurers in the case studies monitor the claims experience of their microinsurance portfolios to a greater or lesser extent. A number of insurers have adjusted premiums or adjusted cover levels based on poor claims experience and have implemented measures to set premiums based on the actual claims experience of individual groups.

- To manage higher than expected claims ratios, Old Mutual adjusted the pricing for the group funeral product and introduced differential pricing among groups (see Box 3). The MAS health insurance product has extensive benefits with fewer waiting periods and exclusions than similar products in the market, resulting in high claims. To address this, ICICI Lombard has attempted to negotiate lower fees for treatment with the healthcare provider and has increased premiums for groups with poor claims experience.

- During the initial years, claims experience from the pawnshop channel was volatile. Experience has taught Malayan to price more accurately. Loss making experience from individual groups is handled through premium adjustments and limiting cover (e.g. removing 'Unprovoked murder and assault' from the product sold through pawn shops.)

4.4 ACQUISITION AND ADMINISTRATION COSTS

Managing the costs of writing microinsurance business is key to creating a viable business whilst keeping premiums affordable for the low-income market.

Table 6: Expense ratios

		Expense Ratio			Acquisition cost ratio			On-going administration cost ratio		
Insurer	Product	2007	2008	2009	2007	2008	2009	2007	2008	2009
CIC Kenya	Bima ya Jamii	35%	41%	58%	16%	15%	19%	20%	27%	38%
	Credit Life	27%	26%	29%	12%	5%	15%	15%	21%	14%
ICIC Lombard India	MAS health insurance	20%	20%	16%	15%	15%	9%	5%	6%	7%
	Weather Insurance	20%	20%	20%	15%	15%	15%	5%	5%	5%
Old Mutual South Africa	Group funeral	30%-40%	>40%	>40%	N/A	30%-40%	30%-40%	N/A	10%-20%	10%-20%
ASR Guatemala	Life Cover	7%	14%	10%	1%	5%	6%	6%	9%	5%
	Student Cover		13%	9%		5%	6%		9%	5%
Malayan Philippines	Microinsurance	40%	38%	35%	36%	33%	32%	4%	5%	3%

Expense ratios are highest for CIC, Malayan and Old Mutual.

- The expense ratios for CIC reflect an allowance for the contribution for corporate expenses that are not directly allocated to a single business unit. It makes sense that the credit life business should be making a contribution to the overall costs of running the insurer as the premium income from this product is becoming a significant part of its life insurance business.
- For Bima ya Jamii, the high expenses reflect the significant amount of resources devoted to developing the new product line and building the capacity of partners around the new initiative. The group funeral product uses a relatively expensive delivery model of salaried agents, leading to higher expense ratios, which is a significant barrier to profitability. The increase in the expense ratios in 2008 is as a result of increased costs

of running the Foundation Market as a separate business unit as well as greater accuracy in identifying costs of writing the business.

It should be noted that expenses for the Bima ya Jamii and the group funeral products have been more accurately analysed than for the other initiatives investigated. ASR and ICICI Lombard do not monitor the costs of managing the business on a product level, but allow for the management costs of microinsurance by allocating the management costs of the relevant business segment (ICICI Lombard) or overall company (ASR) based on premium volumes. If the costs were more accurately allocated to the other microinsurance products, expense ratios would possibly be higher.

- For Malayan the high expense ratios are due to the high commissions paid, which has contributed to the achievement of significant scale.
- The lower expense ratios for the microinsurance products of ICICI Lombard and ASR partly reflects the lower fees paid to partners for the distribution of business and lower management costs attributed to this business.
- The MAS health product and the group funeral product are loss making before taking on-going administration costs and general company expenses into account. The claims ratios for MAS health product are above 100 per cent, implying that this product is not contributing towards supporting the expenses of writing this business. The combined ratios for the group funeral product and the weather insurance product are in excess of 100 per cent implying that these products are not contributing to the management expenses of the company or to the use of resources to write this business that are reflected in the expense allocation. CIC received a donor grant to develop the Bima ya Jamii product. If the company had funded these costs itself, this product would also have been loss-making over the period investigated.

Insurers employed the following measures to manage their acquisition and administration costs:

LOW ACQUISITION COSTS

CIC, ICICI Lombard, ASR and Malayan use partnerships to lower the costs of distributing their microinsurance business.

- CIC and ASR work with partners that are effectively the owners of the insurance company. This affords them special concessions in terms of access to the infrastructure of the partners without having to pay fees for these resources, which represents a considerable advantage in keeping the acquisition costs low.
- The partners of CIC and ICICI Lombard have also been willing to forego or reduce fees because there are other benefits to providing insurance to the customer base of the partner. In the case of the credit life product, the MFIs and SACCOs benefit from having their loan portfolio protected against default due to the death of the borrower. Similarly the index-based weather insurance protects the lender against default on the loan if the crop fails due to extreme rainfall patterns. The health insurance product offers the health care provider a tied client-base where the cost of treatment is covered by the insurer.

- The payment of fees to the partner for distributing and servicing products is common in microinsurance. Even where partners are paid a fee for distributing the product as is the case for the CIC's Bima ya Jamii product and ICICI Lombard's products, using partners to distribute is still less costly than using a employed agency force solely responsible for selling and servicing microinsurance policies, as seen in the higher acquisition cost ratios for Old Mutual.

