
III Life insurance

8 Savings in microinsurance: Lessons from India

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This chapter assesses four products that combine the benefits of insurance and saving offered by Indian insurers and targeting low-income customers. The assessment is timely, as many insurers have launched or are giving serious consideration to initiatives aimed at bringing insurance combined with saving to this market segment.

The first section of this chapter introduces the issues and presents a framework that is used for the product analysis. The products are then described in section 8.2, highlighting the key characteristics that set each apart. This leads to section 8.3, the heart of the discussion, which draws and explains a number of important lessons from this analysis. There are few easy decisions and prospective participants in this market need to think carefully about the most important needs and preferences of their customers, converting these into product design, and then balancing difficult trade-offs.

8.1 Saving and insurance considerations

Collins et al. (2009) highlight three needs that drive much of the financial activity of poor households: basic cash-flow management, coping with risk and raising lump sums. As tempting as it may be to equate these to borrowing, insurance and saving, the financial behaviour of these households – indeed the complexity and uncertainty of their challenging lives – makes such simplification unrealistic. Households often use a combination of financial tools to meet their financial needs, highlighting a need for composite products that combine savings and insurance.

Saving helps low-income households protect themselves against shocks and stabilize their cashflow, yet it has limited potential to shelter people from catastrophe. Adding an insurance component usually means that saving must occur on a regular pre-determined basis over an extended period. Like loan repayment instalments, this requirement can be onerous, yet it also provides a mechanism to

instil discipline and encourage clients to save consistently.¹ As the success of commitments to save shows (see Ashraf et al., 2003 and 2006), low-income households often welcome some structure in their savings mechanisms. Policyholders also benefit from the provision of long-term savings products by insurers because it offers alternatives to suit customer needs and convenient access to other forms of insurance cover.

These types of products are also relevant because they address a reservation that the low-income market has about insurance. For insurance products that do not build value over time, such as term life or property covers, if an insured event does not occur, low-income policyholders often feel that they have wasted their money because they do not have anything to show for the premiums they have paid. Whereas products that combine savings and insurance, like endowment products, cover the risk of death and accumulate value over time.

However, standard endowment products are notorious for providing poor value to customers compared to other saving options, partly due to the high commissions paid to agents. Because of their irregular cash-flows, low-income customers also may have difficulty paying regular premiums, and therefore the surrender value of the product can be quite low (see Roth et al., 2006). Thus, the main thrust behind this chapter is to assess whether the next wave of products that combine savings and insurance has found solutions to overcome the limitations of traditional products, and whether the new products provide better value to low-income customers than the previous generation.

8.1.1 A framework for savings-linked insurance

These products compete for attention with a wide variety of alternatives (formal and informal) and need to be competitive, in the sense that they meet customer needs clearly and effectively. To design such a product, the insurer needs to consider a set of fundamental principles:

- **Primary objective:** What key need does the product seek to meet? To do this, needs must be identified and prioritized. Furthermore, the extent to which customers actually recognize these needs must be estimated or measured.
- **Secondary goals:** What are the other goals for the product and what are the priorities across these goals?
- **Flexibility:** How much can the customer vary the standard terms of the contract to meet a variety of needs, such as unanticipated changes to personal circumstances?

¹ It is important to avoid casting an inflexible payment schedule – whether for saving or loan repayment – in doggedly negative terms. Just as compulsory saving has benefits, households frequently take on credit with fixed repayment instalments precisely because they appreciate the discipline imposed.

- **Understanding and trust:** What features need to be in place to ensure that the customer understands all of the terms and conditions of the arrangement? The importance of customers understanding this promise must not be underestimated. These are long-term products, so keeping customers is just as important as convincing them to purchase the policies in the first place. In addition, helping these customers to understand why the product is good for them – through simplicity of design and frequent communication, for example – is the first step towards gaining their confidence and retaining them.

8.1.2

Product design

Insurers need to consider the four principles outlined above when defining the following components of savings-linked insurance products:

- **Allocation to savings and insurance:** it is difficult to value the respective contributions of saving and insurance equitably, but the allocation of premiums between the two helps to show the relative significance of each. The provider should always be able to make this allocation. For the customer, this is less often possible, so that the insurer should make every effort to explain this allocation – and the corresponding benefits from insurance and savings.
- **Product features:** Characteristics like premium or sum assured minima and maxima are captured here, along with age and term restrictions.
- **Insurance benefit:** This describes the contingencies that are covered, life, health or assets, for example, and how benefits are paid (e.g. lump sum or income, fixed amount or indemnity).²
- **Saving benefit:** This covers the flexibility of the product, limitations on the timing of withdrawal or the opportunity for partial withdrawal during the term of the contract. Other features like the potential or guaranteed investment return may also be important to customers, but the relevance of the return may depend on their financial sophistication. As lower-income customers are generally more exposed to financial stress, they may value flexibility of design – giving them a break from contributions or access to their savings in an emergency – more than the potential for investment return.
- **Charges:** A record of fees, where these are explicit, should form part of a detailed typology.³

² All products covered in this study provide life cover only, although other types of protection are possible.

³ Some products provide a pre-defined set of benefits that include all charges; others levy charges separately. Comparing these offerings is not straightforward, a problem that affects the analysis described in this chapter.

- **Exclusions:** This includes pre-existing conditions or suicide, for example, on life insurance, or limits on claims under asset insurance.
- **Special features:** Additional characteristics not covered by other headings.

There are a number of difficult issues hidden in the detail of these components that insurers must resolve when putting together their products. These trade-offs, some of which are considered in this chapter, strongly define the essence of the product and the nature of the promise to customers. For example, it is clear that not all saving is for fixed periods and known future events.⁴ Insurers need to think carefully about the balance between the promised maturity benefit (received after five or ten years of enrolment) and the terms under which customers might withdraw their accumulated savings during the term of the policy.

8.1.3 Focus on India

The chapter focuses on products in India for two main reasons:

- It proved challenging to find a range of products from other parts of the world that 1) provide meaningful elements of saving and insurance cover, 2) have achieved scale, and 3) are sold by insurers willing to provide insights into the dynamics of their portfolios.
- It is difficult to carry out a fair comparison of products from different parts of the world because these products can be specific to a context, particularly in regards to constraints imposed by regulation.

As described in Chapter 20, India has seen considerable microinsurance development in recent years, including life insurance. Consequently, it has a critical mass of interesting examples with sufficient experience to warrant a specific investigation. Nevertheless, a study like this that focuses on a single country runs some risks. A number of the products included have been withdrawn from the market in response to regulatory changes that forced reconsideration of their design. Furthermore, it can be difficult to transfer the experiences gained in one country to other jurisdictions.

⁴ In the three studies reported by Collins et al. (2009) in Bangladesh, India and South Africa, over half of all savers reported their primary use of the large sums borrowed or accumulated as falling into the category of opportunity rather than emergency or life cycle.

Finally, the study depended on insurers for the information provided. Data on customer choices is limited by competition considerations. The chapter may appear to give preference to the view of the institution over that of the customer, but this has not been the intention and every effort has been made to overcome the limitations of the information available.

8.2 Products considered

The market for savings-linked insurance products in India has been subject to a number of recent regulatory changes,⁵ which have affected those considered in this section. Some of them have been withdrawn from the market for redesign. Changes in referral guidelines have also affected distribution options.

The descriptions of the four products that follow, which predate these changes, are broad, highlighting the most important features of each product. This leads to the discussion in section 8.3 that draws a number of lessons from these similarities and differences. Table 8.1 summarizes the key features of these products.

⁵ The most important of these regulatory requirements for unit-linked investment products are that:

- customers must be locked in for a period of at least five years, reinforcing the fundamental principle that these are long-term financial instruments providing risk protection;
- premiums must be regular and at a constant level;
- charges must be evenly distributed over the initial five years;
- death benefits must meet minimum requirements; and
- a guaranteed minimum investment return must be granted.

For universal life products, renamed variable insurance plans, the combined investment and commission limit is prescribed, and for both sets of products, referral activities have been curtailed in the interest of customer protection.

Table 8.1

Key features of products assessed

	<i>Max New York Life Max Vijay</i>	<i>Bajaj Allianz Sarve Shakti Suraksha</i>	<i>SBI Life Grameen Shakti</i>	<i>ICICI Prudential Anmol Nivesh</i>
Lives covered (approximate)	90 000	3.4 million	1 million	2 300
Allocation to savings and insurance	All premiums to savings; insurance cost deducted	Insurance cost deducted from premium	Implicit; guaranteed maturity and death benefit	Insurance cost deducted, but guarantees provided
Premium payment options	Premiums entirely at option of customer after initial purchase	Monthly, quarterly, half-yearly or annual	Annual only	Annual only
Minimum premium	INR 1 000 (US\$22) initial contribution, INR 10 (US\$0.22) minimum thereafter	INR 45 (US\$1) monthly premium, INR 500 (US\$11) for its annual equivalent	No explicit minimum, but likely to be low	INR 1 200 (US\$26), annual premium only
Term limitations	Ten-year term only	No longer than seventieth birthday of policyholder	Five- or ten-year term only; different maturity benefits	Between 7 and 15 years
Maturity guarantee	No guarantee, but returns declared cannot be removed	Total premiums less cost of cover and administration fees	Explicitly and clearly guaranteed	Total premiums paid
Sum assured (death benefit)	Five times the premiums paid	Guaranteed from outset on group requirements	Guaranteed from outset	Greatest of sum assured, fund value and sum of premiums
Investment returns	Guaranteed once declared	Based on returns on low-risk assets	Implicit in the guarantees	Based on returns on low-risk assets
Earliest available withdrawal	Three years	Immediate	Three years	Three years
Partial withdrawal permitted	Yes	Yes	Not permitted	Yes
Surrender terms	Fair: available after three years with a penalty of 15 per cent until year 6 and 7.5 per cent thereafter	Very good: available from inception and based on account value with penalty, 7 per cent in years one and two, lower thereafter	Fair: available after three years' premiums; 35 per cent and 65 per cent of premiums payable on the 5 and 10-year policies	Good: available from three years with 10 per cent charge, waived if three years of premium have been paid
Policy revival option	Available	Available	Available	Available

Note: Quality assessments mentioned in this table provide a comparison of product features from the perspective of the customer and are therefore subjective rather than technically precise.

8.2.1 MNYL's Max Vijay

The venture of Max New York Life (MNYL) into a microinsurance product, Max Vijay, combining savings and insurance and available to individuals rather than only members of groups has shown, above all, that it can be done. From a product sale perspective alone, the results are good. From the product launch in 2008 to the end of the first quarter of 2010, Max Vijay sold 90 000 policies, a good number, but significantly less than the more than one million policies sold by each of the next two products considered. The project has allowed the insurer to gain first-hand experience in determining customer needs, incentivizing behaviour, and identifying the success factors for such a venture.

Max Vijay offered a savings product with remarkable contribution flexibility, a death benefit that grows with contributions and fair withdrawal terms. The most important features of the product are the following:

- **Contribution flexibility:** Following the payment of a one-off initial contribution, defined by the product sub-type but no less than INR 1 000 (US\$22),⁶ the policyholder is completely free to contribute to the account when able, with no rules on frequency or amount, except for a minimum contribution of INR 10 (US\$0.22), an extraordinarily low threshold.
- **Sum assured linked to premiums:** The benefit payable on death is equal to the value of the accumulated customer account plus five times the contributions paid, ten times in the case of accidental death, encouraging contributions but also keeping under control the cost of insurance, which is deducted monthly to meet this cost.
- **Withdrawals are available from the third anniversary:** Policyholders may surrender or partially surrender the policy from three years onwards, with charges that are fair, though the facility to partially withdraw free of charge on a limited number of occasions is a useful addition to policyholder flexibility.

The most ambitious feature of the project is its distribution model. This is the only product in this set that is available to individuals and marketed to the general public. This limits the potential to achieve economies of scale, as the per-unit distribution costs are significantly higher than if the product were distributed solely through groups, all else being equal.⁷

Key observations on this product are:

- Sales have been good, particularly given the ambition of reaching individuals rather than limiting access to members of groups.
- Without the support of the (voluntary) on-going contributions, the product does not provide particularly good value to the customer and is less likely to generate profit for the insurer. A key imperative, apart from the need to develop a diverse range of efficient distribution channels, is to find ways to motivate this continuous commitment to the saving process, essentially a form of partnership with the insurer (this is explored in more detail in Box 8.1 in the next section).

⁶ The mid-market exchange rate at the end of February 2011 is used throughout the paper, approximately INR 45 to US\$1.00.

⁷ Max New York Life launched this product specifically to learn about its potential and the nature of the market need. It invested a considerable amount of money, recruited a dozen or so senior managers and outsourced the information technology requirements to a major provider.

Through lessons on understanding saving behaviour, reaching customers, designing and pricing products, and running an efficient operation, Max Vijay has provided invaluable experience to MNYL.

8.2.2 Bajaj Allianz's Sarve Shakti Suraksha

Sarve Shakti Suraksha is a savings product that provides a guaranteed maturity benefit, low surrender penalties and an insurance cover that pays a fixed amount on death due to natural or accidental causes.

The product is available to members of targeted groups only. The minimum size of the group is 50 and pricing of the insurance is based on the risk profile of the group. The product is targeted at groups of women who are reached through NGOs and microfinance institutions (MFIs).

The most important features of the product are as follows:

- **Guaranteed insurance benefit:** The sum assured is negotiated with the group and is unchanged throughout the term of the policy.
- **Investment returns on the accumulated savings:** The accounts attributed to individual policyholders are credited with the investment returns earned on the underlying assets, appropriately invested.⁸
- **Withdrawal flexibility:** Policyholders may surrender the policy right from inception at very reasonable charges. This is a unique feature among the products considered in this assessment.

Though the product is available only to those who form part of an applying group, policy records after inception, such as accumulating policy values, are held on an individual basis.

More than three million lives across India have been covered in the two years since launch and assets under management are approaching US\$66 million. It is too early to comment on profitability, though the insurer expects to break even soon. It is also too early to assess the extent to which the product meets customer needs, but other variations are already being considered, and customer satisfaction appears to be high, as supported by persistency through to the beginning of the second year (13 months from inception) of 82 per cent.

Modified versions of this product are now being adopted by Allianz in other regions, such as Indonesia (called Tamadera, launched in October 2010) and parts of South America and West Africa, to suit the distinct requirements of customers in different parts of the world.

⁸ No minimum return is specified, but the benefit on maturity is guaranteed at total premiums less cost of cover and administration fees, suggesting a minimum return for those who reach maturity of no less than zero, after costs.

8.2.3 SBI Life's Grameen Shakti

Grameen Shakti is a simple product provided by SBI Life Insurance designed to reach low-income clients that, while combining insurance and savings, keeps costs low by packing together:

- a term life product priced without any differentiation for age or gender, and
- a simple cash benefit on survival of the pre-defined policy term.

