Chapter – 11
Micro Insurance

Need for Micro-Insurance – Risks Faced by the Poor

11.01 Micro-insurance is a key element in the financial services package for people at the bottom of the pyramid. The poor face more risks than the well-off, but more importantly they are more vulnerable to the same risk. Usually, the poor face two types of risks – idiosyncratic (specific to the household) and covariate (common, eg., drought, epidemic, etc.). To combat these risks, the poor do pro-active risk management – grain storage, savings, asset accumulation (specially bullocks), loans from friends and relatives, etc. However, the prevalent forms of risk management (in kind savings, self-insurance, mutual insurance) which were appropriate earlier are no longer adequate.

11.02 Poverty is not just a state of deprivation but has latent vulnerability. Micro-insurance should, therefore, provide greater economic and psychological security to the poor as it reduces exposure to multiple risks and cushions the impact of a disaster. There is an overwhelming demand for social protection among the poor. Micro-insurance in conjunction with micro savings and micro credit could, therefore, go a long way in keeping this segment away from the poverty trap and would truly be an integral component of financial inclusion.

Defining Micro-Insurance

11.03 The draft paper prepared by the Consultative Group to Assist the Poor (CGAP) working group on micro-insurance defines micro-insurance as "the protection of low income households against specific perils in exchange for premium payments proportionate to the likelihood and cost of the risk involved." The paper deliberates on the key roles to be played by all stakeholders – insurers, regulator and the Government. The working group also agrees that the cost of such cover should be affordable.

Consultative Group on Micro-Insurance Constituted by GoI

11.04 In 2003, GoI constituted a Consultative Group on Micro-Insurance to examine existing insurance schemes for rural and urban poor with specific reference to outreach, pricing, products, servicing and promotion and to examine existing regulations with a view to promoting micro-insurance organisations with specific reference to capital requirements, licensing, monitoring and review, etc. The report of the consultative group has brought out the following key issues :

- Micro-insurance is not viable as a standalone insurance product.
- Micro-insurance has not penetrated rural markets. Traditional insurers have not made much headway in bringing micro-insurance products to the rural poor. (In addition, the Committee feels that micro insurance has not penetrated even among the urban poor).
- Partnership between an insurer and a social organisation like NGO would be desirable to promote micro-insurance by drawing on their mutual strengths.
- Design of micro-insurance products must have the features of simplicity, availability, affordability, accessibility and flexibility.

Findings of the UNDP Study Report

11.05 A study commissioned by the United Nations Development Programme (UNDP) titled "Building Security for the Poor - Potential and Prospects for Micro-insurance in India" states that 90% of the Indian population - some 950 million people - are not covered by insurance and signify an untapped market of nearly US$2 billion. This enormous "missing market" is ready for customized life and non-life insurance, but first, serious mismatches between the needs of the insured and the insurers must be overcome, pitting priorities against profits.

11.06 The UNDP report has analysed six key issues pertinent to the growth of the micro-insurance industry in India, capturing the concerns of different stakeholders as indicated below :

(i) There are specific reasons for low demand for insurance in spite of intense need. Suppliers have their own concerns which helps to explain why there have been so little efforts at market development. Consequently, the rural market is characterized by limited and inappropriate services, inadequate information and capacity gaps.

(ii) There are challenges in product design, which has resulted in a mismatch between needs and standard products on offer. Efforts at product development / diversification have been limited.

(iii) Pricing, including willingness to pay and the availability of subsidies, influence the market. In the absence of a historical data base on claims, premium calculations are based on remote macro aggregates and overcautious margins. Building and sharing claims histories can help in aligning pricing decisions with actuarial calculations, thereby reducing prices.

(iv) Difficulty in distribution is one of the most cited reasons for absence of rural insurance. The high costs of penetrating rural markets, combined with underutilization of available distribution channels, hinder the growth of rural insurance services. This adds to costs, both, managerial and financial. Like inclusive credit, inclusive insurance is expected to be a "low ticket" business, requiring volumes for viability.

(v) Cumbersome and inappropriate procedures inhibit the development of this sector.

(vi) Contrasting perspectives of the insured and the insurers, lead to low customization of products and low demand for what is available.

11.07 The UNDP report further states that micro-insurance solutions should, therefore, attempt at addressing key issues that will improve customer satisfaction (demand-supply gaps, appropriate products and pricing), provide distribution efficiencies for better outreach and remove procedural hassles facilitating easier renewals and claim settlements. With a view to reduce costs, the report has also suggested that the premia payable on micro-insurance be exempted from payment of service tax, which will also enable greater penetration in rural markets.

