Market Review
March 5, 2012

The Potential of Microinsurance

Targeting Middle Income Populations in Emerging Markets.

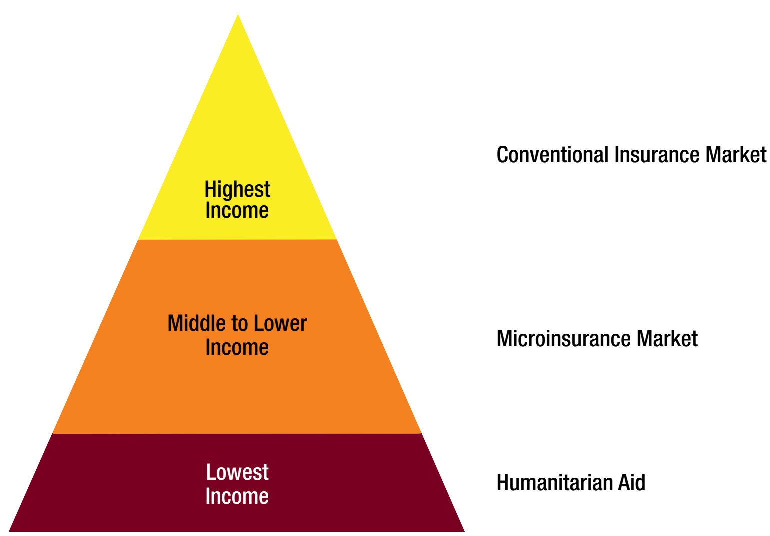
Throughout the world's emerging markets, insurers increasingly are inclined to include microinsurance in their long-term strategies. Microinsurance has challenges – ranging from adverse selection to lack of profitability– that are enough to discourage inclusion of this business in short-term planning. However, increasing global interest in high-growth markets necessitates global insurers to understand this business model. Therefore, this report provides an overview of this type of business, describes the typical participants and discusses its potential.

There is no standard, accepted definition of microinsurance; as such, this report will generalize it as insurance that is accessed by the lower economic echelons of a population. Microinsurance serves to improve coverage of basic human necessities in terms of business lines such as health, life, funeral, property and agriculture. Such micro policies transfer risk from low-income individuals – who do not have access to traditional insurance – to a group. Typical characteristics of microinsurance are:

- Low-cost transactions;
- Simple risk coverage;
- Low net-worth clients; and
- Community involvement.

The characteristics of low-cost transactions, simple risk coverage, and low net-worth clients are similar to those once found in home-service or industrial-life policies around the turn of the 20th century in the United Kingdom and United States. These policies were more prevalent after the industrial revolutions and evolved into more traditional lines that contributed to a virtuous cycle of protection, savings and increased wealth. Present-day emerging market economies that are cultivating microinsurance would like to see a similar evolution.

Exhibit 1
Microinsurance – Its Place on the Income Pyramid



Source: A.M. Best Co.

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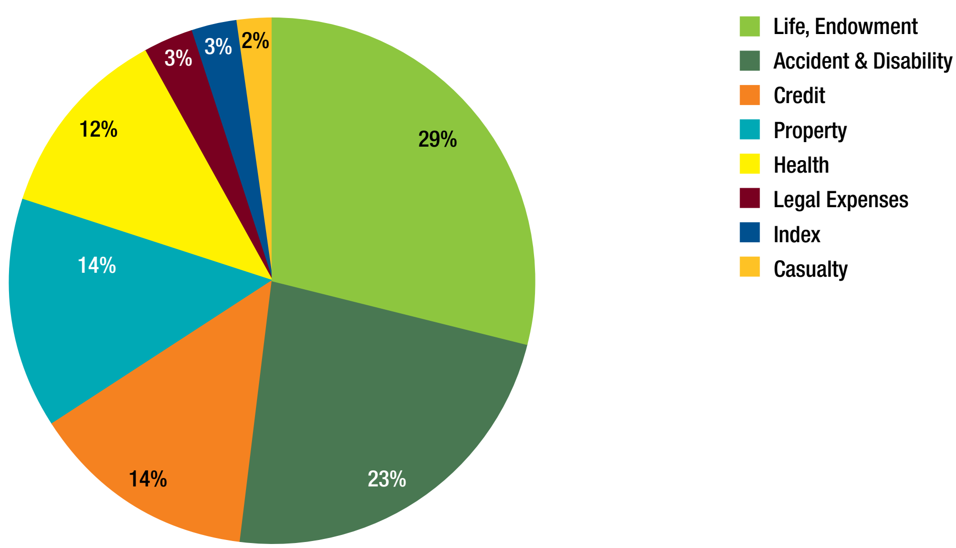
Products and programs are designed for a particular segment of the demographic pyramid (see **Exhibit 1**). The population with an approximate income level falling in the lowest income range receives humanitarian assistance and tends to be out of reach for commercially viable microinsurance programs. Those in the highest income range typically have access to traditional insurance. To these populations, insurance's purposes include access to health services and sustaining families or villages in event of a natural disaster. Swiss Re places the microinsurance market segment, in terms of gross domestic product (GDP) per capita, at the approximate range of $1.25 to $4 per day. In a 2010 Lloyd's study, people in this segment identified the following risks as their main concerns:

1. Illness
2. Death
3. Natural disaster
4. Livestock disease
5. Accident
6. Property Loss

While these priorities imply a strong need among individuals in the middle income range for health insurance, life insurance and agricultural insurance, it does not automatically create demand for it. Without an understanding of and a faith in insurance, this population tends not to look to insurance as the risk-management tool of choice, but instead chooses alternate methods of self-protection. Such methods being applied currently include: informal risk-sharing agreements; conservatism; savings; borrowing – likely at excessive rates; liquidation of assets – primarily agricultural – which provides an immediate source of income but diminishes long-term prospects for a family; or forfeiture of education in exchange for labor.

The most utilized microinsurance products, according to a survey by the Microinsurance Network in 2010, are those that insure against death and accident (see **Exhibit 2**).

Exhibit 2
Microinsurance – Main Products (2010)



Source: Microinsurance Network

The Viability of Microinsurance

Certainly, populations stand to benefit from the existence of microinsurance. Its effects improve the average standard of living in a given country, establish a culture of savings and self-sufficiency, and increase overall economic activity. These benefits are supported by governments, charitable foundations, development banks and other groups that seek to alleviate poverty. But can microinsurance exist as a business model for a profit-seeking enterprise?

The low premiums in microinsurance policies cannot cover the expenses of structures typical to traditional insurance models. Offering protection to customers in exchange for premium payment, the insurer must incur the costs of underwriting, claims processing, analysis, regulation and other overhead. The modern regulatory landscape requires insurers to provide a substantial amount of paid-up capital; gather and report significant premiums, policyholder and claims information; and dedicate staff members to regulate requests and on-site visits. Highly skilled and experienced professionals are required to perform these tasks. For the premium levels and profit margins available in the area of microinsurance, such an infrastructure would not be possible, except perhaps at a huge scale. **Exhibit 3** provides a generic illustration of how typical expenses incurred by insurers can be mitigated in this unique class of business.

Exhibit 3
Microinsurance – Mitigating Expenses Without Compromising Client Benefits

Insurer/Intermediary Cost	Cost Mitigation Technique	Client Value
Pricing the Risk	Standardized Policies and Underwriting for Groups of Policyholders	Simple Product, No Terms to Negotiate
Selling the Policies	Distribution Through Partnerships	Exact Need is Addressed and Within Own Community
Processing the Claims	Indexed or Pre-Determined Payouts With No Adjustment Costs	Quick and Predictable Benefit Realized
Regulatory Compliance	Proportional Regulation or Quotas	Protection to Insured

Source: A.M. Best Co.

Although this illustration does not reflect any reference to donor capital, it is important to note that often, donations and government subsidies are paid to insurance companies, non-governmental organizations (NGOs), governments and service providers to help alleviate these costs. However, A.M. Best contends that long-term sustainability of this business model requires the industry to learn to survive without such direct assistance.

Sharing Costs With the Community

As mentioned in the previous section, insurers incur significant costs associated with the distribution of insurance, the collection of policyholder information that identifies their needs and assesses their risks, and the assessment and payment of claims. Through certain types of organizations or partnerships with community organizations, microfinance institutions (MFIs) and cooperatives, risk-bearing entities can reduce those costs and afford to reduce premium charges to policyholders. This approach often is referred to as the "Partner" (insurer) – "Agent" (community organization) model. Through this method, insurers gain access to large aggregations of clients through an existing channel.