The product is offered only to groups with a minimum of 200 members and has reached close to one million customers in the approximately three years since launch. While banks are the primary means of reaching customers as this helps to overcome practical difficulties such as premium collection, the distribution channels – those that have the relationships with the ultimate customers – are MFIs and self-help groups (SHGs). All premiums are collected by debiting the customer's bank account.⁹

The important features of this product may be summarized under the principle of simplicity:

- **Limited choice of term:** only five- or ten-year terms are available.
- **Limited choice of death benefit:** the sum assured must be a multiple of INR 5 000 (US\$110), up to a maximum of INR 50 000 (US\$1 100).
- **Explicit guarantee on maturity and death benefit:** The death benefit attracts no investment return but is clearly set out, and the maturity benefit is equal to the sum of all premiums under the 10-year policy and half of this sum for its five-year counterpart.

The policyholder receives no investment returns, but also suffers no charges for the cost of providing death cover. Both of these are built into the product design and the assessment of the risks of the guaranteed benefits. One charge is explicit. It is the cost of the service tax on premiums, charged at a rate of 1.03 per cent of the premium. This is added explicitly to the premium so that it does not need to be taken into account later in the policy term.

The policy includes an element of risk-sharing that reduces the margins that the insurer would otherwise need to take into account in its pricing: the death benefit to an entire group is limited to INR 50 000 (US\$1 100). If this threshold is exceeded, subsequent claims are declined and premiums net of service tax and stamp duty are returned to the nominees of covered members.

⁹ While this implies that all of the customers have to have a bank account, the product frequently originates as a service to the members of the self-help group, with the bank operating as a distribution channel.

While the product may be criticized as providing a limited range of options and no more than fair value for money on early termination, its simplicity makes it easily understood and it appears to fulfil a significant need for pure protection with limited savings.

This is probably the most important lesson that may be learned from the SBI Life experience. The insurer has taken the view that customers appreciate the straightforwardness of the product, a simply defined sum assured with limited exclusions and a clearly defined cash-back payment at maturity. The volume of product sales appears to support this view. SBI Life has commenced a programme to roll out the product across India.

8.2.4 ICICI Prudential's Anmol Nivesh

ICICI Pru has developed a policy that combines saving and insurance in a design not far removed from a classic endowment contract: it is a regular-premium investment-linked policy that guarantees, on maturity and death, a benefit no lower than the value of premiums paid, less the value of any partial withdrawals to that point. It has been launched on a pilot basis to workers in the tea plantations of Assam, in India's north-east, and is untested elsewhere.

Elements used from the design of the classic endowment include:

- the combination of a **death benefit and a maturity benefit**, both attracting investment returns, but with guarantees,
- a **unit-linked approach** to investment returns, with assets held in low-risk instruments,
- a **range of policy terms** (7 to 15 years) and sum assured options ranging from INR 6 000 to INR 30 000 (US\$130 to US\$650), and
- a **conventional set of charges**, a premium allocation charge, policy administration charge and mortality charge that do not unduly detract from the effectiveness of the guarantees.

However, the designers of this product have been innovative in a number of respects, all of which assist the policyholder. Examples of these include the following:

- **Cover continuance option.** The life insurance cover continues, for those who have selected this option, even if premiums are stopped, any time after the third anniversary of the product, avoiding an automatic surrender procedure.
- **Bonus allocation of units.** Policyholders are motivated to persist by an allocation of five per cent of one full years' premium every fifth anniversary. The policy administration charge also ceases at the end of five years.

- **Reward for premium persistency.** Surrender may take place at any time after three years. A charge of 10 per cent of the fund is applicable, but this is waived if, at the time of the surrender, three full years of premiums have been paid.

These terms go a long way towards aligning the incentives of the policyholder with those of the insurer, though they do so at some cost to simplicity, increasing the risk of poorer understanding by the policyholder.

This product was designed specifically to reach low-income customers operating in a semi-organized sector. It has been piloted in north-east India to reach tribal tea plantation labourers, using the tea companies as financial intermediaries. Partnership with a tea company does not guarantee access to all of its workers, as this needs to be negotiated at the level of the tea garden falling under the jurisdiction of the company. Nevertheless, 2 300 customers, around a quarter of those targeted, were enrolled and further roll-out was negotiated.

Sales of the product were suspended in July 2010 following the introduction of the regulatory changes discussed earlier in this chapter. A number of changes to product features are to be introduced to ensure compliance with regulatory requirements and to take advantage of the opportunity to respond to the emerging needs of customers. At the time of writing, details had not been finalized.

The initiative has survived thus far on financing by the ILO's Micro-insurance Innovation Facility, but the insurer is optimistic that with economies of scale available through wider distribution, this could become a profitable venture.

8.3 Key lessons learned

Drawing on the analysis of these four products, this section focuses on the most important lessons to consider when designing savings-linked insurance products.

8.3.1 Products may come in many shapes and forms

The four products show different characteristics in a number of key areas as depicted in Table 8.1. Some of these may be described as design differences and are relatively easy to identify. These include:

- premium flexibility,
- minimum premium requirements, and
- surrender terms.

Others are more subtle, but perhaps more sophisticated. Two of these are considered in more detail in the discussion that follows:

- the balance between savings and insurance, and
- the balance between flexibility and simplicity.

Premium flexibility

SBI Life and ICICI Pru require policyholders to pay premiums annually without variation. Bajaj Allianz permits premium payment on one of four different programmes, but on a regular basis. Only MNYL allows a completely flexible approach to premium payment, an almost unheard-of premium-paying flexibility, at least in the context of long-term insurance.

It is not obvious as to what is best for the customer. Consider the issue from a number of different perspectives.

- Annual premiums are larger than those paid more frequently, so there is a material risk of surrender if the customer cannot afford them as they fall due.
- Annual premiums lead to lower collection costs per unit paid, permitting lower charges and better value for customers.
- Where products are sold through facilitating partners, the partners may assist in the aggregation of smaller amounts into annual premiums, deepening the relationships between insurer and partner, and between the partner and customer. SHGs and tea plantations play such a role for SBI Life and ICICI Pru, respectively.
- Permitting customers to choose their premium frequency or allowing contributions to be paid entirely at the convenience of the policyholder may attract more customers and allow them more control over their financial management.
- Keeping the customer to a regular premium, with appropriate grace periods to facilitate recovery from times of hardship, may improve the policyholder's commitment to saving.¹⁰ For Max Vijay, only around 15 000 of its 90 000 customers made contributions after their initial payment, despite the extraordinarily low minimum requirement. This suggests that the insurer may have overestimated the benefit of the flexible approach over the discipline imposed by a regular premium arrangement.

These arguments demonstrate the challenge of establishing the right approach for a particular product and the need to consider the issue from the customers' perspective, in addition to any intermediary entities involved. These decisions are seldom straightforward. Researching customer preferences, evaluating paying

¹⁰ Bajaj Allianz and SBI Life allow 30 days premium payment arrears and all of the insurers in this study permit customers to revive arrangements under which premiums have been unpaid for some time.

capacity, and conducting cost-benefit analyses of different models are among the methods that would assist insurers to evaluate the trade-offs. Low-income households live sophisticated and complex financial lives; insurers should never assume that they know what their customers need.

Minimum premium

The lower the premium threshold, the easier it is for low-income individuals to participate as customers, but the more difficult it is for the insurer to achieve scale efficiencies at the level of the individual contract. On the other hand, a lower premium threshold may translate into a greater number of policies, which across the entire portfolio could be sufficient to create economies of scale.¹¹

ICICI Pru and, to a lesser extent, Bajaj Allianz, have chosen relatively high minimum premiums, with policyholders at the former paying at least INR 1 200 (US\$27) annually and at the latter, if they choose the annual premium option, no less than INR 500 (US\$11). Bajaj Allianz offers smaller premiums for those prepared to contribute more frequently. The implied minimum premium at SBI Life is significantly lower than this, and MNYL offers complete flexibility of contributions starting at INR 10 (US\$0.22) but the initial premium is high at INR 1 000 (US\$22).

It is difficult to say which approach has worked best because the effects of the minimum premium are obscured by other factors. Bajaj Allianz has sold a very large number of policies with Max Vijay selling significantly less, but this is not necessarily attributable to the premium threshold.

Surrender terms

One of the most important design questions in products that combine saving and insurance is the flexibility to withdraw from the policy, partially or completely. Surrender terms under three of the products are similar. Bajaj Allianz stands out as it provides generous terms for policy surrender, particularly by permitting early surrenders. The other insurers permit surrender after three years; Bajaj Allianz permits it immediately after inception, although surrender in the early months is likely to produce a low payout.¹²

¹¹ Viability depends on a number of cost and revenue factors. The lower premium threshold facilitates easier access, resulting in higher take-up and the spreading of fixed portfolio costs across a greater number of contracts, but it may result in higher expenses overall if the costs associated with each new sale are high. Rules are not easily determined and there is no evidence that the four insurers in this study have followed any specific approach. There is no substitute for financial modelling of the alternatives, supported by research on the likely customer take-up at various levels of minimum premium.

¹² It would be useful to understand how many customers take advantage of these surrender terms. The chapter closes with some thoughts on possibilities for further research.

As persistency with savings products is an important determinant of financial success, this approach is risky because it may experience financial losses as significant numbers of policyholders surrender early. However, as a feature differentiating the insurer from competitors, it may pay off because it sends the message to customers that the product is flexible in their hands. Facilitating exit may stimulate higher levels of loyalty, a risk not easily evaluated prior to launch.

All aspects of product design require sensitivity not only to financial effects but also to the impact of incentives on human behaviour. The issue of permitting customers to leave more easily in the hope that, in return, they will not do so, is one that requires a particularly good understanding of the tendency of people to respond to incentives. It touches, also, on the issue of trust, discussed later in this section.

The balance between saving and insurance

One of the main challenges is meeting the cost of providing insurance, the death benefit, while demonstrating adequate commitment to the maturity benefit, the result of the savings effort for those who survive until the end of the policy term. Some might suggest that a minimum insurance benefit is required to meet basic customer needs. Others believe that saving plays an important role in meeting these needs and that the insurance is supplementary. Each insurer needs to take a view on this, based on its understanding of customer preferences.

Four different approaches have been adopted to achieve this balance. These are illustrated with reference to a hypothetical product with a ten-year term, annual premiums of INR 1 000 (US\$22), and the corresponding annual cost of cover and administration fees of INR 30 (US\$0.66) and INR 50 (US\$1.10) respectively.

- **MNYL: Cost of insurance deducted from premiums; no guarantee.** From the premium of INR 1 000 (US\$22), a deduction of INR 30 (US\$0.66) is made to cover the cost of insurance. No guarantee on the maturity benefit is offered. MNYL deducts the cost of cover from the premium and does not provide a guaranteed maturity benefit to balance this. However, it mitigates the risk to the customer by describing and guaranteeing the insurance cost, and it limits the potential erosion of savings by setting the death benefit at a multiple of total premiums paid. The death benefit would be INR 5 000 (US\$110) after year one, five times the annual premium, and an additional INR 5 000 with every subsequent INR 1 000 (US\$22) premium. Furthermore, once returns have been declared, they cannot be removed.
- **Bajaj Allianz: Cost of insurance deducted from premiums; guarantee based on premiums less cost of cover and administration fees.** The guarantee is based on the sum of all premiums, INR 1 000 (US\$22) in each year, less the cost of cover

and administration charges, a total of INR 80 (US\$1.75) in each year, giving a maturity benefit after ten years of not less than INR 9 200 (US\$201). Bajaj Allianz deducts the cost of cover from the premiums. It provides a guaranteed maturity benefit, but does not guarantee the impact of the cost of insurance. This is the easiest guarantee to provide because it exposes the insurer to the least risk. Though it is not good for the customer, it allows the insurer to consider offering good value elsewhere in the product, which Bajaj has chosen to do through the surrender terms.

- **ICICI Prudential: Cost of insurance deducted from premiums; guarantee based on total premiums.** Though the insurer still meets the cost of cover by deducting it from the premium, the guarantee is based on total premiums, in other words INR 10 000 (US\$219) after ten years of INR 1 000 (US\$22) contributions. ICICI Pru provides a maturity benefit that, notwithstanding the cost of insurance cover, is guaranteed to be no less than the value of total premiums paid. It must meet this guarantee from the after-expenses return on the assets and risks failing to do so. It manages this risk by imposing a reasonably high minimum premium and ensuring that the term of the policy is not too short. Note again that, from the point of view of the policyholder, the benefit is good, but it is not without cost in design limitations.
- **SBI Life: Explicit, simple guarantee on benefits; cost of providing the guarantee implicit.** SBI Life has taken a different approach to this guarantee, providing a clearly defined outcome, but not disclosing the costs of providing this outcome. Though the level of risks that it incurs to meet these guarantees is not known – perhaps the combination is profitable – its advantage is that it is simple and more likely to be understood by customers. SBI Life offers, on its ten-year policy, a maturity benefit guaranteed at the total level of premiums less sales tax of 1.03 per cent annually, a little under INR 10 000 following premiums of INR 1 000 annually. The guaranteed benefit under the five-year policy is half of all premiums paid, just under INR 2 500 for the same premium.

Each of these approaches is justifiable. Each may be described as fair to customers, striking a reasonable balance between savings and insurance in a context in which resources are limited. Each has advantages and disadvantages from the point of view of the insurer and policyholder. In addition, each allows the insurer to provide other benefits within the policy design to the customer. The insurer needs to consider the trade-offs and prioritize the most important needs of its customers. As is evident from the differences in product design and customer benefits, the four insurers have adopted different approaches to these priorities.

Choice: The flexibility-simplicity balance

Insurers need to balance the trade-off between simplicity (less choice) and flexibility (more choice). Simplicity is helpful to gain customer trust and improve

understanding of the most important features of the product, while flexibility allows customers to respond to unexpectedly changing circumstances.

Insurers need to decide how much choice to give to their customers. It increases the potential for customer needs to be met, but it also increases the cost of administration. Choice may also decrease the level of customer understanding of the product, and is not always helpful (*see Chapter 13*). Furthermore, flexibility can lead to behaviour that undermines the protection, as seen in the low contributions for the Max Vijay product.

Each insurer has taken a view on the level of choice that it offers:

- **Bajaj Allianz** offers a range of terms, sums assured and premium frequency options, but the decision must be made at the level of the group and all of its members must abide by this selection.
- **SBI Life** allows the group to choose the level of the sum assured and then assesses the risks in order to provide the maturity guarantee. However, it permits only annual premiums and only two options for policy terms.
- **ICICI Pru** limits the term of the policy to a period of 7 to 15 years. It allows the policyholder to choose the level of cover required and the term from within this range. It accepts premiums only on an annual basis, but puts this restriction in place with the customers' cash-flow in mind.
- **BNYL** offers only a ten-year term, but allows its customers complete freedom of premium amount and frequency.