- Most of the insurers offer individual incentives to the staff of the partner or the agency force for selling and retaining business. CIC recently engaged an agency force to distribute the Bima ya Jamii product. These incentives increase the acquisition costs of the microinsurance business, but are necessary to encourage staff to sell voluntary products.

The acquisition costs for the microinsurers in the case studies also reflect marketing and promotional activities.

- Marketing and promotion were 25 per cent of the acquisition costs for ASR in 2009. ASR and CIC are planning to increase their spending on promotional activities for their microinsurance.

- ICICI Lombard has increased the involvement of its staff in the marketing of the health product and enrolment of policyholders, but since costs are not monitored on an individual product basis this increase in cost is not evident in the available financial information. ICICI Lombard has benefited from the promotion of index-based insurance by the government and the promotion of the MAS health insurance product by the health care provider.

- The salaried agency force employed by Old Mutual is a costly distribution model. At present business volumes do not support the costs of the agency force, but it is intended that the group funeral product will support the costs relating to this product through growth projected in the next two to three years. The salaried agent model was chosen because agents need to be remunerated for the servicing of the needs of group members (over and above sales). The experience of Old Mutual illustrates the trade-off between managing the costs of the distribution force, and relying on the agency force to build up a relationship with clients and take on some of the roles of servicing the policies.

EFFICIENT ADMINISTRATION PROCEDURES

CIC, ICICI Lombard and ASR leverage the infrastructure of the partner to collect premiums, pay claims, make policy amendments and communicate with individual policyholders. This has the advantage of reducing the cost of the initiative to the insurer, but relies on the partner to provide quality service and sell or renew polices.

Working with groups rather than individuals does facilitate some cost-efficiencies and allows for Old Mutual to make use of scheme structures to perform some of the policy administration. But the average group size is relatively small (55 in 2009, 65 in 2008) and the larger groups organized by funeral parlours are necessary to spread the costs of this business.

Simplicity of products, limited levels of ongoing policy administration, no or limited underwriting at the policy inception stage and efficient claim payment processes contribute to managing the costs of administering the microinsurance business. In contrast Old Mutual allows changes to lives covered under the insurance policies on a monthly basis. The flexibility of the product increases the administrative load on the scheme, the agent, and Old Mutual, and adds to the costs of writing this business. This illustrates the challenge of providing the flexibility that is demanded by policyholders but still keeping the administration costs low.

4.5 CROSS-CUTTING FACTORS

Two aspects of initiatives cut across the drivers of profitability:

MONITORING EXPERIENCE

All the insurers have devoted resources to this business and have incurred marketing, development, training and systems costs relating to the microinsurance business. However, for the most part, the insurers have not formally monitored the costs associated with setting up the microinsurance initiatives and writing the microinsurance business. As a result, it is difficult to assess the cost of writing the microinsurance business and the financial impact of the efficiencies discussed above.

Managing expenses at a business unit or overall company level allows for cross-subsidises in expenses relating to the products managed under the business unit. This allows the microinsurance initiatives access to the broader resources of the company, but does not allow the insurer to accurately assess the cost of allocating those resources to the microinsurance business.

A number of companies assess the profitability of products and business units by allocating expenses based on premium volumes. Where actual expense information was not available this is the approach that has been taken in this investigation (i.e. for all products except Bima ya Jami and the group funeral product). This gives an indication of how the insurers themselves assess the profitability of the microinsurance business lines and is therefore the approach used in this reaseach. But it is not ideal since insurers have invested significant resources in developing microinsurance and these costs of building the business may not be reflected in proportional expense allocations.
Microinsurance can experience costs that may not be present in traditional insurance, in term of developing relationships with partners and building the capacity of partners in insurance related matters. It is therefore important to monitor microinsurance expenses more accurately to understand the full costs of underwriting this business and to identify deteriorations in experience and implement corrective measures at an early stage.

All of the insurers have ambitious plans to expand microinsurance and devote future resources to this business. CIC is planning to set up a separate business unit, introducing an agency force and a high-cost marketing spend on Bima ya Jamii, which will take a number of years to recover from business profits. ICICI Lombard is devoting more resources from the insurer to work with community groups to encourage higher levels of enrolment for the MAS heath insurance product. ASR is planning to begin marketing individual insurance products. All these measures are expected to increase the expense base of the microinsurance initiatives. As business grows and insurers spend more time building and maintaining the business, it will become increasing important to monitor expenses relating to microinsurance more accurately to better understand the profitability and commercial viability of the business.

ORGANISATIONAL STRUCTURE

The organisational structure of the insurer and the position of microinsurance business within that structuring affect the costs of managing the business and the support for this business through cross-subsidies from traditional insurance products.

- Microinsurance is not managed separately from traditional insurance for ICICI Lombard and ASR. ICICI Lombard allocates resources across the business at a vertical business unit level (e.g. health business). The costs of microinsurance are supported by premium income from the same type of business where necessary. The case is similar for ASR, except that microinsurance is managed under the life insurance department at a company level. This provides for the overlap of skills and resources from the overall business units and allows the expenses of the business to be supported by premium income from other business lines.
- The Old Mutual Foundation Market is a separate business unit to give the necessary level of focus to the market in the development stages. It therefore needs sufficient premium volumes from a variety of products to be sustainable. To date the group funeral product has generated premium volumes at a level that could make some contribution to the infrastructure and internal management costs of the business unit, however, the corresponding costs of distributing the product have limited the scope for this contribution. As a result the Foundation Market still makes use of general infrastructure, resources and expertise from other business units. This illustrates the importance of having support from other business units during the early stages of developing a microinsurance initiative.
- Activities relating to microinsurance business have previously been undertaken by various departments within CIC. The insurer has now set up a separate microinsurance department. It will be a challenge for CIC to establish the microinsurance department as a self-sustainable unit as currently the micro-business relies heavily on the traditional business for support. It is likely that the microinsurance department will rely on resources from other departments where necessary.