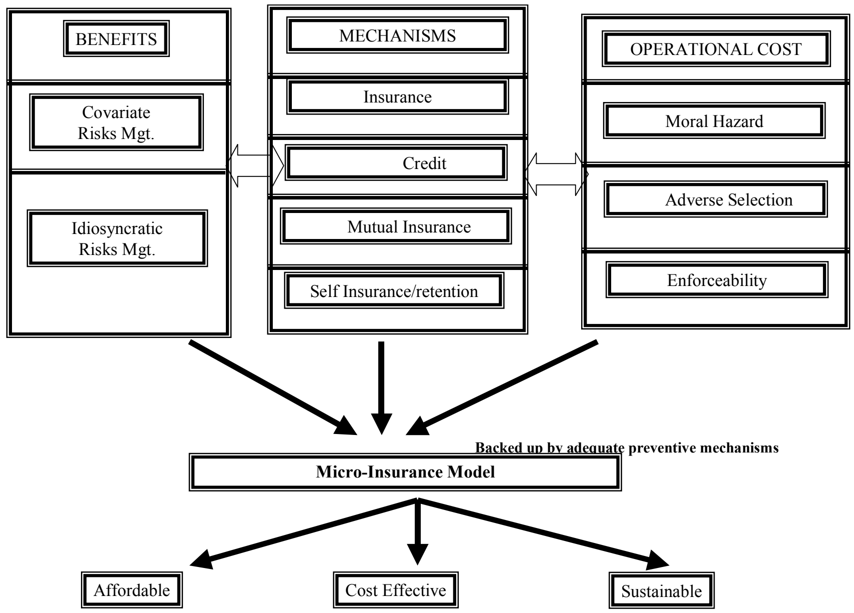
Enabling Environment for Micro-Insurance in the Indian Context

11.08 Helping the rural poor systematically manage financial risks to their livelihoods and lives through micro-insurance offers innovative ways to combat poverty in India. The timing of the UNDP study is strategic as policy interest has been renewed in energizing the rural insurance market in India. The following factors could provide the needed impetus to push micro-insurance to the "next level" in terms of growth and outreach :

- The widening, deepening and upscaling of microfinance interventions has provided the institutional precincts on which the edifice of micro-insurance could be built in rural areas.
- There are a wide range of developmental programmes being supported by the Government like the SGSY, the NREGP, etc., which have facilitated the improvement of income levels of many rural households. The GoI-package of "Doubling Flow of Agricultural Credit" has also enabled greater institutional credit flow for agriculture and allied activities. However, what is of concern is that all these interventions, though ambitious in stated intent, only incidentally address risk, if at all. The most vulnerable rural population - in particular, women - are largely excluded from the insurance market. This only amplifies the felt need of this segment for protection of their lives / income-generating assets against various perils. At present, the Personal Accident Insurance Scheme (PAIS) which is being provided as a bundled offering along with the *Kisan* Credit Card (KCC) Scheme and the *Rashtriya Krishi Bima Yojana* (RKBY) for insuring crops, are, probably, the only borrowal-linked risk-mitigation mechanisms available to rural households. Further, many State Governments are offering health insurance facilities to the rural poor (eg., *Yeshaswini* Scheme of the Government of Karnataka) which have also generated considerable acceptance and awareness about insurance products in the rural areas.
- In October 2004, the RBI permitted RRBs to undertake insurance business as a "corporate agent" without risk participation. As RRBs have a network of branches in rural areas, they could play an important role in increasing outreach.
- Though the 2005 IRDA regulations on micro-insurance have some restrictive aspects, they have also a number of positive features. Its most innovative feature is legally recognizing NGOs, MFIs and SHGs as "micro-insurance agents." This has the potential of significantly increasing rural insurance penetration.
- Many commercial banks have partnered foreign insurance companies for providing life insurance policies. Thus, banking outlets (which number close to 70,000) and more than 1 lakh cooperative societies could provide the needed outreach to purvey micro-insurance facilities, without any further addition to transaction costs.

Addressing Differing Perspectives in Micro-Insurance

11.09 As already indicated, there are contrasting perspectives which have traditionally impeded the growth of this sector globally. The same is true of the Indian experience also. The competing perspectives of the insured, viz., need, affordability and willingness vis-à-vis the insurer's, viz., insurability, profitability and deliverability continue to be the core dilemma in micro-insurance thru' institutional sources. Further, the core problems in institutional insurance, viz., moral hazard, adverse selection and poor infrastructure which results in high claims costs, administrative costs and consequently inadequate coverage have to be addressed effectively, for enabling the growth of an affordable, cost-effective and sustainable model.



