

PRODUCT DESIGN AND INSURANCE RISK MANAGEMENT

Upon entering the low-income market, insurers should establish the need and demand for insurance, determine the risks that can be insured, and devise insurance risk management processes for ensuring the product's viability. Insurers in this market need to be particularly aware that the small premiums and benefits will restrict the scope of marketing, underwriting, claims management and product complexity.

Market research

Product design starts with four basic steps:

- **Define the target group:** The microinsurer needs to decide if it will target the most vulnerable or the broader low-income community.
- **Identify insurable risks:** Determine the risks the target group is most worried about and ensure the insurance offered complements existing informal coping mechanisms.
- **Determine key product features:** Assess the needs and demands of a target market. Get product specific details (e.g. levels of coverage) and types of benefits (e.g. for health insurance; inpatient, outpatient, pharmaceuticals).
- **Establish payment capabilities:** Determine what the target market is willing to pay for the services, as demand can vary tremendously even within the same country.

Affordability and product design preferences should be investigated together to provide real value to the clients. Prospective customers may initially overestimate their capacity to pay, which can lead to subsequent dropouts. Therefore, the household's income level is perhaps a more reliable means of assessing the payment capacity of the target population.

Eligibility

When determining eligibility, it is necessary to consider whether a product is designed for groups or individuals, whether it should be mandatory or voluntary, and what approach the insurer should adopt for covering higher-risk persons. The goal is to strike a balance between broad inclusion, sufficient benefits, low premium rates, and sustainability, and to provide product information for all types.

Group insurance's primary feature is that many people are insured under one master policy. A group policyholder decides on the type of coverage; collecting

premiums; disseminating policy certificates and product information; and filing claims on behalf of the group's members.

Individual microinsurance might be relevant for persons who are not members of existing groups, or for products that cannot be offered using a group approach. It requires a high participation rate among the potential target market to be profitable and can cost more than twice as much as group coverage due to higher sales, underwriting, administration, and claims costs. Making microinsurance work is relatively easy if the targeted population is a well organized group and can accommodate group insurance arrangements, but quite challenging if the market is scattered because of higher costs.

Mandatory insurance can be preferable to voluntary coverage because it reduces administrative costs, lowers the adverse selection risk, improves claims ratios, reduces vulnerability to staff fraud, and makes the product more affordable. On the other hand, with mandatory insurance, insurers and delivery channels tend to overlook consumers' need for information which can cause significant misunderstanding and dissatisfaction with the coverage.

Voluntary insurance is offered in two ways – either members of a group are covered unless they specifically decline coverage or each member of the group must choose to enrol in the scheme. While customers generally prefer voluntary coverage, it exposes the scheme to higher costs and risks. Alternatively, mandatory insurance with voluntary options for one's coverage level could represent a successful combination – a best of both worlds solution.

Terms and payment options

Insurers generally prefer short-term microinsurance policies (12 months or less) because they can more accurately calculate premiums. Customers, however, often would prefer some long-term commitment from the insurer. Short-term covers can have a renewable-term arrangement whereby the policyholder can continue to have coverage without additional underwriting or applications, as long as premium payments are made. This strategy combines the advantages of both short- and long-term coverage – the insurer can adjust the pricing while the insured have continued coverage.

The target market for microinsurance usually has irregular and unpredictable cash flows. To minimize lapses, the premium payment mechanism has to time its payments to correspond with period when households have some surplus income, e.g. harvest season.

Benefits

Microinsurance benefits should be as simple as possible to keep the premiums and the administrative costs low. The target market is often illiterate or uneducated and consequently lacks exposure to insurance. If a product cannot be easily explained in a few minutes, then it is not likely to be well received.

When determining insurance benefits, it is important to ensure that the client can make a claim easily, otherwise the proposed benefit will not be very beneficial. For example, many clients cannot claim for disability because they are unable to demonstrate that it was not a pre-existing condition as they lack formal medical records.

Some delivery channels combine benefits from different insurers to create **basket coverage**. With several benefits integrated into one comprehensive insurance policy, basket coverage can lower operating costs while providing the low-income market with better protection. The downside, however, is that the consumer may not want a bundle of benefits, and it may be difficult to keep the product simple.

Another type of group insurance is **family coverage** that puts all family members under the benefit umbrella. This approach is recommended because it generates more frequent claims and hence positive marketing for the insurer; and it reduces the vulnerability for *all* family members. However, it is important that a microinsurer looks at a target market's family structures before implementing this benefits package. For example, many areas torn by conflict do not have traditional family units, but instead consist of largely extended family members.

Microinsurers must also decide in which manner to distribute their benefits, in cash or in kind. Health insurance benefits are more helpful when given in kind, e.g. paying hospital bills, while life insurance is generally paid out in cash. In life insurance, if the deceased is a breadwinner, insurers should stagger their

payments over a period to assist the household through the transition with lost income.

Long-term clients who have not claimed any benefits need to see that they are getting a value for their money. Some examples of extra benefits include:

- **Premium back features** – a refund of all or part of the premiums paid after several years of enrolment.
- **Paid-up insurance** – after several years of premium payments the coverage may continue for a lifetime without additional premiums.
- **Savings features** – may be bundled with the product and contributions returned with interest dependent on the net earnings of the portfolio.

Management and claims control risk

In general, insurers should avoid elective participation, diverse target populations and numerous product choices – these factors tend to increase adverse selection and thus increase the need for more controls, especially in smaller schemes.

On the other hand, controlling the amount of claims one must process and limiting the claims paid out is another important strategy to maintain the viability of microinsurance schemes. Some most effective claims controls include:

- **Deductibles** – through which all claims below a certain amount are paid by the insured, are especially effective in reducing the administrative burden since smaller claims are not processed.
- **Coinsurance** – where the insured pays a coinsurance of X% of the claim in excess of the deductible
- **Benefit ceilings** – where the insurer pays the difference up to a certain maximum amount.

These claims controls are most effective when used in combination with each other. Finally, insurers can avoid excluding high-risk clients by instituting **waiting periods**, whereby a policyholder cannot access certain benefits for some time after he or she enrolls or have a **benefit schedule** that gradually increases benefits over time. This strategy eliminates screening costs while immediately providing small benefits to all policyholders.

The International Labour Organization (ILO) and the Munich Re Foundation recently published **Protecting the Poor: A Microinsurance Compendium** on behalf of the CGAP Working Group for Microinsurance. This authoritative book analyzes the experiences of more than 40 microinsurance providers and is based on the **Good and Bad Case Study Project** led by the Operation Subgroup and funded by DFID, GTZ, the ILO and SIDA. The translations into French and Spanish are financed by ADA.

The content of this note is based on Chapter 3.1 in Churchill (ed.) 2006. *Protecting the Poor: A Microinsurance Compendium* (Geneva: ILO) – ISBN 978-92-2-119254-1