5 > CONCLUSIONS AND RECOMMENDATIONS

5.1 OVERALL ASSESSMENT OF PROFITABILITY

The profitability experience has been mixed for the five different insurers.

- CIC, ASR and Malayan's compulsory credit life products and basic accidental death and disability products are the most profitable.
- Old Mutual and ICICI Lombard are experiencing challenges with the profitability of the BSSP and MAS health insurance products. Although these insurers have seen a decline in losses on this business following remedial measures, these initiatives are not yet showing profits as measured in this study.
- In addition the MAS health product is loss making from a claims point of view, before expenses relating to this business are taken into account. This means that it is not contributing to the expenses of developing and administering the business or general corporate expenses.

The analysis of the factors driving the profitability revealed that:

- Compulsory products and products with simple life benefits that are easier to price have shown profitability.
- Failure to reach scale and control adverse selection have lead to high claims ratios and the MAS health insurance product being unprofitable.
- Reinsurance has been important for the index-based weather insurance.
- Working with partners can help insurers manage the costs of distributing and administering the business. The Old Mutual salaries agent model showed the highest expense ratios.
- Working with partners that have a social motivation can lead to benefits to members beyond the cover provided by the insurance policies. The Manipal Group provides healthcare awareness campaigns to the community.
- ICICI Lombard has benefited from premium subsidies for the index-based weather insurance product. The subsidies make the product affordable for a higher proportion of the market and have contributed to the achievement of scale in these initiatives.

5.2 IMPORTANCE OF MONITORING EXPERIENCE

Obtaining feedback from partners and the market as well as monitoring the financial performance is key to building a commercially viable microinsurance initiative. All of the insurers in these case studies actively monitor the claims experience of their microinsurance portfolios. However, most do not monitor start up or ongoing expenses relating to microinsurance separately from the expenses of other insurance business. Insurers need to monitor the total costs to gain a fuller understanding of the performance of their microinsurance business.

The experiences of CIC, ICICI Lombard and Old Mutual show that expansion into microinsurance can be an iterative learning process where costly lessons are learnt through an experimentation process. This observation illustrates the importance of monitoring experience, continuously learning from the market and making adjustments to the product and the pricing to improve the viability of products.

5.3 INCREASING FOCUS ON MICROINSURANCE

All of the insurers in this investigation see the vast untapped low-income market as offering a potentially viable business opportunity. Insurers are placing an increasing emphasis on the low-income market in their expansion plans. They are devoting resources to build capacity in the market and create a solid foundation for the microinsurance business. Markets are becoming more competitive and building relationships with partners like MFIs and rural banks is becoming more important. Despite these efforts, some initiatives have not as yet shown profits and still only cover a small segment of the potential market.

5.4 SUGGESTIONS FOR FUTURE RESEARCH

While these five case studies provide valuable insights into the profitability of the microinsurance initiatives of the insurers, it would be pre-mature to draw broad conclusions about the profitability of microinsurance initiatives and one would need care in applying the findings from these case studies to other contexts and products. Further research into the performance of other microinsurance will be helpful in this regard.

In addition rather than investigating individual products, looking at the whole microinsurance initiative and investigating the cross-subsidies between different models and prices would provide interesting insights into the development of microinsurance initiatives within an insurer.

Microfinsurance development is an iterative process of learning and adapting. A number of insurers had implemented measures to manage poor claims experience, but at the time of the research it was not yet evident whether these measures were successful. Further investigation into the results of the changes implemented by insurers would give an indication as to whether these initiatives are starting to show profits or whether there are more fundamental issues relating to the profitability of the business that would need to be resolved.

Most of the insurers did not keep accurate records of the start-up costs and the on-going management costs of microinsurance initiatives. Further projects where researchers work with insurers to gather and analyse expense data will be helpful in understanding the profitability of microinsurance initiatives.

Although this paper considers mainly the viability of microinsurance, The study considers mainly the viability of microinsurance, but a holistic review should evaluate whether products also provide value to clients. The question of viability needs to be balanced with the question of client value, because long-term sustainability depends on products meeting needs and providing value to clients. Future research design will need to consider this important component.

APPENDIX A: FRAMEWORK

The following has been developed to assess the profitability of microinsurance initiatives. This is a framework it is mean to give some general principles that may underlie the profitability of microinsurance initiatives. Not all of these principles will be applicable to the same extent for different initiatives

SCALE

It is well documented in microfinance literature that to achieve commercial success at the bottom of the pyramid, high volumes, often meaning hundreds of thousands, are necessary. One first needs a business model with low incremental manufacturing costs – in the case of microinsurance: distribution, claims and administration costs – and then sufficient scale to cover the overheads and fixed costs. There are several factors that make this a significant challenge for microinsurance:

- Difficulty accessing geographically dispersed low-income customers
- The diversity of insurance needs
- The challenges of finding a stable risk pool not exposed to moral hazard and fraud
- Lack of awareness and understanding of insurance
- High transaction costs

This framework divides the challenge of building scale into the two steps of selling large volumes and then retaining the policies on the books.