Delivery Mechanism : Micro-Insurance Models

11.10 A key concern in the pricing of an insurance product is the element of cost of acquisition and its delivery. Obviously, the delivery costs have to be contained to keep the cost of insurance sufficiently low to attract the poor and to incentivise the insurer to venture into this segment viewing it as a genuine market opportunity.

11.11 The Committee studied four different models for delivering micro-insurance services to the targeted clientele :

Partner - Agent Model :

- Insurers utilize MFIs' delivery mechanism to provide sales and basic services to clients.
- There is no risk and limited administrative burden for MFIs.

Full Service Model :

- The provider is responsible for all aspects of product design, sales, servicing, and claims assessment.
- The insurers are responsible for all insurance-related costs and losses and they retain all profits.

Community Based Model :

- The policy holders own and manage the insurance program, and negotiate with external health care providers.

Provider Model :

- The service provider and the insurer are the same, i.e., hospitals or doctors offer policies to individuals or groups.

Recommendations

Leveraging Existing Network for Micro-Insurance

11.12 It would be difficult for the insurers to establish a vast network for distribution of micro-insurance products. They need to utilize existing Government organizations, banks, MFIs, NGOs and SHGs to increase the outreach of micro-insurance to the poor. The advantages of these entities are that they find greater acceptability among the financially excluded, and with a better understanding of their needs are well equipped to advise them on the choice of products. In India with a vast rural population characterized by challenges and complexities, it makes sense to latch on to an existing mechanism operating in these segments to lower costs and to help the insurer to leverage on the faith already generated by the entity. Hence it would be prudent to choose a partner-agent model for delivery where the insurer underwrites the risk and the distribution is handled by an existing intermediary. This model keeps the cost of insurance attractive enough for the poor to enter and remain in its fold even while addressing the concern of the insurers about the low returns of micro-insurance.

Linking Micro-credit with Micro-insurance

11.13 It is becoming increasingly clear that micro-insurance needs a further push and guidance from the Regulator as well as the Government. The Committee concurs with the view that offering microcredit without micro-insurance is bad financial behaviour, as it is the poor who suffer on account of such bad product design. There is, therefore, a need to emphasise linking of microcredit with micro-insurance.

11.14 Linking micro-insurance with micro-finance makes good business sense. Further, as it helps in bringing down the inherent risk cost of lending, the Committee feels that NABARD should be regularly involved in issues relating to rural and micro insurance to leverage on its experience of being a catalyst in the field of micro-credit.

Implementation Strategy for Micro-Insurance

11.15 Keeping in view the various issues dealt with earlier in this Chapter, the Committee has identified five major areas for formulation of strategies for effective implementation of micro-insurance programmes. These are explained in the following paragraphs :

Human Resources Requirement and Training

11.16 As indicated earlier, the UNDP report states that there is a huge untapped market – of around 950 million people and nearly US$2 billion – for insurance in India. IRDA may consider putting in place an appropriate institutional structure for deciding on service packages including premia and formulating strategies for effective promotion of micro insurance. There is also a felt need for development, of both full-time and part-time staff, thru' effective training in insurance marketing and servicing concepts.

Operations and Systems

11.17 To address the requirements of the huge market potential available, appropriate systems should be evolved for tracking client information, either manually or using technology. While a technology platform may take time for setting up, in the long-run, the same will be cost-effective and reliable. Similarly, the procedures for premium payments, claims and other services should be formalized along with increased customization of products to stimulate demand.

Development of Adequate Feedback Mechanism

11.18 Keeping in view the diverse nature of market requirements, suitable mechanisms to collect market intelligence, collating and interpretation of the same, in a formally structured manner, is important for product development and process refinement. Insurance companies should go beyond devising new products to improving their processes for building awareness, marketing enrollment, premium collection, claim settlement and renewal. For this they need use innovative channels such as business correspondents, SHGs, NGOs and MFIs as also cooperatives and mutual associations. Further, the use of technology such as mobile phones and ATMs for premium collection should be encouraged to keep transaction costs low.

Development of Data Base

11.19 High costs of penetration and acquisition often leads to higher pricing of products, thereby impacting client outreach and market depth. Building up historical data base on risk profiles, claims, settlement ratios, etc., will facilitate in better pricing of products, based on actual rather than presumed risks. Besides enabling cost reduction, warehousing of such data will make the market more transparent for entry of more operators. The IRDA and the Government should help in provision of data such as human mortality and morbidity, weather parameters and livestock mortality/morbidity, on a timely, large sample and regular basis. This will lead to finer pricing on actuarial basis and eventually cut costs of insurance.