Insurance-centric, grass-roots organizations can concentrate on micro-type policies. According to an International Association of Insurance Supervisors (IAIS) – Microinsurance Network 2010 issues paper, mutuals, cooperatives and community-based organizations (MCCOs) play a special role in the distribution of microinsurance. MCCOs, in this definition, include mutuals, cooperatives, friendly societies, burial societies, fraternal societies, risk-pooling organizations, community-based organizations and self-insuring schemes. This group overlaps with the ones previously mentioned, but is established primarily to provide insurance to members.

Aside from insurance-specific groups, other community-based organizations also play a special role in the distribution of microinsurance. These organizations – which commonly focus on fulfilling religious, social, economic or health services – are run by community leaders and are able to identify members' needs, which often include the assuaging of those fears mentioned earlier in this report: protection against illness, death and natural disaster. In many countries, these community organizations have become essential to the distribution of insurance and claims to members.

Leveraging Memberships Structure of Cooperatives

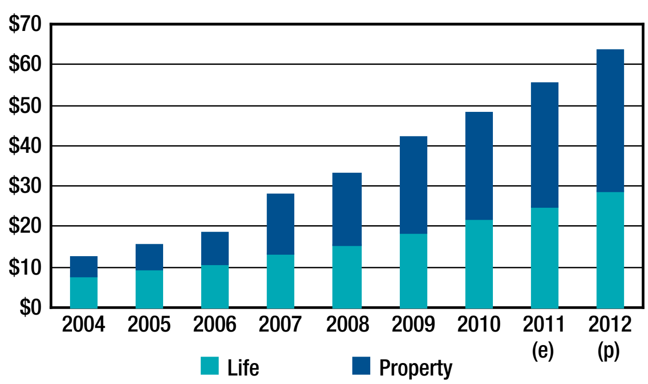
The Latin American Reinsurance Group (LARG) was formed in 2004 to facilitate the joint negotiation and placement of reinsurance treaties. All LARG members, who represent 13 countries, are members of the International Cooperative and Mutual Insurance Federation (ICMIF). The majority of LARG members are small institutions that aim to develop an insurance culture among the low-income populations. That said, not all members offer microinsurance yet.

The Members of LARG Are:

- Aseguradora Tajy, Paraguay
- Central de Cooperativas, Nicaragua
- Columna Compania de Seguros, Guatemala
- Compania de Seguros Equidad, Honduras
- Comupre, Venezuela
- Coop-Seguros, Dominican Republic
- Coopseguros, Ecuador
- La Equidad, Colombia
- Prybe, Mexico
- Seguros del Magisterio, Costa Rica
- Seguros Fedpa, Panama
- Seguros Futuro, El Salvador
- Serviperu, Peru
- Sociedad de Seguros de Vida del Magisterio Nacional, Costa Rica

Source: Grupo Latinoamericano Reaseguro (LARG)

Premiums
($ Millions USD)



Source: LARG

LARG facilitates larger-scale access to reinsurance and raises awareness among populations and governments with the goal of achieving long-term feasibility of insurance for low-income communities. This group also receives assistance from various institutions including ICMIF; Cooperation Society for International Development (SOCODEVI), from Canada; Willis Re, who is the intermediary in the nonlife reinsurance programs; and the reinsurers, American Agricultural Insurance Company, RGA and Shelter.

Latin America's growth of premiums and risks insured is rapid, albeit from a low base. LARG strives to achieve scale and efficiencies so that this program may be sustainable for the long term.

Reducing Costs Through Innovation, Partnerships and Simplicity

Insurers that are successful in this space understand that microinsurance is more complex then merely scaling down traditional insurance, and that creativity and innovation are the keys to its success. A variety of methods are employed on a case-by-case basis to reduce costs.

Many insurers have partnered with a variety of service providers, primarily those dealing in high-volume, easily accessible products – such as cell phone companies, grocery chains, banks (micro-finance institutions) and lotteries – to distribute insurance products. For example, a simple life policy can be bundled with the sale of air time on a mobile phone. The product and its contract are simple to understand and easy to access and pay, and often lead to the gradual increase of coverage. On the benefits side, insurers often partner with service providers such as physician groups, pharmaceutical companies, funeral homes and coffin manufacturers, as well as distributors of agricultural products.