MEASUREMENT

The measure that may be used for assessing the extent to which scale has been reached is the number of policies in force. In addition, given that scale is influenced by both number of policies or number of covered lives and the size of these policies (in terms of premium), it is also necessary to consider the annual gross premium income[15].

In order to provide some context to the interpretation of these figures it is useful to consider the development of these values over time. It will be valuable to compare these measurements (as well as the others provided throughout the framework) across different microinsurance schemes and to traditional insurance, thereby enabling an understanding of the relative impact of the factor being considered.

Box A1: Scale

Performance indicators:

- Number of covered lives
- Annual gross premium income

SELLING LARGE VOLUMES

Conventional insurance is highly customised to individual needs, with an array of policy variations and add-ons, multiple distribution channels and highly sophisticated claims assessment processes. Such customisation involves high costs, at all stages from sales through to policy maintenance and claims, costs which cannot be supported from microinsurance premium levels. Instead microinsurance business models seek simple products that can be sold in a limited number of variations in high volumes.

Box A2: Selling Large Volumes

Performance indicator:

- Number of policies written in a year

[15] In most cases, the framework specifies an annual time period for producing the various measurements. It is possible to collect measurements at more regular intervals, provided these are available.

MEASUREMENT

An appropriate measure for assessing new business volumes is the number of policies written in a year. For microinsurance schemes that have been in existence for a long enough period of time, it will be useful to consider the development of new business policies over time.

DEFINITION OF TARGET MARKET

Microinsurance is easier to make commercially viable when the customer-base being targeted exhibits certain features:

- Low-income, but sufficient income to need insurance (there is an insurable interest)
- The types of risks faced by the target market are insurable (loss of assets, loss of breadwinner, costs of healthcare, etc.)
- An existing group of some kind (churches, MFI clients, co-operatives, retailers, etc.).
- Sufficient level of demand homogeneity. The greater the similarity of the needs of the target market, the more easy it is to scale an insurance offering.

ACCESSING SUFFICIENT CUSTOMER VOLUMES

Selling large volumes of business at low cost requires consistent and cost-effective access to a large pool of potential customers. Microinsurance typically leverages one of or more of the following:

- Existing infrastructure, such as retailers, banks, MFI's, agricultural co-operatives and distribution lists.
- Existing community groups and structures, such as community agents, self-help groups and churches
- Other products, such credit life on micro-loans and crop insurance on sale of seed.

MEETING WIDESPREAD NEEDS

Low-income customers generally have a wide range of insurance needs, not all of which can be successfully addressed by a commercial insurance entity. To achieve the scale required, insurers need to focus on insurance products that are widely demanded by the target market (leaving other needs for government or donors). This requires a thorough knowledge of the market, as small samples can present a misleading picture of the overall group.

An awareness of inter- and intra-market cultural factors is important. Funeral insurance for example is widely demanded in some markets, but almost non-existent in others.

PRODUCT AFFORDABILITY

For a microinsurance product to be successfully sold, it needs to be designed in such a way as to reduce the premium to its lowest level. The affordability constraints imposed by low-income and competing spending priorities often mean that even small reductions in premiums expand the potential market significantly. Some of the key ways of keeping premiums as low as possible include:

- Restrict the benefits to those that are the most important to the customer base as a whole. Peripheral benefits that increase the premium slightly may push the whole policy beyond affordability limits. Perils that are not critical to the policyholder should be excluded (though policy exclusions that are complicated to administer should be avoided).
- Reduce the delivery and operational expenses, as well as the customer transaction costs, to an absolute minimum.

- Avoid products subject to significant fraud, moral hazard and adverse selection. In conventional insurance, the premiums are effectively loaded to allow for the effect of these factors. Microinsurance policyholders will not generally be able to fund these loadings, and such products may not be commercially viable.
- Accurate risk pricing. A new product sold into an un-serviced market is difficult to price, as there is no experience of previous profitability. Many conventional insurers would simply increase the price to compensate for the claims uncertainty, a technique that will not often work with a product that is as price-elastic as microinsurance. Instead microinsurers should concentrate where there is appropriate data for pricing: weather data, mortality statistics, experience in other countries or regions
- Price for growth. Allowances for fixed expense recoveries and profit margins should be based on the assumption that volumes grow to their full potential. Conservative pricing early on in a microinsurance initiative may, as with risk pricing, cause the scheme to fail.
- Premium subsidies may be made available to policyholders who would otherwise not be able to afford the products, particularly if the product serves a wider purpose of improving the lives of the low-income market e.g. health insurance

Measurement: The affordability of a product may be measured by considering the average annual per-policy premium. In this case in particular, in order to put the measurement in context, it will be valuable to compare the average premium value to the average income of potential policyholders within the target market In addition, comparisons may be made to other expenditure items, for example the cost of basic food items.

> Box A3: Product Affordability
>
> Performance indicator:
>
> - Average Annual Per-Policy Premium

INCENTIVISATION OF DISTRIBUTION

Incentivisation of sales agents is critical to the success of a microinsurance scheme, as selling microinsurance often requires careful explanation of the product and how it works. Care should be taken not to incentivise mis-selling.