Consumer Education, Marketing and Grievance Handling

11.20 The micro-insurance sector is unique in the sense that there is an ongoing challenge to explain the concept and benefits to the insured. Creating awareness thru' use of pictorial posters, local folk arts and street theatres might be useful to explain the mechanisms of insurance. Local community-based organisations could organize premium collections, as they have better access to the local people. To make it more acceptable to the people, micro-insurance products, apart from covering only risks, should also provide an opportunity for providing long term savings (endowment).

IRDA's Regulations on Micro-Insurance

11.21 Building on the recommendations of the consultative group, IRDA notified Micro-Insurance Regulations on 10th November 2005 with the following key features to promote and regulate micro-insurance products. The regulations focus on the direction, design and delivery of the products :

- A tie-up between life and non life insurance players for integration of product to address risks to the individual, his family, his assets and habitat,
- Monitoring product design through "file and use",
- Breakthrough in distribution channels with inclusion of NGOs, SHGs, MFIs and PACS to provide micro-insurance, with appropriate compensation for their services,
- Enlarged servicing activities entrusted to micro-insurance agents,
- Issue of policy documents in simple vernacular language.

11.22 Currently the IRDA regulations do not favor composite insurance (i.e., life and non-life insurances by the same company) and also limit the agency tie-up to one life and one non-life insurer. However, in recognition of the uniqueness of micro-insurance, these regulations enable life and non-life companies to tie-up for offering a combined policy in rural areas. Further, the IRDA has allowed insurers to issue policies with a maximum cover of Rs. 50,000 for general and life insurance under these regulations. The regulations have also eased the norms for entry of agents relating to training and pre-recruitment examination. As an attraction, remuneration to agents has also been leveled across the term of the policy.

11.23 Another striking feature of the regulation is the provision of extending coverage to the family as a unit as against the system of insurance coverage to individual lives. The insurer has to take IRDA's prior approval for launching micro-insurance products through the "file and use" mode. The maximum cover will be Rs. 30,000 per annum for a dwelling and contents or livestock or tools or implements or other named assets or crop insurance against all perils. For individual and group health insurance, the maximum cover is Rs. 30,000 per annum per individual. For personal accident policies the maximum Rs. 50,000 per annum and is open to 5-70 age group.

11.24 In case of life micro-insurance products, the cover amount for term insurance ranges between Rs. 5,000-50,000 for a minimum term of five years and maximum of 15 years. The entry age for this product is kept between 18-60. Endowment insurance policy provides cover for Rs. 5,000-30,000 for a minimum five years and maximum 15 years for people aged between 18 and 60. Further, an insurer can collect the premium for both life and general insurance components directly from the consumer or agents.

11.25 At the time of opening of the insurance sector, IRDA had decided that all insurers, including the new entrants, should fulfill certain obligations to spread insurance in rural areas. Specific regulations have been issued prescribing targets in terms of quantum of policies to be written in the rural sector consistent with the years of their operations and also certain quantified target for coverage of lives in the social sector. With a view to encouraging the insurers to meet these obligations and give a fillip to micro-insurance products, IRDA also decided that all micro-insurance products may be reckoned for the purpose of fulfillment of the social obligation and where such policy are issued in rural area they could also be reckoned for rural sector obligation. IRDA has also proposed to benchmark the above obligations with reference to quantified limits of sums assured under micro-insurance policies. The above approach would ensure the faster development of the micro-insurance market and take the insurance penetration to rural areas.

11.26 The Committee wholly subscribes to the initiatives of IRDA in widening outreach of micro-insurance products to the rural poor and recommends that the same may be implemented with renewed zeal as providing micro-insurance is a necessary and essential adjunct in the inclusive process. The IRDA should continue to impose Rural and Social Sector Obligations but there should be no unreasonable caps on premiums and channel commissions. This is in line with the de-tariffing process in other sectors also. In the long run, it is only when the insurance companies find it profitable to serve this market that they will do so on their own.

Other Recommendations

11.27 Micro-insurance in India is a new concept and in the real sense, is yet to be tested for its conduciveness to the needs of the target segment. The most significant constraint is the lack of base line data on potential claims that can help the insurers to design or price products. The consumption and saving patterns are also a critical aid to assess the insurance needs. The issue of moral hazard and adverse selection is a matter of concern for the insurer. Above all, spreading awareness among this segment of insurable population and capacity building of the delivery organisations are major challenges.

Product Development / Process Re-engineering

11.28 Customised product development to suit the varying requirements of the local populace is a pre-requisite. The processes / procedures are to be streamlined and simplified, to facilitate easier access for the rural poor. Information should be made available in vernacular for easy understanding of the terms on offer.