These decisions have consequences for the financial viability of the product and the potential to offer positive features in other parts of the design. The Max Vijay product provides remarkable flexibility, but the insurer found it difficult to motivate customers to make these contributions on a regular basis. After paying their initial premium, approximately five out of six customers did not pay any additional premiums despite the very small instalment amounts. This, in turn, has undermined the financial viability of the portfolio, which reduces either the insurer's profitability or the investment return available to customers, or both.

Need for persistency

There is one characteristic of policies with savings elements that must be noted: the need for persistency. Lapse rates in all long-term insurance products can be high: 10, 20 or even 30 per cent per year. Persistency levels are a key marker of insurer success. A failure to keep customers for a sizeable part of the duration of the policy hurts the insurer in three ways:

- I. A surrender takes away the marginal benefit of the fees that the policy provides to the insurer.

2. A surrender takes with it assets that are under the care of the insurer, reducing both the fees and the margins that the insurer may have been able to generate for policies on books.

And, most importantly for savings policies,

3. A policy that is surrendered may result in financial loss because the insurer may not have covered all of its costs of issuing and maintaining the policy, or setting aside assets to meet guarantees.

All long-term insurance policies are dependent for their financial success on persistency, but this is much more important for savings policies than for pure insurance policies because the incidence of profitability is heavily skewed towards the later years of the policy. Moreover, what is good for the insurer is frequently also good for the customer, who needs the product range to be financially sound and for this success to be shared with the customer.¹³

Price for scale

Insurers should make an effort to: 1) price as keenly as possible, making every effort to provide value for money to their customers, 2) test the willingness of the market to accept this price through a combination, if possible, of pre-design research and testing of market responses to the actual prices of products, and 3) compare to the corresponding prices charged by competitors where possible. A significant number of policies sold is usually more indicative of profitability than the margin available on each product. In this environment of small units, costs simply cannot be covered without the numbers. This does not mean that there is no margin in pricing for products. First, customers may not be particularly price-sensitive if the primary needs are being met. Second, profit gained through unexpectedly successful selling can be shared with policyholders if the mechanisms to do so are in the product design. Third, these are long-term arrangements and margins are needed to protect against unexpected terminations.

8.3.2

Distribution is key

Effective distribution is especially important in microinsurance products that include savings components because achieving scale is so crucial to the success of the product. In addition, participation in a long-term arrangement depends on

¹³ How this success is shared varies from product to product. While financial sustainability is important to the policyholder as the insurer is more likely to honour its promises, the policyholder also has an interest in the profit margins of the insurer, which should be low enough to share success with the policyholder, but not so low as to undermine the soundness of the portfolio.

customer understanding of the benefits of the policy, and the distribution channel plays a significant role in establishing and maintaining this understanding.

One important decision regarding distribution is whether to sell to the microinsurance public at large or whether to limit access to members of organized groups. The insurers reviewed have followed three different approaches:

1. **Group membership only.** Bajaj Allianz and SBI Life only make their products available to members of groups, with the intention of selling to all of the members of that group. Bajaj Allianz sets the terms of the contract based on an underwriting exercise covering the group, suggesting that all or a substantial proportion of the members of the group must take up the insurance.
2. **Targeted at members of groups.** The ICICI Pru product is targeted at workers on tea plantations, but participation is not compulsory for every member of the group. The group coordinators facilitate the transaction, but the decision to enrol is taken by each member individually.
3. **Available to individuals.** Max Vijay is marketed to and available to individuals through a range of distribution channels.

Selling only to groups has a number of advantages:

- It assists with scale efficiency by adding a larger number of policies with every successful sale.
- These groups contribute to enhancing the loyalty of customers, through education, practical assistance, and perhaps even peer pressure.
- It brings into play an intermediary who has the interests of policyholders at heart and frequently also a willingness to encourage persistency and to help with saving for widely-spaced contributions.
- It contributes to solidarity between members, improving understanding of the product, celebrating payment of benefits and improving persistency.

Distributing to group members appears to be the key point of differentiation between the products and the scale achieved. The two providers that sell only to groups have reached significant scale, each covering more than one million lives. The other two insurers have had encouraging starts, but cannot be described as successful in terms of number of policies sold or profitability.

A key lesson from the Max Vijay initiative is the importance of the distribution channel (*see Box 8.1*). The distribution channel needs to have an interest in encouraging active savings from customers, but finding such a channel is not always easy. Retail stores, for example, have an incentive to encourage people to spend, not save. When selling through retail stores, the savings product competes with other products in the store, both for the retailer (in terms of commission to

be earned from other high-margin products) and the client. Conflicts of interest also arise when savings-linked insurance is sold through banks, as banks have an incentive to make clients enrol in their own savings products. SHGs may have similar conflicts, but are fundamentally interested in the welfare of their members and hence may be better suited to encouraging a long-term savings product.

Box 8.1

Channel experimentation in Max Vijay

Max Vijay has tested a variety of channels, using “push” and “pull” methods. Push channels are those in which intermediaries actively persuade customers to purchase the product. These were used primarily to encourage the relatively high-premium initial uptake of the product. The push channels utilized were a financial product distributor, MFIs, NGOs and government centres.

Pull channels are those in which product sales points are established and customers are encouraged to purchase products from these points. These were primarily local retailers, including “mom and pop” shops, which policyholders regularly frequented and were therefore convenient locations for customers to make additional contributions to their Max Vijay policy.

Experience across distribution channels has varied. The financial product intermediary generated the majority of sales, but at the expense of other MNYL products targeted at higher-income customers. This channel, however, produced poor results in the area of on-going contributions.

Overall, additional contributions were made in only one-sixth of the policies. Success rates were highest in the retail channels, particularly in the city of Agra, where more than half of the policies sold were credited with top-up contributions by policyholders. It is clear from the experience to date that the product will provide clients with value – and probably the insurer with profit – only if regular saving behaviour is developed and sustained, which suggests that even marginal efforts to promote a culture of continuous saving could pay off well in terms of new sales, improved persistency and growth in savings.

Sources: Adapted from Harmeling, 2010.

8.3.3

Design priorities

A careful analysis of four insurers that have adopted different approaches to extending savings and insurance products to low-income households provides some preliminary insights for others interested in designing similar products.

Establish the key objective and focus everything on this. Microinsurance customers live complex financial lives, but it is not possible for products to meet all needs. Customers need products that meet one specific goal. They must understand what they are purchasing, particularly if the product seeks to com-

bine elements of insurance and saving. The distribution channel, the product design and the internal infrastructure of the insurer must support this. Failure to focus on one goal compromises the clarity of the message to customers, reducing the sales potential and undermining customer loyalty to the detriment of the sustainability of the business.

Prioritize distribution. Portfolio scale is crucial for insurance products that provide savings, so giving the business the best opportunity to sell large numbers of contracts is a priority. This probably means making some tough decisions early on, for example to exclude access for the general public, but these can be reviewed once a sustainable structure has been achieved. Successful insurers in this study have been single-minded in their approach to distribution.

Stimulate trust and loyalty. From a number of different perspectives it seems that trust plays a significant part in the success of the insurer, whether the primary channel of product distribution is intermediated or not. Insurers, it follows, should monitor the satisfaction of customers with the product and services being received from the insurer and intermediaries. This should extend through the whole chain of contact with customers. Good client service, timely payment of claims, minimal exclusions and smooth administration service all serve to enhance the reputation of the insurer in the community that it serves. Happy customers are more likely to stay; and keeping existing customers is cheaper than replacing them with new ones. Insurers must recognize that it is not primarily about sales, but about persistency, as customers who leave early are worse than those not gained at all.

Simplicity has merit. In savings products, as in microinsurance more generally, some compromise on flexibility in favour of simplicity seems to have helped in at least two of the examples considered in this chapter. It appears that, while consumers generally desire choice, they acknowledge and appreciate the benefits of longer-term contractual arrangements that impose constraints, in premium payment for example, in return for rewards. This has a considerable positive impact on the sustainability of the product and must be considered by the insurer in the context of the product's key objectives. Simplicity enhances customer understanding which, in turn, is likely to improve loyalty and hence the financial sustainability of the portfolio. It may alienate customers with more sophisticated needs, but these can be met at a later stage through product enhancement. The reverse is not true, as it is almost impossible to simplify an existing product.

8.4

Concluding thoughts and way forward

Microinsurance practitioners are paying more attention to the manner in which customers might be encouraged to combine savings with insurance. A number of insurers in India have launched products that do just this (this chapter considers

four of them), providing some preliminary lessons for other insurers in a similar position, namely:

- determine business and design priorities and stick to them;
- prioritize distribution;
- stimulate trust and loyalty; and
- design for simplicity, focusing on customer understanding.

Trade-offs are an unavoidable part of the product design process. Ultimately, insurers need to make their own decisions on these issues, acknowledging the importance of their context. Customer satisfaction does not come easily.

A number of questions have emerged in the course of this research that could not be answered with the information available from insurers. Further research is needed in a number of areas, including:

- the effectiveness of different distribution channels and commission models in delivering sales, and the quality of these sales, in terms of persistency rates, for each of these models;
- the take-up and persistency of customers across product variations, for example, the term of policies purchased and the level of cover – and premium – where options are available;
- incidence and causes of policy lapses, characteristics of lapsing customers, and influence of product features (such as surrender terms) on lapse rates;
- the proportion of group members taking up cover made available to them through the group and the persistency experience of the members; and
- customer satisfaction levels and the link to product design.

All of this research requires considerable commitment from insurers and some of it might be difficult to cover in the public domain, but these insights would be of tremendous benefit to others considering a venture into this segment.

9 Improving credit life microinsurance

John Wipf, Eamon Kelly and Michael J. McCord

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Credit life cover – insurance that covers the outstanding principal and interest of a loan if a borrower dies – is the logical starting point for organizations new to microinsurance. It is generally easy to introduce, simple for clients to understand, and seen by financial intermediaries as a complement to their core business. Credit life can help create an understanding of microinsurance and expand demand by building an insurance culture. When borrowers see benefits from such products, it makes them more receptive to other insurance products.

Unfortunately, credit life insurance is often designed poorly and provides little value to the insured client. When products provide little value to clients, the common negative attitude towards insurance is reinforced. Thus, improving the value of credit life products may help improve overall demand for microinsurance.

To understand the status of credit life microinsurance, and to formulate ways to improve the overall quality of credit life products, this chapter responds to the following questions:

- What is credit life insurance and how is it structured?
- Who benefits from this cover: borrowers, lenders and insurers?
- How is good value for clients measured, and is it achieved?
- What are examples of credit life products that provide value to clients?
- How might credit life products be expanded or adjusted to offer greater value to clients?
- What operational considerations are necessary to improve credit life products?

This chapter addresses these questions primarily based on the authors' years of experience working with credit life products. Additionally, to build a pool of similar data, a survey of credit life products was conducted with 30 organizations, intentionally selected because of the diverse characteristics of their products and contexts, including regional representation and varied institutional arrangements. Although the results from this sample are not representative of credit-linked microinsurance products, they are certainly illustrative, reflecting the range of good and bad practices.

9.1 What is credit life insurance?

Credit life insurance is among the most common types of microinsurance (Roth et al., 2007; Matul et al., 2010). The primary purpose of this product is to ensure that the outstanding debt is extinguished if a borrower dies. The product is typically mandatory as a precondition for obtaining a loan from microfinance institutions (MFIs).¹ The product can, however, be designed in different ways and provided through a variety of institutional arrangements.

9.1.1 Types of credit life cover

Basic credit life, which covers only the principal and interest of an outstanding loan on the death of the borrower, is the simplest form, though it can be structured in a variety of ways. Premiums, for example, may be paid up-front, either deducted from or added to the loan, or they may be factored into the loan interest rate and collected throughout the loan period. When they are integrated into the interest rate, borrowers are often unaware that they have cover.

The lenders' approach to credit life depends on their objectives. Some organizations use credit life as a benefit to clients, others as an additional source of income, and others as a building block of more comprehensive cover. For lenders interested in the latter objective, they are likely to provide **enhanced credit life**, which comes in three variations:

- **Enhanced life cover** provides the basic cover plus additional benefits such as a funeral payout.
- **Enhanced risks cover** includes basic cover plus additional risks such as disability cover for the borrower, a personal accident rider, or fire cover for business premises.
- **Enhanced family cover** expands the basic and sometimes the enhanced cover to include death or disability of family members.

9.1.2 Institutional arrangements for credit life

There are a number of institutional configurations for delivering credit life. While the lender is always present as the distributor, the underwriting institution is typically either a commercial insurer, a member-owned mutual benefit associa-

¹ The term “microfinance institution” (MFI) refers to any institution providing credit and sometimes savings services to low-income markets.

tion (MBA)² affiliated with the lender, or a cooperative insurer.³ Sometimes there is no external insurer at all as the lender retains the default risk due to client death, as in the case of Banco Compartamos in Mexico for its basic credit life cover.

Where allowed by regulation, self-insurance by MFIs is certainly an option. The cost of maintaining an internal reserve is minimal compared to the administrative cost of managing collections, bookkeeping, and transfers on the MFI side, and managing client records and claims on the insurer's side. Many lenders retain the risk because it results in better value and faster service, and enables them to adapt the product to suit their borrowers' needs. This is possible only up to a prudential amount. For example, the MFIs of the Confédération des Institutions Financières (CIF) in West Africa self-insure the death risk up to a maximum of 10 million CFA francs (US\$20 792). The CIF plans to establish a life insurance company in West Africa to cover the excess credit life of several major financial institutions.

Some MFIs charge a fee to clients when the risk is held internally and some even set up a reserve for this specific purpose such as a "Reserve for Possible Loan Losses Due to Client Death". These MFIs may charge clients, but the fee is often allocated directly to income in their books. This is both an unhealthy practice and a sign of how insignificant some MFIs really consider their losses due to client death.

From the moment the institution wants to offer more cover to clients, it becomes necessary to cede the risk. As survey respondents noted, besides the legal issue of retaining risk, they were concerned with putting their core capital at risk and not having the technical capacity to manage the insurance cover.

If an insurer is the underwriter, there may also be an intermediary involved. Some intermediaries fulfil only the sales and facilitation functions of an agent, while others design products, pre-process and pre-pay claims, and encode or reformat the operations data to the insurer's specifications. PlaNet Guarantee performs such a role, working as a broker for MFIs, and linking the insurer with a reinsurer. The rationale for intermediaries' existence is to add value for the lender, insured clients and the underwriter. Intermediaries, however, may find themselves squeezed out of this business as margins decrease, and both lenders and insurers decide that they can manage such simple products on their own. For intermediaries it becomes difficult to argue that they really do add value when insurers and/or delivery channels are willing to manage it themselves (*see Chapter 23*).