ALLOWING FOR TARGET MARKET'S SPECIFIC PREFERENCES

Microinsurance schemes need to take careful consideration of the way clients prefer to purchase products:

- Product design aligned with the cultural practices of customers
- Premium collection based on how customers prefer to transact
- Suitable method of communication
- Benefits and benefit payment methods take clients preferences into account
- Appropriate level of technology in interacting with clients
- Product designed in conjunction with the target market

CUSTOMER EDUCATION

In low-income communities, insurance is generally unfamiliar and poorly understood, or not seen as offering good value due to previous sales and claims practices. For microinsurance to be successfully sold in large volumes, people need to have a clear idea of how the product works, and confidence that it will do what it says.
There are a number of ways of establishing trust in the minds of the microinsurance customer-base, including advertising claim payments and leveraging existing brands. Ultimately unless there is consistency between what is sold and what is delivered it will not be possible to build significant scale. Building a brand specific to the microinsurance scheme may be necessary to avoid confusion with competing offerings that may not offer similar value.

RETENTION

As with other forms of insurance, microinsurance policies may incur high upfront acquisition and policy initiation costs. Policies need to remain in force for a reasonable period of time after inception so that these costs can be recovered, but also so that customers obtain real value from their policies (particularly where there are waiting periods).

MEASUREMENT

In some cases the measurement of retention may become fairly complicated. For example, retention levels may be calculated for each year of duration since the policy's inception date.
A simplified approach to this measurement is to consider the number of policies renewed annually. This "one-year" measurement is generally suited to microinsurance business, since the business is likely to be annually renewable.

> Box A4: Retention
>
> Performance indicator:
>
> - Number of policies renewed annually

PRODUCT DESIGN

The most effective way of encouraging persistency is to build it in to the design of the policy. There are a range of techniques that can be applied here, including:

- cashback rewards, where payments are made on policies that have been in force for a long duration (e.g. 3 years)
- flexible premium payments (allowing for fluctuations in low-income household income),
- distribution channel remuneration structures, and
- making the insurance compulsory

ALIGNING PRODUCT AND NEEDS

The single most important determinant of persistency is whether the product sold is aligned with the customer's needs. While it is often necessary to make potential customers aware of the risks to which they are exposed, and as such insurance is often "sold", where this extends to over-selling or mis-selling persistency experience is typically poor.
The primary mitigants to mis-selling are a well-structured sales process, customer understanding of the product, and intermediary remuneration that is aligned with persistency.

CLIENT SATISFACTION

Poor persistency often results from customer perceptions of poor service by the insurer or its agents. In under-regulated markets, insurance contracts are often based heavily on trust. If a microinsurance scheme is seen not to be caring for the community, even if just through mis-directed communication, the scheme is likely to experience high lapses.
When it comes to claims, customers are highly sensitive to the consistency between the sales message and the payouts. If there are misunderstandings of how the product operates, exclusions that were not mentioned up front, or just generally poor service during the claims process, policy lapses are likely to be high. On the contrary, many microinsurance schemes celebrate successful claims as a way of marketing the value of the product.

CLIENTS CONTINUE TO VALUE PRODUCT

For a microinsurance relationship to be sustainable, the client needs to continue to value the product and to believe it offers good value for the cover it provides. Particularly in low-income communities this is only likely to be the case where there is a relatively high claim frequency, and where claims are well advertised. For covariant risks (such as weather-related insurance), where there may be few claims in an area for several years, awareness campaigns are needed not just to sell policies, but to retain customers during low-claim periods. Claims should also be paid promptly, as late payment can be as good as no payment for a low-income household.

INCENTIVISE DISTRIBUTION CORRECTLY

The design of remuneration arrangements for agents selling and servicing microinsurance policies is critical to good retention. Paying high upfront commission will tend to incentivise mis-selling and churning, while deferring remuneration can make the arrangement uneconomic for agents.

MANAGING CLAIMS COSTS

Microinsurance is effective when the protection required is provided at the lowest cost. Fraud, moral hazard and anti-selection all hinder this objective and need to be carefully managed in any microinsurance scheme. We divide the claims-related risks that may threaten the viability of a microinsurance scheme into those arising at underwriting (policy initiation) stage, risks arising during the policy term, and risks arising at claims stage.

MEASUREMENT

Box A5: Managing Claims Costs

Performance indicator:

$$AnnualGrossClaimsRatio = \frac{ClaimsIncurred}{GrossPremiumsEarned}$$

The key measurement for assessing claims cost is the annual gross claims ratio, which is calculated by dividing gross incurred claims by gross earned premiums. The claims ratio net of reinsurance gives an indication of the claims relating to the risk that is retained on the books.

UNDERWRITING STAGE RISKS

UNDER-PRICING

Where anti-selection is being effectively managed, and the product terms are clear, the main remaining risk at inception is mis-pricing. Particularly on new products or new markets, there is often insufficient data to be able to perform a reliable pricing exercise. Being conservative with pricing is likely to affect product affordability and hence scale. Starting low and later revising premiums based on claims experience is also unlikely to be acceptable to customers, and may make a previously successful scheme unviable. It is therefore critical that there is considerable effort to estimate risk costs as accurately as possible up front, so that sufficient, sustainable premiums can be determined.

POOR UNDERSTANDING OF PRODUCT BEING SOLD

Where the policyholder does not have a good understanding of what is covered by the policy, there are risks that there will be loss of customer goodwill at claim stage. In addition to the effect on retention and new business sales, there are likely to be higher claims handling expenses, and pressure on insurers to pay claims on benefits not provided by the policy.