Building Data Base

11.29 With a view to bringing down product costs, building data base of claim histories, risk profiles, etc., are to be undertaken. This will also help in aligning pricing decisions with actuarial calculations.

Using Existing Infrastructure

11.30 Micro-insurance service providers can use the existing banking infrastructure and also adopt the agency-mode (NGOs, SHGs, NBFCs, etc.) for providing services, thereby leveraging on the existing physical branch network and reducing costs.

Use of Technology

11.31 The technology platforms being envisioned to facilitate financial inclusion should enable micro-insurance transactions also. Towards this end, there is a need to integrate the various modules - savings, credit, insurance, etc. - into the technology framework so that holistic inclusive efforts are possible in the rural areas.

Review of existing schemes

11.32 There are a large number of group life and health insurance schemes which are run by various central ministries and State Governments. The level of actual coverage in terms of claims preferred and settled in such schemes is disturbingly low. These schemes should be reviewed by an expert group set up by the IRDA.

11.33 The above are general recommendations. However, with reference to specific segments, the Committee makes the following recommendations:

(a) Life Insurance**:**

11.34 A wide range of products are available but penetration is really limited in rural areas. The procedural requirements at the time of entry and in case of claims settlement are cumbersome. The commission structure for agents is also heavily weighed in favour of getting new policies with very little incentive to service existing policies. In this regard, Micro Insurance Guidelines (MIG) 2005 issued by IRDA has provided for equal commission throughout the life of a policy and this will now remove the disincentive in servicing existing policy holders.

(b) Health Insurance**:**

11.35 In case of Health Insurance, penetration level is even much lower than Life Insurance. The two categories viz., Critical Illness and Hospitalisation are the main product segments. Some State Governments have developed Health Insurance schemes which are still in very early stages. The Committee has observed that mutual health insurance models have advantages of its members performing a number of roles such as awareness creation, marketing, enrolment, premium collection, claims processing, monitoring, etc. Under this arrangement, the costs of offering small-ticket health insurance gets significantly reduced. The high covariant risks such as epidemics will have to be taken care of by a mutual entity taking reinsurance for such risks. IRDA has also suggested that the capital requirements for stand-alone health insurance companies be reduced to Rs.50 crore as against Rs.100 crore for Life Insurance Companies and the Committee endorses the same.

(c) Crop Insurance**:**

11.36 This is a very important risk mitigation arrangement for small and marginal farmers. However, the present scheme suffers from very serious implementation problems. Leaving the discretion to notify crops/regions to state governments has contributed to adverse selection. Further, claims settlement based on yield estimation has been cumbersome and the sampling area for crop cutting experiments is very large. An alternative model based on weather insurance has been attempted. Farmers are happier with it because of quick settlements. On the down side premium rates are very high. Further, due to low density of weather stations, the problem of large area averaging is a critical factor even with weather insurance. To counter this, there is a need for having a large number of smaller weather stations. The Committee recommends that policies be evolved to make crop insurance universal, viz., applicable to all crops/regions and pricing actuarial.

(d) Livestock Insurance**:**

11.37 As in Life Insurance, the problem lies in the process of enrollment and claims settlement. Several pilots indicate that the involvement of local organisations like SHGs, dairy co-operatives, NGOs and MFIs improves the quality of service, reduces false claims and expedites claims settlement. The Committee recommends that these experiences be studied and adopted by insurance companies.

(e) Asset Insurance:

11.38 This could cover a wide range including residential buildings, farm and non-farm equipments and vehicles. For poor households, insurance for a hut, irrigation pump, a handloom or a bullock cart could have considerable economic significance. Products are available but penetration levels are negligible. The main constraint seems to be lack of distribution channels appropriate for lower income groups. The Committee again recommends that involving local NGOs, MFIs, SHGs, etc. as distribution channels as well as facilitators of claim settlements would be quite useful.

Inventory of Micro-insurance Schemes - ILO

The ILO (2004) has recently prepared an inventory of micro-insurance schemes operational in India.

- The inventory lists 51 schemes that are operational in India.
- Most of the schemes were launched in the last 4-5 years.
- 43 schemes for which the information is available cover 5.2 million people.
- Most insurance schemes (66%) are linked with micro finance services provided by specialised institutions or non-specialised organisations. 22% of the schemes are implemented by community-based organisations and 12% by health care providers.
- Life and health are the two most popular risks for which insurance is demanded; 59% of schemes provide life insurance and 57% of them provide health insurance.
- Most schemes (74%) operate in 4 southern States of India: Andhra Pradesh (27%), Tamil Nadu (23%), Karnataka (17%) and Kerala (8%). The two western States: Maharashtra (12%) and Gujarat (6%) account for 18% of the schemes.