

## Providing Insurance of Real Value to the Poor

This final Microinsurance in Focus Note has been written by Ellis Wohlner and concludes the series with reminding us that microinsurance is at the end of the day about providing real value to the poor.

### Challenges

Many people, rich or poor, are reluctant to buy insurance because they do not want to think about loss, illness or death.

In some fatalistic cultures, the very act of buying insurance may be regarded as an ill omen. Many people are also reluctant to buy something often difficult to understand, and where they fear that the intangible product may be of little real value to them. Not entirely without cause, many people, rich or poor, fear being cheated by insurance providers and agents.

Regardless of the market, insurance is most often sold, not bought. This is even more so among low income households in developing countries where insurance is an unfamiliar financial service. Marketing, selling, underwriting and administering insurance on a one-by-one basis is very expensive and, especially in the case of microinsurance products, can easily consume an overwhelming portion of the premium. The promotion and dissemination of **microinsurance of real value** to the poor therefore **requires new thinking and approaches** by donor organizations and microinsurance providers.

### Clear examples of inadequate value

The case studies contain examples of microinsurance products that do not provide real value to the poor, either because the product itself does not meet the actual needs/demands of the poor or because the premium and expense levels are too high, and the claims levels too low, for the product in question.

**Example 1:** An endowment insurance product in a less-developed country where it is questionable if the (dominant) savings element in the product can be securely and productively invested in a way that at least exceeds the rate of inflation, where persistency rates were 45 per cent, where 15 per cent of all claims were rejected, where the claims benefits were less than 8 per cent of the premium, and where expenses were 6 times higher. All the measures referred to make the product clearly of poor value; e.g., the claims level alone, of only 8 per cent, means that the policyholders

are paying 10 times as much as they would have to if the claims level was 80 per cent.

**Example 2:** A personal accident insurance product where claims benefits amounted to only 16 per cent of premiums, and where expenses were 4 times greater. Here, the policyholder is paying 5 times as much as would be necessary if the claims level was 80 per cent.

Both examples are dramatic cases of how the limited resources of the poor can be wasted by bad products.

### Real Value

In both examples above, the overall plans cannot reasonably be said to be of value to the poor (even in a lottery, there are always winners, but if only a tiny fraction of the money is distributed in prizes - or otherwise beneficially used - one can legitimately question the lottery's overall justification).

There is no simple definition of what constitutes "real value", though certain **criteria** can be laid down:

- The product should meet real risks of low-income households
- Premium payment schedules should strive to match policyholders' cash flows
- The coverage should be easily understood/non-deceptive
- Procedures for claiming benefits should be simple
- The portion of premiums being used to pay claims should be high, at least 60 %
- Expenses must be kept as low as possible, rarely exceeding 25-30 % of premiums
- Net income (profit) to the insurer should be modest, at most 5-10 % of premiums.

The CGAP Working Group on Microinsurance's subgroup on Performance Indicators is in the process of defining key indicators and obtaining broad agreement on standards, and the last three criteria above are based on this work.

### New thinking and approaches

The voluntary microinsurance product, Family Group Life Insurance (FGL) was launched by League Life Insurance Company in Michigan in 1963 for members of credit unions and their immediate dependents. It pro-

vided USD 2,000 of term life coverage on each member up to age 65, USD 1,000 on his/her spouse up to age 65, and USD 1,000 on every dependent child in the member's household up to age 19 (23 if still studying) – all for a premium of 50 cents per week, automatically deducted every quarter from the member's savings account (USD 6.50 for thirteen weeks).

League Life Insurance Company was wholly owned by the Michigan Credit Union League, the state association of about 1,000 credit unions. All marketing was by direct mail and no sales commissions were paid. "Experts" in direct marketing said that sales to 1 or 2 per cent of eligible members would constitute a success. Actual sales levels were as high as 50 per cent! The Michigan association of life insurance agents made strenuous attempts to stop the launching of FGL, fearing a loss of business and spoke of "unfair competition". In fact, their sales later increased greatly due to increased insurance awareness among the 500,000 of Michigan's two million families who enrolled in FGL. For many, it was their first life insurance unconnected with the work place.

**Total costs** for the scheme amounted only to **12 per cent** of premiums. **Over 80 per cent of premiums were paid out in claims.**

## Conclusions

As earlier noted, marketing, sales, underwriting and administration costs weigh heavily in all individual insurance products, and are frequently prohibitive factors in microinsurance. The most obvious solution, which can secure real value to the poor in any country, is through the use of suitable **group insurance** products developed in collaboration with the poor who, for other reasons, already belong to existing groups.

Not only will the use of group microinsurance products allow for the drastic reduction of costs, they will also eliminate most underwriting and permit many more people to obtain insurance cover, which in itself is **an important social benefit to society**. Additionally, the already existing group provides a **voice for the members** in deciding with the insurance provider on how the insurance coverage is designed and priced. The group offers a **mechanism for premium collection** – included in the membership fee, or included in purchases, or through direct deduction from member accounts, etc – as well as a **natural conduit for educating** the group members about insurance and discussing future products.

Neither *all* insurance, nor *all* microinsurance, nor *all* group insurance (whether micro or not) is necessarily *good*; i.e., providing **real value** to the insureds. However, the provision of microinsurance to the poor, and the poor's use of extremely scarce resources to pay for the coverage places a strong moral obligation on both donor organizations and on insurance providers to do everything in their power to see to it that the insurance products provided are of **real value to the poor**. The provision of **group microinsurance** is probably the most important technique available.

Individual insurance products can be needed and of real value even to the poor - when either group products are not available or special needs are to be met - but the onus in such cases are on the microinsurance provider to ensure that the products offered are of real value to the poor (as defined by the CGAP Working Group on Microinsurance's sub-group on Key Indicators).

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 Practices in Microinsurance** 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.