This situation is particularly acute where the product is not clear on the exact nature of the cover provided, and where there are different understandings and practices amongst agents. It is critical that policies are clear and unambiguous on the nature of the cover provided, and this generally means keeping the product as simple as possible.

ANTI-SELECTION

Microinsurance products are necessarily simple and understandable, and are not subject to complex underwriting and pricing procedures. They are therefore very exposed to anti-selection, where higher risk policyholders take out policies and lower risk policyholders do not. Anti-selection increases the average per-policy risk costs, leading to underwriting losses, and in due course higher premiums and further erosion of the pool of better risks.

Anti-selection is most effectively managed by making the insurance compulsory, or by bundling with other products (such as credit). Where this is not possible, it is usually necessary to include forms of explicit or implicit underwriting, such as inspection of livestock by a veterinarian, or a waiting period (e.g. no illness claims for the first 3 months).

PROCESS RISKS

RANDOM VOLATILITY

Once a microinsurance scheme has reached scale, the risk pool will almost certainly be diverse enough that individual claims will have a negligible effect on overall results. During pilots, and over small time periods and sub-regions, it is important to differentiate between unsustainable pricing and "bad luck". Result volatility is an inherent part of insurance business, and a few bad months do not necessary mean the whole business model is flawed.

COVARIANT RISKS

Microinsurance is frequently exposed to risks that are likely to affect a large number of policies simultaneously. Typical examples include:

- Droughts and floods (agricultural insurance)
- Pandemics (life/health insurance)
- Inflation in health costs (medical insurance)
- Natural catastrophes (property/life insurance)

If these risks are not appropriately managed, claims experience can spike significantly when one of the covariant factors deteriorates (e.g. no rain) or there is a large catastrophe, even to the point where the insurer is unable to make all the necessary claims payments. These covariant risks can be managed by diversifying across product types and geographies, but this is frequently impractical for regionally established insurers. A more effective way is to use reinsurance, if suitable cover is available at reasonable cost. Donors and governments are also frequently involved in providing protection for very poor years.

REINSURANCE

Management of covariant risks is critical for microinsurance schemes, particularly those that are geographically concentrated. Reinsurance that is appropriately structured and priced is usually the most effective way of transferring these risks. Reinsurers and other international funds pool the risks at a global level and are less affected by regional fluctuations.

MORAL HAZARD

Other than for specific products such as life insurance and index insurance, moral hazard (where the presence of insurance encourages risky behaviour) is a difficult problem affecting microinsurance. The most common ways of addressing it are to rely on group monitoring and enforcement, and to dis-incentivise risky behaviour in the product design (excesses, cashbacks, etc.).

CLAIMS-STAGE RISKS

CLAIMS FRAUD

The extension of moral hazard is where an insured lodges a claim that is known to be invalid. For example, an item of property could be given to a friend and then a claim submitted for the theft of the item. As with moral hazard, certain types of cover are more exposed to fraud than others. For those heavily exposed to fraud, and where it is difficult to identify the fraud at claims stage, the most promising approach seems to be to rely on a group that has sight and control of each group member's actions.

CLAIMS HANDLING EXPENSES

Claims handling processes for microinsurance need to be designed to address the key checks necessary at a minimum of expense.

Measurement: A measurement for assessing claims handling expenses is to express claims handling expenses as a percentage of claims paid. It will also be valuable to consider the "per-claim" claims handling expenses, which is calculated by dividing the total annual claims handling expenses by the number of claims during the year.

Box A6: Claims Handling Expenses

$$Claims\ Expense\ Ratio = \frac{Claims\ Handling\ Expenses}{Claims\ Paid}$$

$$\text{"Per Claim" Claims Expense Ratio} = \frac{Claims\ Handling\ Expenses}{Number\ of\ Claims}$$

MANAGING ACQUISITION AND ADMINISTRATION COSTS

LOW-COST DISTRIBUTION

This section and the next focus on the operations of the insurer, starting with how to deliver microinsurance at low cost. The following are the key distribution challenges:

- Accessing a customer base that is geographically dispersed
- Bridging gaps in awareness and understanding
- Assessing the needs of the customer
- Convincing the customer of the value of the product (selling skills)
- Initiating the policy, performing underwriting and establishing an on-going servicing arrangement

The primary challenge is to overcome all the above at the lowest possible cost, which means tiny fractions of the norms in conventional insurance. The cost constraint severely limits the approach of sending out dedicated insurance agents to sell microinsurance one-on-one to individual customers. Instead there is often reliance on groups such as co-operatives and/or existing infrastructure such as retail outlets.

MEASUREMENT

The level of distribution costs may be measured be considering acquisition expenses as a percentage of gross premiums. It would also be useful to consider the "per-policy" acquisition cost.

Box A7: Low Cost Distribution

Performance indicators:

$$Acquisition\ Expense\ Ratio = \frac{Acquisition\ Expenses}{Gross\ Written\ Premiums}$$

$$\text{"Per Policy" Acquisition Expense Ratio} = \frac{Acquisition\ Expenses}{Number\ of\ Policies}$$

USE OF GROUPS

One of the main benefits of distributing microinsurance through associations and groups of various kinds is the ability to access large numbers of customers at low cost. The main selling work becomes convincing the group that it is worth endorsing the product. Once this has been achieved, high penetration levels are expected, or the product may effectively become compulsory.