² Typically this is a risk-bearing organization, either formal or informal, which is separate from the lender and owned by the borrowers themselves.

³ In some countries, the cooperative institutions own an insurance company that focuses on providing products for their primary member-households. For these, there are sometimes special concessions by the regulator such as reduced capital requirements.

9.2 Who benefits from credit life?

Credit life insurance is often criticized because it is perceived as more valuable for insurers and lenders than for insured borrowers. In the early nineteenth century, credit life was promoted in the United States using the slogan “the debt shall die with the debtor”. It was considered disgraceful to leave a burden of debt for surviving dependents or relatives. Moreover, banks were more likely to approve a loan if part of their risk was covered by the borrower being insured. Credit life thus evolved with a clear purpose to protect both lender and borrower. In the context of microinsurance, it is useful to assess the value of credit life from the perspectives of the various stakeholders – borrowers, lenders and insurers.

9.2.1 Borrowers

For the insured household, credit life must settle the debt of a borrower on death without causing financial strain to the deceased’s family. When a microentrepreneur dies, the surviving household members are financially affected in several ways. First, there are the hospital, funeral and burial costs to settle. Apart from being one, if not the main, breadwinner, the deceased is often the skilled manager behind the household business. Thus in addition to losing her productivity, the household suffers from loss of her business skills, experience and expertise.⁴ As the business struggles to survive, the household may resort to selling inventory and liquidating productive assets at discounted prices in order to service the unpaid loan. For a household in this situation, having the outstanding loan settled by insurance is useful as long as the lender halts pressure for loan payment and the insurer pays any additional benefits rapidly.

Insurance protection is also valuable for borrowers of an MFI using the group-lending methodology. When a borrower dies, the MFI can require the remaining group members to pay the debts of the deceased from their savings. This has negative implications for group morale and the risk of losing savings discourages savings growth. Under such circumstances, borrowers often appreciate insurance as an important protection against the death of fellow group members.

Despite these potential benefits, borrowers often express little or no satisfaction with basic credit life products. One reason, as one survey respondent noted, is that “credit life is only moderately valuable because the majority of covered borrowers are not even aware that they have cover”. Since there is often no direct charge to clients for basic credit life, or because the premium is perceived as a fee for obtaining the loan, clients may be unaware of their cover status. In a client satisfaction study in Zambia, MFI clients indicated that they had only learned that they had insurance from the research team (Manje, 2007).

⁴ This chapter uses the feminine pronoun to refer to microentrepreneurs and borrowers as many MFIs primarily serve women.

Borrowers often perceive credit life as a product that benefits the lender, and not them. To understand why, it is important to look at how MFIs deal with credit default due to death without credit life insurance. Because of the stigma and extremely bad public relations that result from collecting debts from a deceased's estate, many MFIs simply write off the loan when a borrower dies. In this case, a transition to insurance would not provide additional value if it only covered the loan.

An improved value proposition would include cover beyond basic credit life so that surviving families receive a financial benefit on the client's death, or the client receives some benefit on the death of a family member and/or cover in the event of another risk. In MFIs that primarily serve women, for example, borrowers tend to be much more concerned about cover for their spouse's life than their own (*see Chapter 16*). Such enhanced and family products are more expensive, but even with the additional cost, they provide greater value to clients if the products respond to their needs and are efficiently delivered.

Value is eventually context-specific, as seen in the case of Allianz Indonesia (*Box 9.1*).

Box 9.1

Impact on clients

In one of the few assessments of credit life products, research assessed the impact of a credit life product offered by Allianz Indonesia. The study found that such a product was not needed because the assumed post-mortem financial crisis did not exist. Community and family support among low-asset Muslim Indonesians was strong enough to largely cover funeral expenses and provide for the bereaved family. This support was driven by the perception of death as a collective risk in the light of the moral economy and hinged on principles of balanced reciprocity. Thus in this case, credit life products did not fill a demand gap for clients. The study concluded that it is important to understand demand before offering credit life or any microinsurance product.

Source: Adapted from Hintz, 2010b.

Even with enhanced risk and/or family cover, the level of awareness and experiences of insured borrowers directly affect the perception of product value. For borrowers surviving a previous loan cycle, or for those applying for the first time, credit life may not seem valuable even if the purpose of the cover is clear to them. Paying a premium for an intangible benefit can be viewed as a waste of hard-earned money because borrowers “know” beforehand that they will survive the term of the loan. Indeed, mortality rates of MFI clientele tend to be significantly lower than those for the average population because the MFI primarily lends to healthy and productive clients. In general, greater appreciation of credit life occurs with increased age, when people have witnessed a benefit payout, have dependents or have benefited from consumer education.

9.2.2 Lenders

For a lender, it is much easier to be positive about credit life insurance. Unlike the borrower who is limited to her individual experience, the lender can evaluate the financial impact of credit life on its entire portfolio of loans. Eliminating the risk of borrower mortality with the cost passed on to the borrower is prudent risk management and established business practice. Lending institutions in the survey appreciated credit life as being valuable for their organization, because:

- it protects the company, shareholders or member-owners, and their loan portfolio;
- it increases fee income;
- there is no need to seek repayment from a deceased borrower's estate;
- offering quality insurance enhances corporate image, increases reputation in their markets, attracts new clients and improves customer loyalty;
- it helps fulfil their social mission in that they help clients and their families to manage risks;
- it enables a broader range of financial services to be provided.

For lenders, credit life – and especially enhanced credit life – can be a competitive advantage, as it was for VisionFund (*Box 9.2*).

Box 9.2

Credit life as a competitive advantage in Cambodia

Cambodia has a relatively high microfinance penetration and significant competition among MFIs. One MFI, VisionFund, uses its credit life product as a comparative advantage. It promotes its loan products as superior to competitors' because the outstanding debt is waived if the borrower dies. In addition, there are funeral benefits for the borrower, spouse and children. "Insurance" is never mentioned in its promotional materials or in interactions with borrowers. The premium is "invisible" since it is embedded in the interest rate. Credit life is regarded as highly valuable by this successful MFI because it has given it an important competitive edge.

Source: Authors.

At corporate level, lenders may promote credit life as a competitive advantage. However, field staff interacting with clients typically do not use this as a marketing advantage and tend to be weak at informing clients of this cover. Sometimes, even the staff are ill-informed. The mandatory nature of basic credit life facilitates this apathy to educating clients about what they are purchasing. Additionally, since basic credit life has proliferated throughout microfinance, its status as a market advantage is questionable. In Uganda, after a few large MFIs began offering enhanced and family credit life products, this level of cover became a market

expectation on the part of clients, who moved from MFIs without cover to those with the product.

In many instances MFIs focus on creating value for themselves and not for their clients (*see Box 9.3*). When MFIs retain the risk of portfolio loss due to borrower death, they often charge significant fees for the service (up to 3 per cent of the initial loan), while facing much lower claims experience. The presence of insurance should mean that lenders could theoretically lower interest rates. The authors, however, found no examples of the presence of credit life products leading to any clear reduction in interest rates on loans.

Box 9.3

Benefit flows in credit life

Richard Leftley, CEO of the multinational microinsurance broker MicroEnsure, relates his experience with credit life and MFIs. “In 2002, most MFIs that we worked with charged borrowers a flat one per cent of the loan value and used the resulting funds to pay off the outstanding loans when borrowers died; no insurer was involved. As we started to implement credit life at these MFIs, we noticed that they continued to charge borrowers one per cent even though the insurance company was charging 0.3 to 0.5 per cent of the loan value. In essence, the MFI outsourced the risk for a lower price, but did not pass the saving on to their borrowers, rather the delta was being booked as revenue. This practice is widespread today, which is a great shame, as we should all be focused on delivering good value for our clients.”

Source: Adapted from Leftley, 2010.

9.2.3 Insurers and intermediaries

The insurers and intermediaries that were surveyed generally stated an interest in credit life products because they:

- are straightforward and thus easy to sell and administer;
- tend to be very profitable, and can enable an insurer to experiment with additional products that might not be as profitable in the short term;
- represent a good entry level into microfinance markets with a chance to establish trust at both institutional and household levels;
- are a good way to create demand and awareness for insurance;
- provide relatively easy access to a large customer base with a potential growing demand for other insurance services in the future.

Insurers and intermediaries usually approach credit life as an anchor of their microinsurance business since it allows them to enter that market with a relatively

easy product. Without much risk, they can learn about the market, understand mortality rates and test controls, while generating significant profits. However, too often, credit life is as far as insurers venture into microinsurance. In these cases the motivations of both insurer and lender are satisfied – profits and portfolio cover – and neither is particularly concerned about the remaining risk-protection needs of their low-income market.

9.3 Quantifying the value of credit life

An important aspect of value is the amount and type of credit life cover one can buy for a given price. An actuary determines this by calculating the average expected claim for each borrower, which is then loaded to derive the premium rate. A similar measure, the incurred claims ratio, can be calculated retrospectively on the basis of claims experience. Intuitively, this indicator, sometimes called the loss ratio, is the proportion of premium paid back to the collective insured borrowers in the form of insurance benefits. In the absence of adverse selection and fraud, a “high” ratio signifies good value for money. Related measures are the incurred expense ratio, which indicates how much premium is used to manage and administer the product, and the net income ratio, which shows how profitable the product is for the insurer. With these ratios, one can begin to quantify value for clients, as illustrated in Table 9.1 (Wipf and Garand, 2010).

Table 9.1

Key performance indicators for credit life			
Indicator	Calculation	Range for good financial value ¹	Interpretation from consumer perspective
Incurred expense ratio	Incurred expenses/earned premium ²	Below 25%	This ratio measures the efficiency of the credit life product. The more efficient it is, the more valuable it can be if the savings on expenses are used to reduce the premium rate rather than increase profit.
Incurred claims ratio	Incurred claims/earned premium	Above 60%	Shows how valuable the credit life product is. A “high” ratio, in the absence of fraud and adverse selection, means the price of cover is relatively “low” (the value is “high”).
Net income ratio	Net income/earned premium	Not more than 10%	Shows how profitable the product is. Profit can be reduced by lowering the premium rate and thus increasing value for money.

¹ These proposed limits on the ratios are the collective opinion of the authors. Note that the sum of the ratios may exceed 100 per cent because interest on reserves increases the net income ratio.

² In accrual accounting, premium is earned throughout the term of a loan in a pattern that reflects the risk of the insurance cover and the cost of administering it. The premium earning pattern is thus independent of how the premium was paid

This chapter assumes the following five characteristics of a “valuable” credit life microinsurance product:

- a) **Relevant:** The product protects a borrower’s household from relevant risks including having to deal with an outstanding loan following the borrower’s death.
- b) **Timely:** The insurer settles the claim in a timely manner before the outstanding loan has an adverse effect on the household’s finances.
- c) **Understandable:** The majority of borrowers understand the product even when it is mandatory.
- d) **Facilitates access:** The lender’s portfolio is protected, which makes it easier for poor households to access credit.
- e) **Value for money:** There is good value for money as defined by the three value indicators in Table 9.1.

To assess financial value, the authors analysed the financial information provided by 17 institutions participating in the survey. These institutions were selected on the basis of the authors’ identification of credit life programmes that in aggregate offer a variety of covers, under a variety of different models, and where management was willing to provide data (a significant challenge). Table 9.2 provides key financial data for these institutions’ credit life operations and relevant characteristics of the institutions, but their specific identities are obscured as a condition of providing the data. Even then, not all requested data was available; for many it was difficult to provide the information because of the accounting methods they used for these products.

The findings are particularly remarkable because of the enormous range of the results. While credit life is commonly assumed to be profitable for insurers and lenders, these results illustrate that this is not universally true. Of the 12 institutions that reported their profitability in Table 9.2, eight were indeed significantly above the 10 per cent target, but two were loss making and thus have significant issues.

Table 9.2

Value for money of credit life programmes (ranked by claims ratio)									
<i>Type of organization</i>	<i>Name</i>	<i>Model¹</i>	<i>Cover</i>	<i>Commis- sion</i>	<i>Admin exp</i>	<i>Claims ratio</i>	<i>Profit</i>	<i>Con- tin- gency</i>	<i>Comment</i>
				%	%	%	% ²	% ³	
Unsustainable									
MFI	Alpha	PA	Family	n.a.	n.a.	119	n.a.	n.a.	Not sustainable
MFI	Beta	PA	Basic	n.a.	n.a.	95	<0	n.a.	High rate of HIV+
Value for clients									
Broker/ intermediary	Gamma	PIA	Life and disability for borrower	15	12.5	70	2.5	n.a.	Priced for low profit
MFI	Epsilon	PA	Family	n.a.	n.a.	65	n.a.	n.a.	
MFI	Zeta	PA	Family	n.a.	n.a.	64	n.a.	n.a.	
Takaful intermediary	Theta	PIA	Basic	25	10	60	5	n.a.	Pricing, not actual
Commercial insurer (including Takaful)	Iota	PA, PIA	Mixed portfolio	5–16 varies by account	22	60	approx. 16 average	n.a.	Profit is returned to MFIs (80% for conventional and 70% for Takaful)
Self-insured MFI	Kappa	SI-MFI	Family	0	21	57	8	14	Building up reserves
Poor value for clients									
Cooperative insurer	Lambda	PA, PIA	Mixed portfolio	0–40 (varies)	15	30	25 average	n.a.	
Commercial insurer	Nu	PA, PIA	Mixed portfolio	10	20	28	42	n.a.	
MBA	Omicron	MBA	Basic	25	20	25	20	10	
Self-insured MFI	Pi	SI-MFI	Basic	12	10	24	54	n.a.	
Self-insured credit union network	Rho	SI-CUN	Basic	10	10	22	58	n.a.	
MBA	Sigma	MBA	Basic	n.a.	n.a.	18.5	n.a.	n.a.	
MBA	Tau	MBA	Basic	0	19	13	68	n.a.	
Self-insured MFI	Upsilon	SI-MFI	Extended life for borrower and spouse	18	89	12	<0	n.a.	Voluntary participation
Cooperative insurer	Psi	PA	Mixed portfolio	8	8	11	63	n.a.	Very uncompetitive

¹ PA = Partner agent; PIA = partner-intermediary-agent; SI-MFI = self-insured MFI; MBA = mutual benefit association; SI-CUN = self-insured credit union network.

² For some, profit excludes interest earnings on reserves.

³ Contingency reserve does not include unearned premium or claims reserves.

From the client's perspective, if good value for money includes a claims ratio of at least 60 per cent, only six of the 17 in this sample meet that criterion. It is particularly striking that member-based delivery models (MBAs, cooperatives, credit unions) ranked among the least valuable in the sample. The results suggest that these cooperatives and MBAs do not face competition, and products are often priced to generate additional surplus to build equity and reserves. Some

organizations have limited technical capacity and prefer to price conservatively, while some mimic other products in the market since they do not have the ability to price correctly. Nevertheless, as these organizations are directly or indirectly owned by the insured households, an “excess” surplus should ideally trickle back to members in an indirect manner by way of expanded services and other benefits. For example, CIC in Kenya uses its surplus on credit life to finance other services for its members and clients (*see Chapter 18*).

Members of MBAs are typically required to buy a primary life and accident product as a condition of membership, in addition to the basic credit life required of borrowers. However, for many, this insurance cover is all that they can afford to buy. This reduction in purchasing power illustrates a crucial point about MBAs in the sample providing products with very low claims ratios. The surpluses that client-members are supplying to the MBAs are crowding out the client’s ability to acquire other, potentially more valuable cover.

A review of the products based on the type of cover shows that basic cover in five of the cases falls into the “poor value” group. Though there are enhanced products in each value group, five (50 per cent) of the enhanced products fall within the “value for clients” group, compared to only one (17 per cent) of the basic products. Clearly, in this sample, those offering enhanced products have a stronger focus on providing value to their clients.

Providing balanced financial benefits across clients, lenders and insurers helps to promote value in credit life. Schemes that carefully track their financial results and are aware of the importance of providing good value to the market will realize positive long-term effects on their brand name. A key means of providing better value to clients is by including benefits that have a greater impact on them.

9.4

Existing expanded products

The strategy of using credit life as a profit driver has been historically successful, but recently, in several countries, the credit life market has become more competitive, driving down premium rates and forcing insurers and lenders to rethink their microinsurance strategy. This evolution is good for borrowers, who are seeing a greater variety of benefits and covers offered in response to the suppliers’ desire to retain the business. Because of a desire to provide better value to clients or improve competitive positioning, many organizations have expanded beyond basic credit life in terms of enhancing the cover related to the client, covering additional risks, and/or covering other family members in the borrower’s household.

9.4.1**Enhanced life cover**

Another common way of enhancing the value of credit life is by making the sum assured the original loan amount instead of the outstanding balance at the time of death. This is done for two reasons: a) to ensure that delinquent loans with accrued interest and penalties are better covered, since death is often preceded by a period of illness; and b) to provide some financial benefit to dependents. This cover almost doubles the premium cost, since the fixed sum assured is about twice that of the declining sum assured. The problem is that, while there is almost always some benefit payable to beneficiaries, the amount is uncertain, and therefore the borrower's preference for a certain fixed benefit for beneficiaries is not met. Some institutions have addressed this problem by combining a declining sum assured with a fixed sum assured term life policy. This provides the benefit of credit life cover with the confidence of a fixed benefit to the family on death.

9.4.2**Enhanced risks cover**

Another common enhancement is the addition of total and permanent disability (TPD) of the borrower resulting from an accident as a condition for repayment of the loan. This cover tends to be very inexpensive since it occurs so rarely, and hence it adds little value overall, other than possibly providing a perception of greater value. Accidents are somewhat rare, and it is even rarer for someone to survive an accident and remain permanently unable to pursue a livelihood, which is how accidental TPD is often defined. Usually, disability is assessed by a medical professional 90 to 180 days after the accident. If cover is for TPD resulting from any cause including sickness, the value and cost of the additional cover increases considerably.

Although found in some commercial credit life products, temporary or partial disability cover which triggers temporary loan repayments by the insurer on behalf of the borrower is not a common feature with microinsurance. While this type of cover may help people overcome a short-term financial difficulty, controls to combat moral hazard and fraud are too difficult and expensive to manage in view of the small amounts of the loan payments.

A unique variation on this approach comes from a South Asian microinsurer, whose product covers only the borrower, but has the following additional features:

- The sum assured is the disbursed loan amount, which is paid in the event of natural death, accidental death, or total permanent disability due to accident.
- An additional benefit equal to the sum assured is paid in the event of accidental death.

- In the event of permanent partial disability due to accident, the benefit is 50 per cent of the sum assured.
- An educational cash grant amounting to a maximum of 10 per cent of the sum assured is paid in the event of death by any covered event.
- In the event of hospitalization for at least three days, hospital cash amounts to 0.5 per cent of the sum assured per day (with a cap) up to a maximum of ten days during the term (the first three days of hospitalization are not covered).

For the medical portion, pre-existing conditions, maternity and circumcision are excluded on top of the standard exclusions such as attempted suicide and participation in a criminal activity. In the event of death or total permanent disability, the outstanding loan amount is deducted by the MFI from the benefits due.

Another example is provided by Opportunity Uganda Ltd. Opportunity provides short-term loans to a large number of market vendors for purchasing stock. The small shops are located in wet and dry market areas that are prone to many risks, especially fire. Opportunity's credit life insurance protects not only against the death of the borrower but also against fire – if a fire destroys a vendor's shop the insurer will pay off the outstanding loan. Having experienced the devastating economic impact of a market fire on a number of its clients, Opportunity is exploring the possibility of extending fire cover to protect the entire stock of the borrower, not just the outstanding loan. Such cover could be easily added to the existing credit life product with the purpose of protecting the vendor's stock-based equity that has been built up over months or years.

Other examples of cover enhancements include Microfund for Women in Jordan, which provides daily cash assistance in case of hospitalization; Allianz Indonesia, which allows borrowers to insure up to three times the value of the loan; and PlaNet Guarantee, which provides indemnity in the event of death due to road accident in Cambodia.

9.4.3

Enhanced family cover

Since the financial crisis for a borrower occurs when family members experience insurable events, some lenders have pushed for credit life to cover other persons besides the borrower. Most often the spouse is covered, and occasionally children and parents. Sometimes, as with the AIG Uganda's group personal accident policy, benefits are graduated with the spouse and children being covered at a reduced level, 50 and 25 per cent respectively, of the borrower's sum assured in addition to loan repayment.

An enhancement for family cover usually involves full or partial repayment of the loan if the spouse of the principal insured dies. This is valuable cover since the spouse is often an important breadwinner. Sometimes the spouse is the actual user of the loan proceeds, as in the case of a farmer who sends his wife to attend group meetings as he must tend his fields. Additionally, many households rely on two incomes and when one of the breadwinners dies this has a dramatic impact on household well-being. Covering the other breadwinner can help stabilize the household finances, or at least mitigate the economic damage. Other benefits offered include funeral cover for spouse and children (VisionFund in Cambodia), and disability for the spouse (MicroEnsure in Philippines).

Once the family cover is added, however, a dramatic shift in information asymmetry occurs because, although the client is known to the lender, the risk of insuring the family and especially the spouse is less clear. Microfinance clients are often women. Husbands of low-income women tend to have riskier work as well as riskier lifestyles. Thus, the cost of covering spouses can be significantly higher than covering the client. In two examples, the AIG product in Uganda experienced a mortality ratio of one female client death to four spouse deaths (McCord et al., 2005a), and CARD MBA experienced one client death to 3.2 spouse deaths (McCord and Buczkowski, 2004). Often, to manage the added risk, the insurer begins with a moderate cover for the spouse and increases it as experience builds up and the true risk is better understood over time. Such cover, though potentially challenging, is of great benefit to the client.

It should be understood that not all product innovation is successful. One South-East Asian MFI initially designed its credit life product on the basis of market research, from which it concluded that a savings component was important. The product was offered on a voluntary basis and consisted of a death and total permanent disability cover for the borrower amounting to the original loan amount. From this, the outstanding loan at time of death was deducted and the balance paid to dependents. The spouse and children were also covered, their cover amounting to 50 per cent and 25 per cent of the borrower's cover respectively. The savings component was 50 per cent of the premium, which was returned with interest when the client left the MFI. The main design problem was that the entire premium was deducted up-front from the loan, which made it unattractive to the market. Hence take-up was low. Eventually, to reduce the premium deduction, both the savings component and the cover for children were dropped. Sales of the product still remain too low for sustainability, mainly because market awareness is low, participation is voluntary and the premium remains payable up-front.

9.4.4 Provider considerations

Insurers and intermediaries often offer several versions of credit life cover and some have the capacity to develop a specific combination of features that their distribution partners request. Lenders should be aware of this opportunity for flexibility and innovation, and utilize it to ensure the evolution of products to enhance value for their clients. Offering such a variety of products requires flexible administration systems and actuarial capacity. Other insurers, such as “Iota” in Table 9.2, offer their partners a basket of pre-priced components and allow them to choose a suitable combination.

Takaful credit life may be regarded as an added benefit since it permits cover within the boundaries of religious beliefs and because it may result in additional secondary services. Takaful principles require that much of the surplus from risk-pooling be returned to the insured and, while partners have the ability to do this directly, they may opt for indirect methods such as adding an additional service or reducing the cost of existing services. One insurer, Allianz Indonesia, offers both conventional and Takaful (i.e. Shariah-compliant insurance) versions of credit life. In line with Shariah principles, it returns as much as 70 per cent of the profits on completed business to its distribution partners.

Some MFIs prefer not to expand credit life beyond its basic form for a number of reasons; some, like “Lambda”, have very well developed banc-assurance distribution systems. Through a large number of MFIs, cooperatives and bank branches, it retails a range of life and non-life products to those institutions’ customers. In these cases, clients would still have the opportunity to purchase the additional products, but would have more flexibility (at least as a group) to select the most appropriate combination of products. The preference of these providers is for simple credit life that insures only loans, and customers are expected to voluntarily buy extra insurance products to suit their varied needs.

Equity Insurance Agency in Kenya employs such a strategy of offering a variety of products to its clients and limiting its mandatory cover to basic credit life. For Equity, this requires spending a great deal of its resources on educating its target market to improve understanding and stimulate demand for micro-insurance.

9.5 Operational aspects

Basic credit life cover can be simple to administer, especially once the operational details are clearly structured. As innovations are introduced to offer value to clients however, the level of complexity increases and additional operational issues should be considered. This section looks at a number of operational issues that should be addressed before a product is introduced.

9.5.1 Period of cover

Microinsurers need to be careful with the maturity of basic credit life products. Does the policy terminate at the scheduled loan due date? Not all clients are punctual in delivering full payment. Some institutions offer two weeks or more as a grace period to retain the cover when the client is late in making the final payment. Some institutions charge a periodic (weekly or monthly) premium, rather than a single premium up-front, which allows for cover regardless of the actual repayment period. Others automatically require up to two extra months of cover beyond the loan maturity date, possibly to bridge periods between loans.

Tying expanded benefits to credit life can exacerbate this timing problem because there is a lack of parity between risk durations. Risk of credit default due to death has a fixed term, as the loan has an expiry date by which it is expected to be fully repaid. Yet the risk of financial crises due to breadwinner death or loss of the business is continual. Thus, linking the period of cover to the loan can be a problem, especially if people do not continually borrow.

What happens if a loan is repaid early and insurance covers more than the outstanding loan? For some products, cover automatically ceases. For others with enhanced benefits, cover continues to the end of the scheduled loan term. Some organizations provide a partial refund of the premium. Given the small premiums of even expanded credit life, the administrative cost of refunding a small piece of a tiny premium might be excessive. CLIMBS in the Philippines lets its distribution partner decide whether the premium should be partly refunded; if no refund is due, then cover continues until the original expiry date. As CLIMBS has good administration software, it is relatively simple to provide the refunds but it must then claw back some reinsurance premium and commissions as well, requiring some administrative effort.

9.5.2 Premium collection and financing

Premium collection can be effectively managed using several methods. For the majority of schemes, the premium is paid **explicitly** by the client, typically with a single premium at the start of the loan term. Collection from the client is usually in the form of a deduction from the loan or is added to the loan amount and amortized. These methods add interest expense to the cost of the credit life cover for the client. Other methods include:

- periodic withdrawals from a savings account (practised by some credit cooperatives)
- premium payable with each loan payment
- premium embedded in the loan interest rate

- monthly premium payable based on total value of the loan portfolio (bulk credit life where the institution is the beneficiary and policyholder)
- term insurance bought for clients by an MFI
- self-insured through an internal fund sourced from MFI profits

Different methods have an impact on operational efficiency. Depending on the level of automation, multiple premium payments may cause additional operating costs. Payment methods also have an impact on marketing. When the client requests a loan of a certain amount and receives less due to the premium deduction, confusion can ensue. Furthermore, if the cost of insurance is fully charged up-front, it can drive clients to competitor MFIs, especially if insurance cover is not highly valued.

The majority of programmes base their premium rates on the loan amount or sum insured (with enhanced and family products). This effectively links the premium to the financial risk and capacity to pay. A few schemes have a single fixed premium for all clients irrespective of the loan amount or term. This arrangement is easier to implement and explain, but it raises equity issues. If there is a range of loan sizes, clients with smaller loans and shorter terms subsidize the larger and longer loans. In one example, a self-insured MFI initially started out with a single fixed premium but after a few years its members became more aware of the inequity and many complained. Today it calculates premiums based on the initial loan amount.

An interesting case from an actuarial viewpoint arises when the premium is embedded in the interest rate. For example, VisionFund (Cambodia) offers fixed funeral benefits for the family, but a monthly premium is charged on the outstanding balance of the loan (loan repayments are made monthly). With inflation and the improvement in the economic situation of borrowers, the average loan sizes increase over time, and hence the base on which the premium is calculated continues to grow while funeral benefits remain fixed. This requires frequent re-pricing and adjustment of the rate (at least every 12 to 24 months). The organization collects very good data to permit accurate actuarial analysis.

9.5.3 Education and promotion

A very important distribution function is to educate clients about the credit life product that they receive to ensure that the borrowers and beneficiaries understand the cover, terms of cover, and what to do in the event of a claim. Most information is provided verbally during the loan application process and many institutions, especially those with enhanced and family cover, offer explanatory materials such as brochures. Some, like MicroEnsure in the Philippines, use a formal financial literacy training tool as well as educational comic books.

The focus of insurance managers interviewed for this chapter appears to be on promoting their products to their distribution partners. Other than Micro-Ensure, it is not clear to what extent they assist their partners with developing education methods. One intermediary complained that with a small commission it is left to do everything on its own without any help from insurers.

One insurer in Ghana said that he did “not want to tell his clients that they were covered because they will make claims”. If credit life is expected to be of benefit to clients and serve as the foundation for an insurance culture, institutions must make sure clients understand the benefit they have in working with an institution that offers quality credit life cover. Demand for microinsurance can only come if the market understands what it is buying and sees that the obligations under that insurance contract are met.