LEVERAGING EXISTING INFRASTRUCTURE OF PARTNERS OR WITHIN INSURER

It is rarely cost-effective to build the physical, human and technological infrastructure needed to sell (and administer) microinsurance for this purpose alone. Leveraging existing community infrastructure, MFIs, retail stores, etc. eliminates these costs, allowing microinsurance to be sold on a marginal cost basis, where it only needs to cover the costs associated with the sales process.

Part of this approach usually involves relying on agents that are selling not just microinsurance, but also other products. The level of training these agents obtain is likely to be low, and it will be critical to keep products simple.

BUNDLE PRODUCTS

Often linked to the use of existing groups or infrastructure is the ability to bundle microinsurance into other products (credit, seed, livestock feed, membership subscriptions, etc.). Making insurance either compulsory or "tick-the-box" reduces the distribution costs significantly (though should not negate the need to explain how the insurance works).

SIMPLICITY

As mentioned previously, complex products incur costs all through the value chain, and are almost always inappropriate for low-income customers. Microinsurance schemes generally endeavour to keep all aspects of the product and how it is sold as simple as possible. There have been some innovations in how to risk manage microinsurance products without introducing complex underwriting criteria and exclusions. In contrast to other types of insurance, index-based insurance is inherently simple, but reducing basis risk often requires adding additional triggers and other forms of complexity.

USE OF TECHNOLOGY

Developments in technology offer massive potential to reach low-income customers, and many microinsurance schemes are applying technology in a range innovative ways, including mobile banking and remote collection of data. Technology has the potential to reduce the costs of providing microinsurance significantly, but players should also take care not to introduce additional complexity and novelty to a customer base that is already dealing with the unfamiliarity of insurance.

EFFICIENT ADMINISTRATION PROCEDURES

As with other aspects of microinsurance delivery, the small policy size implies that the costs of administering a policy must be kept to a minimum. This applies particularly to the marginal costs of administration, as opposed to fixed costs, which should be able to be covered if volumes are sufficient.
The primary administrative processes that give rise to marginal costs are the following:

- Policy initiation
- Collection of premiums
- Claims handling and payments
- Policy amendments, terminations, renewals and client communication

Fixed costs include the broader expenses of IT, executive management, compliance, etc.

MEASUREMENT

A practical measure that may be used for monitoring administration costs includes the annual on-going administration costs expressed as a percentage of annual gross premiums. The on-going "per-policy" administration costs should also be derived.

Box A8: Effective Administration (Admin) Procedures

Performance indicators:

$$\textit{Admin Expense Ratio} = \frac{\textit{Admin Expenses}}{\textit{Gross Written Premiums}}$$

$$\text{"Per Policy" Admin Expense Ratio} = \frac{\textit{Admin Expenses}}{\textit{Total Number of Policies}}$$

POLICY INITIATION

The distribution model is likely to have a direct bearing on the costs of policy initiation. Where existing infrastructure is being leveraged or the policyholders form part of a group, much of the initial underwriting and data collection may be relatively straightforward (e.g. guaranteed acceptance) and cost-effective. Where infrastructure has been established specifically for microinsurance, the initiation costs are likely to be significantly higher, and the whole initiation process will need to be very carefully specified and managed.

COLLECTION OF PREMIUMS

Premium collection is a critical aspect of a microinsurance scheme, and typically receives considerable focus. Schemes that rely on individuals making regular (monthly) premium payments in cash generally struggle with retention, and incur high costs. Accordingly most microinsurance schemes rely on upfront payment of single premiums and tend to piggy back off other payments, such as loan issuance, a purchase, or payment of membership fees of some kind.
Where premiums are to be collected regularly, it is usual to give the policyholder grace periods when income may be insufficient. For salaried low-income policyholders, insurers typically try to have the premium deducted directly off the salary, so that other spending priorities do not erode the available funds.

CLAIMS HANDLING AND PAYMENTS

Claims handling expenses need to be minimised while ensuring adequate verification of claims. Microinsurance tends to function best when claims are straightforward to verify and not easily subject to fraud (e.g. life insurance) or when a group is involved in claims management (e.g. farming co-operative). In these circumstances the claims processing can often be handled remotely, with little need to send out claims assessors or go through long claims verification processes.

POLICY AMENDMENTS, TERMINATIONS, RENEWALS AND CLIENT COMMUNICATION

Microinsurance products generally avoid giving the policyholder significant scope to adjust policy terms on a regular basis, due to the administrative costs involved. This is achieved by offering a very limited range of standardised, simple products.

While limited client contact may reduce the costs for the insurer, it may also leave the client questioning the value of the product they are paying for. There is thus a need to strike a balance between the benefits of client communication and the costs of doing so. Groups are an effective means of maintaining regular contact with policyholders without the insurer having to deal with individuals or by individuals on a day-to-day basis.

ADMINISTRATION SYSTEMS

There are a wide range of approaches to administration and the systems that support it. Some of the considerations in this area include

- Choice of administration software
- Level of centralisation
- Integration with third-party systems (MFI's, retail outlets, etc.)
- Management information
- Data storage

It is preferable to have "live and on-line" access to policyholder records and business performance, rather than a system that uses off-line processing. For insurance sold in remote areas this may not always be possible, and systems will need to be able to cope with off-line policy inceptions and administration.