9.5.4 **Organizational capacity**

Many organizations know what innovations their borrowers would like, but the MFIs often do not have the capacity to change processes or systems to accommodate expanded versions of credit life. Capacity self-assessment is tricky in itself, as institutions often think they have more capacity than they do.

MFIs typically have limited technical capacity in microinsurance and have little interest in developing such capacity given that their core competency is in credit and savings. Some have access to expertise through their partners (insurers or intermediaries), while others source expertise from microinsurance technical resource centres and actuarial consultants.

Capacity can be greatly enhanced with systems and software to track activity. Those without capacity should develop these systems because even credit life becomes complicated when it is enhanced with additional covers.

Institutions that have sufficient capacity sometimes face other challenges that prevent them from making changes. One insurer with a successful Takaful product notes that it has sufficient capacity, but finds it difficult to persuade shareholders and management to prioritize the development of new microinsurance products. Other reasons for limited expansion include:

- Desire to focus on achieving much greater outreach before adding additional products.
- SICL in Sri Lanka remains conservative because there are only two actuaries in the country, and neither has microinsurance experience. Thus product expansion carries significant additional risk that it is unwilling to take on.
- Some mutuals are still focused on building up a surplus and reserves before venturing into new products.

- Some institutions claim their customers are satisfied with the basic offerings and are not aware that there is demand for anything else.

9.6 Conclusions and recommendations

Borrowers enrolled in group liability models, those with relatively high-value loans (which lenders are not willing to write off), and those in cultures that consider leaving debt after death as taboo, may benefit from credit life insurance. In most cases, however, credit life remains a product seen as benefiting the lending institutions. The financial value to clients is often poor with credit life, especially for cooperative-based programmes. For cooperatives, the reasons for poor value include limited competition, a policy of building up surplus and contingency reserves without infusing external funds, lack of focus on providing financial value due to complacency, and cautious overpricing due to a lack of actuarial expertise.

The involvement of many parties – lender, broker, insurer and reinsurer – can add inefficiencies to credit life products. Cases where lenders manage the credit life on their own have potential to keep costs much lower, but are frequently focused on fee generation rather than value creation.

There is a demand from clients for innovation beyond basic credit life. The value of credit life is significantly improved when there is enhanced cover available and the loss of family members is added. Product expansion typically occurs by adding cover of additional risk events (as with total permanent disability), an increased cover amount (such as cover of three times the loan amount), other insured persons (preferably the spouse), or insurance for other assets (such as the home). Voluntary credit life insurance may also lead to improved products, as they require a positive purchase decision from clients, but such products have proved difficult to sell.

There are often constraints on expanding credit life products, such as technical capacity, financial capacity, management requirements, an unclear business case and price sensitivity in the market. Front-line organizations may cede or retain the insurance risk depending on their situation and their plans for micro-insurance product evolution. Some strive to reduce cost and improve value, some lack access to alternative options, and others seek to optimize their profit.

The structure of the product – credit life as a stand-alone product in contrast to an enhanced product with family cover and/or cover for other risks – has a considerable impact on operational issues. These issues include continuity of cover, premium calculation and collection methods. They need to be considered before the introduction of the product to ensure clarity and to minimize conflicts. Product adjustments to include families, or at least spouses, need to be carried out carefully and must factor in claims controls and pricing issues.

Insurers and lenders may benefit from credit life premiums at first, but the benefits should be utilized to create an array of products that could be subsidized from the funds generated by the credit life product. However, the evolution commonly stops at basic credit life and does not continue to include products that clients may value. Where this evolution progresses, insurers, lenders and borrowers often benefit, though such benefits should not be assumed.

In conclusion, this chapter makes several recommendations about the development and implementation of credit life products:

- Credit life should be seen as a start and not an end. Clients across the globe can benefit if insurers and lenders learn from the basic credit life products and use that learning to expand options available to clients.
- Basic credit life (including with spouses) should be treated as a stand-alone product and priced relative to loan volume. Other products should be priced on the basis of their specific risk. These are often priced together and because of the different risk characteristics this makes little sense.
- Administration of credit life products should be simple, with active effort made to reduce costs. Savings should be passed on to clients either through lower premiums or through an evolution of microinsurance products to provide greater benefits.
- In most cases, basic credit life can be provided efficiently by lenders as an adjunct to their “Reserve for Possible Loan Losses”. There should be no legal issues barring lenders from providing this, as credit life simply covers default in the event of death. Where there are very large loans, significant potential for catastrophic loss or a real expectation and active plan to enhance the credit life to respond better to clients, there is value in passing on the credit life product to an insurer. Otherwise, it is more efficient if the mortality risk of the portfolio is borne by the lender.
- Examples in this chapter demonstrate that credit life products can be flexible and responsive to the needs of insurers, lenders and clients. The lender needs to assess its role in providing valuable products to clients and should assume the responsibility of representing its clients’ needs. Basic credit life is not sufficient for the needs of low-income clients. Credit life offers insurers and lenders an entry point to assist clients in managing their risks in an efficient and effective manner. This opportunity should not be overlooked.

10 Funeral insurance

Christine Hougaard and Doubell Chamberlain

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This chapter considers the current and potential role and value of funeral insurance for low-income consumers based on evidence from selected countries. Despite the different experiences across countries, the following important themes emerge:

1. **Funerals and related expenses are often prominent** in the minds of low-income households and, accordingly, many households place high priority on finding ways to deal with funeral expenses and are willing to dedicate part of the household income to funeral cover.
2. **There is a strong link between funeral insurance and the underlying service, namely the funeral.** This link to a tangible service is an important driver of demand as well as, in some cases, of the choice of distribution channel used.
3. **Funeral insurance is provided in both formal and informal markets.** In some instances, funeral parlours self-insure – that is, informally act as insurers. Informal funeral insurance also occurs where groups of people pool funds to help cope with funeral expenses. Funeral insurance is an important product in some formal markets and is at the forefront of many commercial insurers' drive to reach down the income spectrum. As such, it has been one of the focus areas for alternative distribution innovation.
4. **Funeral insurers are challenged to deliver better value to customers.** As section 10.3.1 indicates, the combination of strong demand for funeral cover and the close association with funeral services may lead to consumer vulnerability. A number of trends are, however, starting to emerge to counter abuse and provide enhanced value.

The sections below consider these themes in more detail.

10.1 Funeral cover matters

Funeral insurance is a term life insurance policy where the benefit is used to cover funeral expenses. The benefit can be in the form of a funeral service, a cash benefit that can be used to help pay for a funeral, or a combination of the two. Outside credit life insurance (*see Chapter 9*), funeral insurance is the most prevalent form of microinsurance in a number of countries (*see Box 10.1*).

Box 10.1

Mapping funeral insurance



A survey of microinsurance practitioners in **Africa** found that 14.7 million people in 32 African countries were covered by microinsurance products. South Africa, where funeral insurance is by far the biggest microinsurance product, accounts for more than half of this (8.2 million). Survey respondents were providing life cover to 9.1 million low-income persons, of which 6.2 million had funeral cover (Matul et al., 2010).

Dercon et al. (2004; 2006) highlight the history, prevalence and social role of informal group-based funeral insurance in **Ethiopia** and the **United Republic of Tanzania**. Dercon et al. (2008) find that nearly 90 per cent of rural households in a relatively representative sample of the rural Ethiopian population belong to at least one *iddir*.

In **Kenya**, survey data show that up to four million adult Kenyans are part of a society or group that fulfils a welfare function such as the provision of a funeral payout on death in the family or payment of hospitalization costs (FSD Kenya, 2009).

The latest survey data for **South Africa** (FinMark Trust, 2009) show that 43.5 per cent of all adults have some form of life cover. Of them,

- 45 per cent indicated that they have funeral cover through a burial society; and
- 27 per cent indicated that they have funeral cover that was bought from a retail store.

Eighty per cent of the South African Financial Diaries sample (Collins et al., 2009) had at least one form of funeral cover and most of them had more than one:

- 26 per cent of households had a formal funeral plan;
- 57 per cent of households belonged to a burial society; and
- 24 per cent had some kind of policy with a funeral parlour.



A study on microinsurance in **Colombia** (Cáceres and Zuluaga, 2008) quoted 2006 data by the Colombian industry association which estimates that 24 per cent of the 2.7 million microinsurance policies are for funeral insurance. In addition, industry sources estimate that the informal funeral cover market, provided through funeral service providers, could serve up to three million clients.

Though no hard data is available on the reach of informal funeral cover provided outside of the insurance industry by funeral homes in **Brazil**, industry players estimate that as much as 20 to 25 million people have funeral cover – the bulk of which covers low-income persons (Bester et al., 2010).



A similar study in the Philippines (Llanto et al., 2008) estimated that about half of the members of the 22 000 active financial cooperatives (or about 1.2 million adults) were covered by informal, in-house funeral insurance, which equated to roughly 41 per cent of the total microinsurance market. In addition, informal funeral groups known as *damayan* funds are widespread.¹

Why is funeral insurance so popular in the countries reviewed? A number of social, cultural and economic factors contribute to the demand for such insurance.

Paying last respects. Some cultures attach great importance to a dignified funeral. The risk of death and the need to find ways of providing for the related expenses are constantly on people's minds. In some cultures, funerals are seen as essential to honour the dead. For example, in South Africa a dignified funeral is given high financial priority as part of the cultural belief in the importance of honouring ancestors. Expensive funerals that include food and transport for those attending the funeral are the norm. Market research conducted by Alternative Insurance Company (AIC) in Haiti (Nabeth and Barrau, 2010) likewise showed that Haitians believe that a dignified funeral is essential to ensure that the soul of the deceased will look after them. As one focus group respondent remarked, "I also want a brass band for my funeral. I won't entertain the idea of not having a brass band; when I'm in my coffin, I will take my leave to the rhythm of a brass band!"

Funerals are also an opportunity for relatives to keep in contact and maintain social ties. There may be social pressure to have an elaborate funeral ceremony, just as in other cultures an expensive wedding ceremony – relative to the income of the family – may be important. Even in cases where municipalities offer free burials for those who cannot afford a private burial, some focus group respondents indicated that the family's pride would not allow a "pauper's funeral". The cultural significance of funerals is an important driver of insurance demand but, as discussed later in this chapter, it is also a driver of vulnerability.

¹ "*Damayan*" is a Filipino word that means "to console", "to empathize with the other" or "to be a part of" a certain unfortunate or unforeseen event. This comes from the local practice of helping one's neighbour who might be in great need. In practice, each individual in a *damayan* fund voluntarily pledges and contributes a certain amount to a fund that will be given to the aggrieved party, who is likewise a contributor to the fund. Membership of the fund is voluntary and the benefits are not pre-determined but contingent on the funds collected.

Living in the shadow of death. Funerals are not only important culturally, they are also a practical reality. Focus group discussions in Brazil, Colombia, Haiti, Kenya and the Philippines indicated that the risk of death is a primary concern for low-income households because of the serious financial implications. Ethiopians often regard drought as the primary risk facing individuals. Focus group participants, however, regarded drought as “in God’s hands” and instead focused on the financial risks of death and illness in considering coping strategies. In the *Financial Diaries* from South Africa, death affected more than four-fifths of the households during the study year and funerals were by far the most common financial emergency (Collins et al., 2009). In Zambia, when asked why they are most concerned about death risks, one focus group participant remarked: “It just comes suddenly. Even today a funeral can happen.”

This prioritization, however, is not universal. In India, the risk of death was not emphasized in focus groups. Rather, health risks were the top priority. In Uganda, likewise, the risk of death was not ranked highly. In some countries such as Côte d’Ivoire there is a difference according to tribe and religion, and in majority Muslim countries such as Senegal funerals are not considered important at all.² In such environments, where elaborate funerals are not the norm, there are nevertheless other costs associated with the death of a family member that imply that similar risk cover (even if not called funeral insurance) may still be of value.

Matter over mind. In some countries, people are reluctant to talk about death. Buying funeral insurance may even be regarded as bad luck. As one focus group participant in Brazil remarked, “I don’t like to speak about death. It’s like someone is cursing me. I immediately change the subject. Insurance! Don’t even think about it!”

Surprisingly, funeral insurance is sometimes even popular in countries where people are reluctant to talk about death. This can be regarded as a feat of pragmatism over cultural taboos. Focus group research in Brazil revealed that people tend to take out funeral cover on relatives to avoid the financial impact of a funeral. They therefore have an insurable interest in the life of relatives for whom they would be expected to make a funeral contribution. Funeral cover then becomes an income-smoothing strategy. This holds true even for wealthier individuals. In Indonesia, McCord et al. (2005b) noted that wealthy people were joining *arisans*, local multipurpose social assistance groups, so that funds from the *arisan* could smooth the demands on them from others, and create a mechanism whereby relatives and others are not demoralized by the frequent need to approach the wealthy for help.

² Source: Discussion with CGSI Consulting.

A substantial financial impact. Though there is variation across countries, it is commonly accepted that a funeral is a substantial expense:

- In Ethiopia, a funeral can cost up to a quarter of annual income (Dercon et al., 2008).
- In Brazil, funeral insurer SINAF estimates that the average household spends approximately one month of household income on just a regular funeral, increasing to more than a month's wages for more expensive options.
- In Haiti, market research³ found that a mid-range funeral costs between US\$1 000 and US\$1 300, which is roughly equivalent to the GDP per capita (IMF, 2010).
- Roth (1999) found that funerals in one South African township cost approximately 15 times the average monthly household income. The South African *Financial Diaries* suggest that households spend about seven months' income on a single funeral (Collins et al., 2009).
- In Zambia and Kenya focus groups confirmed that funerals are a very big expense. The cost of the funeral feast and transport for the guests often exceeds that of the funeral service itself, a phenomenon that is also borne out by the South African *Financial Diaries*.

Not just the expense of a funeral. While the importance and cost of the funeral is emphasized above, it is not the only cost stemming from a death in the family. Debts have to be settled, day to day expenses have to be paid and visiting relatives need to be fed, often resulting in a multilayered approach to managing the costs (*see Box 10.2*). Where sickness preceded death, medical bills may already have drained family savings or entailed taking out a loan. Where the deceased was a breadwinner, the loss of income will furthermore present a major challenge. Even if the deceased was not a breadwinner, there can be significant lost earnings during the mourning period, as organizing a funeral and hosting relatives may result in inability to work for weeks.

Box 10.2

Why have multiple funeral insurance policies?

“As a person you have needs, there is a hierarchy of needs. Socially you need to have money should something happen – so you need the burial society, and then you need the undertakers who will take care of the funeral. The money from the insurance company takes time to pay out so whenever that money comes, you can settle all your outstanding bills, so it is worth it. It's for peace of mind in a way.”

Source: South African focus group participant.

³ By CGSI consulting, for Alternative Insurance Company Haiti.

Coping with the cost. The financial shock of the funeral has to be managed in some way. Market research indicates that people use a variety of coping mechanisms, including drawing on savings, taking out loans, calling on family and friends for contributions or selling assets or business inventory – often, due to the time pressure, at less than the asset or stock is worth. An extreme coping mechanism mentioned in focus groups in Zambia was taking children out of school to help in the business or collect money.

An example from the *Financial Diaries* research conducted in South Africa illustrates the variety of coping strategies employed (see Table 10.1). When the brother of one of the respondents died, she used numerous ways to cover the expenses of the burial. While contributions from family and the community are a reliable coping mechanism mentioned time and again in the market research, there is also consensus that it is simply not enough. Generally, the market research confirms that many of the coping strategies are either unreliable or will not be sufficient by themselves and may plunge people (further) into debt. Furthermore, where families and the community contribute, the net effect may be a reduction in income for the whole community over time. Some form of funeral cover is therefore often regarded as non-negotiable to respondents in market research.

Table 10.1

Thembi's coping strategies

<i>Sources of funds</i>	<i>US\$</i>	<i>Uses of funds</i>	<i>US\$</i>
Payout from burial society	154	Undertaker	538
Contribution from relative	231	Tent	91
Contribution from relative	154	Pots	35
Contribution from relative	154	Food	649
Rental of cooking pots by relative	35	Sheep	100
Purchase of sheep by relatives	100		
Borrow from aunt's burial society (no interest)	154		
Borrow from cousin's savings club (30 per cent per month)	92		
Borrow from cousin (no interest)	108		
Use income (social grant money)	92		
Use deceased brother's grant money	49		
Total	1 414		1 413

Source: Collins et al., 2009.

10.2 Key characteristics of funeral cover

Now that it has been established why people want funeral insurance, 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?

10.2.1 One product, many providers

As illustrated in Table 10.2, funeral insurance is provided by a variety of risk carriers, both cooperative and corporate, informal and formal.

Table 10.2

Types of funeral insurance providers

	<i>Formal</i>	<i>Informal</i>
Mutual	Cooperative insurers Examples: Solidaria and La Equidad in Colombia	Community risk-pooling groups Examples: <i>Iddir</i> , <i>damayan</i> funds, burial societies, funeral associations
Corporate	Commercial insurers Examples: SINAF (Brazil), Sanlam Sky, Hollard (South Africa), AIC (Haiti)	Funeral undertakers Examples: funeral homes in Brazil or Colombia, undertakers in South Africa, certain pre-need companies in the Philippines

As part of the **formal** insurance market funeral insurance is provided by both commercial insurers and mutual or cooperative insurers. Either mutual or corporate entities can also provide **informal** funeral policies:

- Informal insurance provided by **mutual** entities includes the in-house funeral cover provided by cooperatives in the Philippines that are not registered insurers, or the informal risk-pooling groups found in various guises in different countries: *iddir* in Ethiopia, funeral associations or funds in Zambia, *damayan* funds in the Philippines, welfare societies in Kenya or burial societies in South Africa.
- Informal funeral insurance is **corporate** where funeral service providers, who are commercial rather than member-based organizations, carry risk in-house. Even if such undertakers are registered as a company or partnership (that is, are formal entities), the funeral cover provided will be informal, and possibly illegal, if it is not underwritten by a licensed insurer.

10.2.2 Is it insurance or not?

Where funeral insurance provides in-kind benefits, namely a funeral service, such benefits sometimes fall outside the regulatory definition of insurance. For example, in Brazil, Colombia and Kenya, funeral assistance provided in kind is explicitly excluded from the regulatory definition of insurance.⁴ The market is therefore not subject to insurance regulation or supervision. In other instances, informal risk-pooling where there is no contractual guarantee for the benefits provided, or where groups are smaller than a certain threshold size, is implicitly not regarded as insurance. This is for example the case for burial societies in South Africa or, until recently, *damayan* funds in the Philippines.⁵ It is therefore legal for them to continue to operate informally.

Such intentional exclusion of certain activities from the formal insurance market is known as regulatory forbearance. Regulatory forbearance can be in recognition of the low insurance risk posed by certain practices, or can come about due to pragmatic concerns, for example a lack of supervisory capacity to enforce insurance regulation across thousands of groups. It can even be the result of lobbying by strong industry groups. In Brazil, for example, recent attempts to incorporate funeral assistance into a microinsurance bill were thwarted by funeral home lobbying of Congress.

10.2.3 Salient underwriting features

Funeral insurance is essentially an entry-level, simple and affordable life insurance product. There are a number of common product design elements:

- **Group pricing.** Funeral insurance is most often priced and adjusted on the experience of groups, even if sold individually. That means that there is limited or no individual underwriting, which helps to make the premiums affordable.
- **Renewable.** As with other microinsurance products, insurers' lack of experience with the target market means that they may have limited actuarial data on it, in turn implying that it may be difficult to get pricing exactly right. Due to this uncertainty, insurers are generally (though not always) reluctant to commit to a whole-life/long-term price guarantee or contract, preferring to opt for renewable

⁴ In Colombia, a 2006 opinion issued by the Financial Superintendence (based on a 2003 constitutional court judgment) held that the policies provided by funeral service providers fell outside the definition of insurance in the Fundamental Law of the Financial System. These providers therefore operate on an unregulated and unsupervised basis. In Brazil, CNSP Resolution 102/2004 differentiates between "insurance cover" and "assistance services" and allows funeral assistance services to operate outside the definition of insurance as it entails in-kind benefits (assistance services) rather than monetary reimbursement in the event of a claim. In Kenya, the definition of insurance excludes all benefits in kind. Funeral benefits are explicitly mentioned under this exemption.

⁵ Note that legislation passed in 2010 requires *damayan* funds to be registered. They may therefore no longer operate informally with the sanction of the regulator.

term cover. This gives the insurer the option of not renewing the contract when it expires or adjusting the price on each renewal in line with the risk experience of the group. Many funeral policies are therefore renewable monthly or annually.

- **Waiting periods to counter anti-selection.** Where there is no individual underwriting, anti-selection may be a challenge. People may be prone to buying funeral insurance on the life of a relative who is ill or dying. Such anti-selection is typically countered by waiting periods. Waiting periods of up to six months are common practice in the funeral insurance industry. For example, a policy may be structured to cover only accidental death for the first six months, with no claims for natural death allowed. From month seven onwards the policy will cover all life risks. Another method to counter anti-selection may be to increase the schedule of benefits over a period of, say, three to five years, for example by paying only 10 per cent of the benefit in the first year, 25 per cent in the second year and so forth.
- **Limited exclusions.** Though some exclusions may apply, funeral insurers tend to limit exclusions, for example for pre-existing conditions, as they are complex to communicate to prospective clients and costly to enforce. Instead, to keep the policy as simple as possible, insurers tend to price for the risk of anti-selection associated with no exclusions, or to manage it through the imposition of a waiting period.

10.2.4 The nail in the coffin

Perhaps the quintessential element of funeral insurance is its close association with the underlying funeral service. In some cases, the benefit provided will be a funeral service rather than a cash payout. Even where there is a cash benefit, it is the need to pay for the underlying funeral service that drives the demand for funeral insurance. The link with funerals matters on three fronts: tangibility, distribution and self-insurance.

Tangibility. The fact that benefits are often described in terms of a funeral service of a certain standard makes funeral insurance very tangible in the eyes of consumers. Low-income consumers place high value on tangible benefits. For budget-constrained individuals the opportunity cost of paying insurance premiums is high. Consequently, the promise of a sum of money that may or may not be enough to cover the expenses at the time of need may be less enticing than the assurance that their expenses will be covered or that certain necessities will be provided in the event of a certain peril. Tangibility is also becoming popular as a means of communicating value for other types of microinsurance. Apart from funerals, tangible benefits include grocery baskets or coupons, discounts at certain stores, the replacement of an insured item, or payment of school fees or other bills for a predetermined period. Increasingly, funeral insurers are adding

such other tangible benefits to the funeral insurance offering to enhance the clients' perception of value. For example:

- Hollard (South Africa) now offers a funeral insurance product that provides a rental car for making funeral arrangements, a certain amount of mobile phone airtime (once again for making funeral arrangements) and payments towards groceries for six or twelve months after the funeral – all in addition to the lump-sum cash payout for the funeral.
- In Viet Nam, where talking about death is still a cultural taboo, a composite product that combines funeral cover with hospitalization cover, the provision of an ambulance for emergencies and the payment of school or pre-school fees could be popular, according to focus groups led by Groupama Vietnam.

Distribution. Given the link to the funeral service, stand-alone funeral insurance is often distributed through the funeral service provider in the markets reviewed.⁶ Distribution through the undertaker reduces distribution costs and may facilitate take-up: people are clients of the funeral home and regard insurance as a way of pre-funding the funeral. The flipside, however, is that an under-developed funeral services market may undermine demand for funeral insurance. Likewise, customers may not be happy with the level of service received in kind.

Self-insurance. As mentioned above, in some cases undertakers act as insurers of their own book without being licensed insurers. Examples include some pre-need companies in the Philippines that have their own chapels and crematoria and provide life plans, “death care” plans or cremation plans without buying a guarantee for the risk from an insurer. Another example is the funeral homes or cemeteries in Brazil that sell funeral plans. Where this is the case, specific consumer vulnerabilities may arise (*see section 10.3.2*).

10.2.5 Alternative distribution

The fate of funeral insurance is not solely linked to funeral service providers. Funeral insurance is the source of much activity and innovation in the commercial insurance sector's efforts to develop viable products targeted at the low-income market. Specifically, the funeral insurance market is seeing substantial developments in alternative distribution channels.

⁶ Note that this phenomenon is found in some countries, notably Brazil, Colombia and South Africa, but does not account for the bulk of the funeral insurance market globally. In most countries, funeral insurance is simply sold by insurers through traditional or alternative distribution channels and benefits are provided in cash rather than in kind. In such cases, funeral insurance may also be a rider on or component of a broader insurance policy

Mobile phone channel. Term life or funeral policies, being affordable and simple, are one of the first insurance products introduced through mobile network operators. For example, mobile operator Tigo in Ghana provides free funeral insurance cover as an incentive for buying airtime (the more airtime you buy, the more cover you receive). Not only does this instantaneously extend funeral insurance to millions of customers, but it is hoped that it will provide an introduction to the concept of insurance that will enable the company to sell more complex, voluntary insurance products to its customers in the future. The model uses SMS and media campaigns to inform clients of the amount paid out in claims and the fact that payments were made within 48 hours of receiving the necessary documents. These campaigns aim to overcome negative perceptions of insurance.

Another model involves offering mobile network customers the option to buy insurance voluntarily, using their phones as a premium payment platform. Besides using mobile phones to pay premiums, a number of insurers are also harnessing the mobile phone to communicate with clients, for example to inform them that premiums are due (*see Chapter 24*).

A funeral off the shelf. Off-the-shelf funeral policies are another example of alternative distribution. In South Africa, for example, funeral insurance is the only product that the market is familiar enough with for it to have become commoditized. That means funeral insurance can be sold off the shelf through passive sales techniques (*see Chapter 22*), relying on consumers to purchase it without face-to-face, active sales by an agent (*see Box 10.3*).

Box 10.3

Alternative distribution: Pep-Hollard, South Africa

Pep is the largest low-income clothing retailer in South Africa. It has teamed up with innovative insurer Hollard to provide funeral insurance sold off the shelf at premiums that start from around US\$5 per month for a funeral policy covering the whole family, with a benefit of around US\$1000 per person. The “insurance starter pack”, as it is called, contains a policy card, the policy document and other information. The cashier captures the buyer’s basic details and a call centre then phones the client to activate the policy.

The customer is given the choice of a number of options with regard to the benefit level and the number of people to include as lives assured. There is also an option to cover just elderly parents. Each policy option pays out a cash amount that can be used towards a funeral or for any other purpose at the discretion of the beneficiary.

Source: Adapted from Smith and Smit, 2010b.

“Sold, not bought”. Zuluaga (2010) highlights the use and potential of alternative distribution channels such as utility companies or retailers for funeral insurance in Colombia. In contrast to the South African experience, one of the main lessons from Colombia is the need for active sales. Even if clients find it convenient to pay premiums through a channel with which they have an existing relationship (e.g. at the cashier in-store, or through an add-on to a utility account), they will initially need to be persuaded to purchase it through active and often face-to-face sales techniques (*see Box 10.4*).

Box 10.4

Alternative distribution: CODENSA Mapfre, Colombia

Bogota electricity utility CODENSA and insurer Mapfre have teamed up to offer CODENSA's two million clients a number of insurance options, among them three family funeral plans that provide in-kind funeral service payouts at a monthly premium starting from US\$2. CODENSA sees the insurance products as a way of providing additional services to its electricity client base, thereby increasing client retention. It plays an active role in sales and marketing, as well as in product administration.

Different marketing techniques are employed. Initially, a pamphlet with insurance product information was included in the electricity bills sent out to clients, but this passive form of marketing was not effective. Currently, marketing is conducted through a combination of call centre and face-to-face sales. The customer database is used to identify prospective clients based on their income strata and to locate them geographically. Prospective clients are then contacted by telephone. If the call centre does not close the sale but generates interest, a sales agent will be sent to the person's home. The CODENSA sales force also operates on a door-to-door basis (targeting specific neighbourhoods at a time) in parallel to the call centre marketing drive.

Source: Zuluaga, 2010.

10.3 Delivering value

This section considers the value proposition of funeral insurance to its clients and looks at ways in which insurers are starting to improve value.

10.3.1 Consumer vulnerabilities

The cultural importance of a dignified funeral found in a number of countries may create vulnerability to abuse in the funeral insurance market. Such vulnerability is exacerbated by the strong link between funeral insurance

and the underlying service provider. Where benefits are provided by a particular funeral parlour, it will create a captive market for that service provider. This arrangement can lead to a number of consumer protection concerns:

- **Geographical limitations.** Where there is no cash-payout option, clients can only receive the funeral service benefit in the geographical area served by the funeral parlour in question. There is a problem if a client moves to a different town or city. In some instances, clients may pay premiums for a long time, only to find that they are unable to claim because they have moved outside the service area of the funeral parlour.
- **Multiple cover.** A person can only have one funeral. Thus, should different family members insure the same life under different policies, they will forfeit all but one policy's benefits if the policy benefit is a funeral service with no option for a cash payout. Over-insurance can be an issue even where the benefit is not linked to the underlying service. To minimize sales costs, insurers often only check the identity numbers of lives assured and beneficiaries at the claims stage. It may therefore happen that more than one family member has insured the same life under different policies. Where this is not permitted under the conditions of the policy, it results in only one policy being paid out.
- **Inflated costs.** The fact that the undertaker knows that the insurance will ensure that people use its funeral service, thereby creating a captive client base, may drive up the cost of the funerals provided.⁷ There will be no effective competition in the market, as the client cannot compare different service providers' services and prices at the time of the funeral.
- **Cost-benefit mismatch.** Where consumers are promised a funeral service rather than a cash benefit, they have no guarantee that the cost of the service will actually be the stated monetary value. The "value" of the funeral offered may therefore be inflated vis-à-vis the actual cost of the service rendered. Consumers may be misled into paying inflated premiums in the belief that it will provide them with a superior funeral,⁸ resulting in a situation where clients are not happy with the level of the service (e.g. finding the coffin to be inferior to the one promised beforehand). In this way, unscrupulous behaviour by funeral service providers could undermine trust in the funeral insurance industry.