APPENDIX B: CALCULATION OF PERFORMANCE INDICATORS

Item	Calculation
High Level Performance Indicators	
Gross insurance profit ratio	Gross insurance profit / Gross earned premiums
Gross insurance profit	Gross earned premiums – gross claims incurred - expenses
Net insurance profit ratio	Net insurance profit / Net earned premiums
Net insurance profit	Net earned premiums – Net claims incurred – expenses (net of reinsurance)
Scale	
Number of covered lives	N/A
Annual Gross Premium Income	N/A
Number of policies written in a year	N/A
Average annual per policy premium	Annual Gross Written Premiums / Number of policies
Number of policies	Number of policies renewed annual
Renewal rate	Number of policies renewed (current year) / Number of policies (previous year)
Managing Claims Costs	
Gross claims ratio	Gross claims incurred / Gross earned premiums
Net claims ratio	Net claims incurred / Net earned premium
Claims Expense Ratio	Claims Handling Expenses / Claims Paid
Per-Claim Claims Expense Ratio	Claims Handling Expenses / Number of claims
Managing Expenses	
Acquisition Expense Ratio	Acquisition Expenses / Gross Written Premiums
Per Policy Acquisition Expense Ratio	Acquisition Expenses / Number of policies

Administration Expense Ratio	$\dfrac{\text{Administration Expenses}}{\text{Gross Written Premiums}}$
Per Policy Administration Expense Ratio	$\dfrac{\text{Administration Expenses}}{\text{Number of policies}}$
Overall Expense ratio	$\dfrac{\text{Total Expenses}}{\text{Gross written premiums}}$

APPENDIX C: WORKSHOP SCHEDULE

COMPANY STRUCTURE

- Structure of the company
    - Position of microinsurance in the structure of the company
- Company approach to microinsurance
    - Support given by traditional business
    - Role of donors, government and social welfare
- Overview of the microinsurance initiative
    - Structure of the business
    - Target market
    - Products
    - Financial reporting on microinsurance initiatives
- High-level insights into drivers of profitability (general approach to drivers of profitability, reasons for success/failure, relative importance of drivers), including:
    - Volumes
    - Retention
    - Managing claims costs
    - Managing risks at underwriting e.g. anti-selection, mis-selling, under-pricing
    - Managing risks at claims stage e.g. fraud, use of reinsurance
    - Low cost distribution
    - Managing administration costs
- Broad lessons learnt
    - Approach to monitoring and managing the initiative
    - Reasons for actual experience being different to expected
    - Subsequent changes to approach
- Market challenges and competition

The purpose of this workshop is to obtain a high level overview of the company strategy around microinsurance, the profitability of microinsurance initiatives and the lessons learnt from past experience.

MICROINSURANCE DEPARTMENT

- Structure and resources of the microinsurance department, if it exists
- Overview of the operations of the microinsurance department, sections of other department that are responsible for microinsurance and how these various departments interact
- Where does the microinsurance initiative fit, in terms of:
    - Staff allocation
    - Importance in the past
    - Importance into the future
- Profitability of microinsurance initiatives
    - How is the profitability of the microinsurance initiative measured
    - Allocation of expenses to microinsurance (current and future)
    - Profitability of microinsurance over time relative to other business

- Insights into drivers of profitability
    - Volumes
    - Retention
    - Managing claims costs
    - Managing risks at underwriting e.g. anti-selection, mis-selling, under-pricing
    - Managing risks at claims stage e.g. fraud, use of reinsurance
    - Low cost distribution
    - Managing administration costs
- How are costs allocated to microinsurance
- How much support does the traditional business give to microinsurance
- Walk through claims process
- Walk through distribution process (model, remuneration)
- Definition of new business for the individual products analysed (new policies, new partnerships? Which is more valuable from a profitability perspective?)
- Management of partnerships:
    - Attracting new partners
    - Accessing new and existing partners (travel for example)
    - Getting new partners on the system
    - Managing partner relationships
    - Any remuneration for partners?
    - Relative costs of setting up and maintaining partner relationships
    - Dealing with risks related to partnerships (moral hazard/fraud)
- Monitoring the profitability of the business
- Future plans for the initiative

MARKETING

- Microinsurance budget relative to traditional business (is it separated)?
- Means of handling the need to keep costs low
- Approximate proportion of time spent on microinsurance marketing
- Staff allocation to microinsurance
- Past and future importance of the initiative

DISTRIBUTION

- Walk through the distribution process for microinsurance
- Handling the need to keep costs low (difference in approach)
- Staff allocation to microinsurance
- Differences in approach for the each individual product analysed
- Other (perhaps non-traditional) roles that the agency force plays (educator, admin)
- Challenges/benefits of working with partners rather than directly with the client
- Remuneration
- Accessing partners and managing relationships

PRODUCT DEVELOPMENT

- Walk through product development process
- Insights into drivers of profitability
    - Volumes
    - Retention
    - Managing claims costs
    - Managing risks at underwriting e.g. anti-selection, mis-selling, under-pricing
    - Managing risks at claims stage e.g. fraud, use of reinsurance
    - Low cost distribution
    - Managing administration costs

MICROINSURANCE INNOVATION FACILITY

Housed at the International Labour Organization's Social Finance Programme, the Microinsurance Innovation Facility seeks to increase the availability of quality insurance for the developing world's low income families to help them guard against risk and overcome poverty. The Facility was launched in 2008 with the support of a grant from the Bill & Melinda Gates Foundation.

See more at: www.ilo.org/microinsurance

International Labour Office

microinsurance innovation facility

The social dimension of finance

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