⁷ See, for example, the findings regarding Indonesia noted by Hintz (2010a).

⁸ This was a striking finding of the South African focus group research. One respondent mentioned that he was paying R350 (US\$49) per month – or around 10 per cent of his total monthly income – for a funeral parlour policy. He justified such a high monthly premium by the fact that he had been assured that he would receive a very fancy coffin and the best service as part of the package. Respondents were also asked about the details of their current policies. In most cases, the premiums of the policies used by various respondents would differ substantially, but this information was never met with concern and did not lead them to question the value of their own policies.

While funeral parlours may, therefore, be a valuable partner for insurers in distributing insurance, caution has to be exercised to avoid anti-competitive and abusive practices and to ensure that the insurance provides value for the client and not only for the funeral industry. In some cases this will require specific regulatory intervention.

Just a fancier coffin? Extending insurance cover under such conditions may simply fuel further cost increases and serve to line the pockets of the funeral industry. As the demand for funeral insurance is driven by the demand for the underlying service, the danger is that the cultural or social pressure for a dignified funeral may be exploited (intentionally or unintentionally) to push the price of funerals to unnecessarily high levels. Even where the funeral service provider is not the insurer or is not directly linked to the insurer, the fact that a funeral expense benefit of a certain amount will be paid out implicitly caters for a funeral costing the same amount or more. Should the insurance benefit increase, some argue, it could lead to a more expensive funeral. In this way, insurance may fuel higher funeral costs.

Yet it is not necessarily the case that funeral insurance just leads to fancier funerals. As indicated in section 10.1, expenditure on funerals tends to be high regardless of whether the person has funeral insurance. As the focus group research indicated, people will “beg, steal or borrow” to pay for the funeral. They buy funeral insurance in response to the reality of a funeral as an unavoidable expense. Importantly, there is also evidence that, where families have the choice and receive a cash payout, insurance benefits are not only used to pay for the cost of a funeral, but deal with other financial effects of a death in the family (e.g. settling debts, dealing with loss of income or paying for essential services and food).

The perils of informal risk management. Though insurers’ practices do give rise to complaints, consumers are particularly vulnerable where funeral insurance is provided outside the regulated insurance market. Funeral service providers that provide in-house coverage without an insurance licence do not comply with any insurance regulation. They do not price products actuarially and generally do not separate their insurance business from the funeral service business. Contributions collected are often not kept aside as reserves against future claims; instead, funeral services are paid out on a cash-flow basis. When cash-flow problems arise or mortality experience is higher than expected, providers that operate on a cash-flow basis will no longer be able to honour their commitments. While the absence of compliance costs and actuarial practices reduce short-term operating expenses, the fact that risks are not adequately managed is to the ultimate detriment of consumers.

Having said this, it is important to note that the informal market does offer a number of advantages vis-à-vis the formal market. For example, it tends to pay benefits more quickly and with fewer documentation requirements. It may also

be less strict regarding aspects such as insurable interest.⁹ Most importantly, the informal market often serves communities where no formal products are available, thereby extending access to insurance. These are some of the issues for insurers to consider when designing products and business models.

10.3.2 Making funeral insurance better

How can funeral insurance provide better value to consumers and avoid consumer protection concerns? To answer this question, it is important to know the target market's preferences and behaviours, and to tailor products and services to clients' needs. A number of insurers are already addressing these issues, as is apparent from the examples below.

Portability. In some countries insurers are moving to de-couple the insurance benefit from a particular service provider or, alternatively, the insurer seeks to exercise increasing control over the services delivered by its network of parlours. Ultimately, it is the insurer who will bear reputational risk if the funeral parlour does not deliver value. Such de-coupling increases insurers' ability to limit the possible abuse of customers in the funeral services industry as clients will not be tied to any one funeral service provider. For example:

- AIC makes use of a network of accredited funeral service providers and clients can claim the service at any one. Another option, for example provided by some insurers in South Africa, would be to provide discount vouchers redeemable at a range of accredited funeral parlours or specific funeral parlour chains.
- A number of South African funeral insurers are paying cash benefits that beneficiaries can use at their own discretion to buy a funeral service from any service provider or help cover any other expenses.

Pay when it's needed. The payment of claims is when intangible insurance finally becomes real, and it is a powerful marketing opportunity for insurers (*see Box 10.5*). Yet rejected and delayed claims are the subject of recurring complaints against the insurance industry. Swift claims processing is very important in the

⁹ Formal products tend to have strict rules on insurable interest to counter abuse. However, the "traditional" concept of insurable interest is not necessarily in line with the liabilities faced by the poor. For example, the fine print of a policy may stipulate that only family members where there is some legal relationship, proven by documentation, may be covered on a policy. A policyholder, faced with the need to pay for funeral expenses for a number of relatives, may however decide to include a step-mother, an unofficial foster child or a distant relative on the policy. At the claims stage, it may emerge that these persons did not meet the insurable interest criteria. This then forms the basis for the repudiation of the claim, even if the person in fact had a real insurable interest given the allocation of financial responsibilities within the community. Insurable interest is a valid concern and it may be difficult for the formal market to be more accommodating in this regard. By contrast, insurable-interest conditions are often less strict in the informal market.

case of funeral insurance, as funeral expenses cannot be put off until the claim is paid. Insurers are starting to focus on better claims service as a way of improving the value of funeral insurance. Increasingly, promises are made for a maximum number of days for claims settlement and in some cases, such as the Philippines, this is even entrenched in regulation. MicroEnsure Philippines introduced a product feature whereby the first 10 per cent of the benefit is paid within 24 hours without any need for proof of death. The remaining 90 per cent is then paid later, after all documentation has been submitted. In South Africa, insurers as a rule promise to pay claims within 48 hours of receiving all the necessary documentation. In other countries the promise is five or ten days. This is an area where continuous improvement will be needed.

Box 10.5

The importance of claims: Alternative Insurance Company (AIC), Haiti

During the devastating earthquake that struck Haiti in January 2010, claiming the lives of more than 220 000 people, AIC's approach was to encourage claims – to the point that it explicitly decided to pay claims even where there were valid contractual grounds for repudiation. It embarked on an advertisement campaign to inform potential claimants that they should claim and where they could do so, sent text messages to all policyholders to the same effect, approved claims even where policyholders used non-accredited undertakers, and provided full service benefits to clients with lower cover in recognition of the important word-of-mouth effect in the community of a successful claims experience. AIC therefore regards successful claims not as a loss, but as an essential component of its business model.

Source: Nabeth and Barrau, 2010; discussion with O. Barrau, President of AIC, 2010.

There are a number of other ways in which formal insurers are seeking to enhance the funeral insurance product and address some of the challenges noted above: some are finding innovative ways of reducing the documentation burden, for example by using a call centre to collect policy details from the client; some make use of grace periods and other product design elements to provide flexibility for clients who may not have a regular income.¹⁰

Business rationale for better value. The above measures are not implemented for altruistic reasons; they make business sense for insurers to improve value and overcome negative perceptions in the funeral insurance market. Through the

¹⁰ In South Africa, these factors have contributed to the dramatic increase in the share of the formal sector in the funeral insurance market: survey data show that between 2003 and 2007 the number of people with funeral cover in South Africa increased by roughly 10 per cent per annum; formal cover growth has exceeded 20 per cent annually. This means that the share of the formal market has risen significantly vis-à-vis the informal market.

power of word-of-mouth marketing, better value will lead to higher volumes, or conversely poor value will soon undermine volumes. Furthermore, countering abuse and focusing on speedy claims payment may lead to lower lapse rates. Higher persistency is attractive because client acquisition represents a significant cost that may take several months of premium contributions to recover.¹¹

The business case for better value may also lie in the distribution partnership. The distribution partner, be it a retailer, mobile network operator or utility company, may carry reputational risk should the insurance product sold under its brand name provide poor value. It is therefore in insurers' interest to continuously improve customer value, as this will strengthen the distribution partnership.

Beyond the funeral. Since the cost of the funeral is not the only financial need should a family member die, insurers are starting to move beyond pure funeral insurance to design policies that provide a cash payout, part of which may be used to cover the cost of a funeral. As discussed in section 10.2.4, they are also starting to include innovative tangible benefits as part of the product suite. In this way, as Box 10.6 illustrates, funeral insurance is starting to evolve into life insurance, which in turn can form the basis for a bundled offering of life and other types of cover.

Box 10.6

The role of market research in designing funeral-plus products

- **Pep-Hollard, South Africa.** One of the options of the Pep-Hollard Family Funeral Plan (*see Box 10.3*) provides a monthly payout for a fixed number of months rather than a lump sum benefit (Smit and Smith, 2010b). Even though the product is still marketed as funeral insurance – as the market is familiar with this product category – this way of structuring the benefits explicitly recognizes customers' need for an income stream rather than just covering the funeral expense. It also addresses the phenomenon found in the South African focus groups that participants tended to have more than one funeral policy, each for a different purpose. This policy would look after the on-going cash needs of the family.
- **AIC, Haiti.** As its name suggests, AIC takes a fresh approach to funeral insurance. Before launching its funeral insurance product, Protecta, it undertook extensive market research. Based on the resulting insights it gleaned about the target market, AIC designed Protecta to offer four benefit levels (ranging from around US\$1125 to US\$2500) and four plan options for each benefit level (discussion with O. Barrau, President of AIC, 2010):

¹¹ In an early study on the scope for microinsurance in South Africa (Bester et al., 2003), actuarial calculations showed that a decrease of 25 per cent in policy lapses in the lower-income life insurance market would reduce the price of policies by 18 per cent.

1. **Protecta Classic:** the full benefit amount is paid out in the form of a funeral service from an accredited funeral parlour.
 2. **Protecta Plus:** a funeral service plus a fixed cash component that the beneficiary can use towards additional expenses. This benefit was included to cater for the ancillary expenses related to the funeral, such as food and transport, but also to allow for a small cash benefit to tide the family over after a family member dies.
 3. **Protecta Cash-back:** a proportion of the premium is reimbursed every three years, provided that all premium payments are up to date. This option was included to increase the value proposition to clients so that they do not think that they pay premiums without getting anything back if there is no claim. It is also a way for AIC to keep the renewal rate as high as possible.
 4. **Protecta Five Star:** includes all of the above benefits. Experience has shown that this plan is the most popular. This popularity has a lot to do with the name of the plan, which recognizes the cultural significance of a dignified funeral in Haiti.
- **UNACOOPEC, Ivory Coast.** UNACOOPEC, a microfinance institution with more than 800 000 clients, believes strongly in the role of market research. In partnership with Allianz, the MFI developed an insurance product on the basis of market research that indicated that people often take out loans to cover the funeral expenses of a family member. This finding indicated a definite need for funeral insurance, which was confirmed by the rapid take-up of the product during the pilot phase. Policyholders are given the choice of spending the full benefit on a funeral, receiving a cash payout, or a combination of the two. In the case of the latter option, the beneficiary receives a voucher to purchase the service at a funeral parlour. If the service costs less than the voucher amount, the remainder is paid out in cash.
 - **SINAF Brazil.** SINAF is a formal funeral insurer in Brazil, a country where funeral assistance is largely provided outside the definition of insurance by unregulated funeral service providers. Based on its market research, it offers clients a number of options for funeral and funeral-plus cover. Clients can choose the premium and benefit level for the plan that best suits their needs. The most basic plan covers just funeral expenses. Clients are then offered the option to also include personal accident cover, i.e. to add a cash benefit in the case of accidental death. The third option is to add an income protection component that provides a monthly cash payout equating to a proportion of the deceased's monthly income for a specified number of months. Therefore the policy provides protection against loss of income due to the death of a breadwinner over and above the funeral cover.

Pure funeral insurance already represents an intergenerational transfer by avoiding expenses that may set the next generation back in their asset-accumulation process. “Funeral-plus” insurance and extending benefits beyond funeral costs will play an even larger role as a form of long-term saving for the next generation. In this way, funeral insurance can form the basis for the development of a broad-based life insurance market.

10.4

Conclusion

This chapter has shown that funeral insurance is one of the most popular micro-insurance products in a number of countries. While being part of the broader microinsurance market, it also has a number of particular features. Funeral insurance is not just insurance business as usual; it requires a dedicated understanding of the dynamics driving funeral insurance markets. This applies both to insurers seeking to target and distribute it effectively and to regulators seeking to find the right regulatory approach to it. Often, these dynamics relate to the underlying funeral service. The funeral service channel may drive demand, distribution and underwriting of funeral insurance. The link to the funeral service creates a tangible benefit for funeral insurance that engenders trust and provides real value, but that can also cause vulnerability to consumer abuse. Increasingly, insurers are starting to focus on ways to provide better value by adding on elements beyond pure funeral insurance. In this way, funeral insurance is evolving into life insurance that can form the basis for asset accumulation and intergenerational transfers.

In conclusion, the experiences reflected in this chapter raise six key principles for the delivery of value in the funeral insurance market:

1. Do not forget the importance of tangibility and providing for the immediate needs of the client following a loved one's death. Funeral insurance need not entail an in-kind benefit (funeral service) to be tangible. Innovative ideas based on consultation with the market can lead to improved take-up and retention, and better client value.
2. Retain the focus on simplicity, even while adding additional components to increase value (*see Chapter 15*).
3. The funeral cannot wait for the payout – swift claims handling is key. Tardy claims payment will undermine consumer trust. Product simplification and minimization of exclusions that have to be assessed at the claims stage may improve claims-handling efficiency.
4. While informal insurance may pose many risks, commercial insurers have much to learn from the level of service delivered by informal players.

5. It makes business sense to ensure good value. In the interest of creating a vibrant insurance market characterized by high persistency, insurers have to ensure that their clients derive value. In addition to considering their own product and performance, insurers may have to delink insurance benefits from specific funeral providers or exercise control over provider networks to ensure client value.
6. Think beyond the funeral. Funeral insurance may be the starting point to build a life insurance market amongst low-income households.