Reminiscent of the early days of U.S. industrial life insurance, door-to-door selling of insurance policies does occur. For example, a community member would sell a product such as funeral insurance door-to-door, receiving a percentage of premiums sold. With this method, the product and brand gain traction through the development of personal relationships. This style of distribution is similar to the community partnerships, except that it infiltrates a community that is linked in its geography as opposed to its beliefs or occupation.

To reduce claims-adjusting and data-collection costs, and to contribute to scale, insurance can be written in more general terms. For example, health insurance in the microinsurance market omits screening for pre-existing conditions and its related expenses. Coverage is simple and payout is limited. In the area of catastrophe protection, index insurance is utilized. For example, if a particular event threshold – perhaps a level of rainfall or magnitude of earthquake– is met, an insurance company will pay out on all policies, regardless of damage. Beyond utilization by farmers for agricultural risks, governments also buy such products to cover for earthquake risks that are beyond the capacity of their state disaster relief funds, such as Mexico's disaster fund, FONDEN, and the Caribbean Catastrophe Risk Insurance Facility (CCRIF).

The Role of Regulators

As previously mentioned, it is in the interest of governments and charitable organizations to encourage the growth of this class of insurance. Typically, insurance regulators are responsible for protecting policyholders and for guaranteeing the population's access to insurance in their respective domiciles. As microinsurance emerges as the potential method of granting access to the underserved members of their population, regulators can present insurers an incentive to offer products to the lower-income populations, such as reducing licensing requirements or making regulations proportional to the risks being taken. In the case of India, the Insurance Regulatory and Development Authority (IRDA) requires companies seeking to write business in India to dedicate a portion of their capacity to increasing access to insurance for the country's underinsured populations.

The IAIS has provided guidance to regulators around the world on how to regulate microinsurance and has been innovative in its approach to microinsurance, as it has actively engaged in modifying core regulatory principals for the purpose of increasing insurance accessibility. Additionally, the Group of Twenty (G-20) finance ministers who have included increasing access to insurance in their Mexico agenda later this year.

Proportionality is a core concept that applies to capital requirements, flexibility in pricing, policy structure, unorthodox distribution and transparency regarding clients. Specifically, regulators seeking to increase the population's access to insurance can do so by easing insurers' regulatory burdens and reducing their cost-intensive obligations such as initial capital and data, and reporting requirements. Regulators also can enact regulation on microinsurance which can simplify policies and reduce administrative expenses. Although regulation should protect policyholders from fraudulent insurance schemes, it should not make products cost-prohibitive to insureds or create a burden for insurers.

Microinsurance as a Long-Term Growth Strategy

A case can be made for a microinsurance strategy.

To create a successful microinsurance program, there must be cooperation, innovation and a great deal of flexibility by donor organizations, risk-bearing entities, governments and community groups.

In this market, the majority of risk-bearing entities are commercial insurers that often work with community groups for distribution purposes, and enter this sector with various motives, ranging from the philanthropic to the opportunistic. Specifically, an insurer's participation in microinsurance programs may afford it the following advantages:

- Gaining access to new and potentially high-growth markets.
- Enhancing the brand by creating a favorable image to the general population.
- Enabling compliance with government requirements.
- Being a means to learn the nuances of a given market for the sake of future product development.
- Enabling a company to diversify, as well as create new cross-selling opportunities.

The Microinsurance Network's 2010 survey stated that private-sector participants expect the business to more than double in the next three years as insurance awareness grows and governments increase their incentives for companies to participate in this segment. Companies with longer-term perspectives and a desire to grow in emerging markets can use a microinsurance strategy to build insurance awareness along with building their brands.

Exhibit 4
Microinsurance – Average Annual Income by Quintile for Selected Countries

Shaded items indicate that they fall within the theorized "target" demographic of microinsurance products. ($USD)

			Quintile				
Country	GDP Per Capita	Population (Millions)	Lowest	Second	Third	Fourth	Highest
Bangladesh	$690	167	$323	$435	$556	$728	$1,406
Kenya	882	41	214	383	582	886	2,347
Pakistan	1,164	175	524	722	918	1,204	2,452
Vietnam	1,362	89	499	743	1,026	1,447	3,093
India	1,527	1,207	617	861	1,141	1,556	3,462
Nigeria	1,541	160	395	745	1,131	1,688	3,746
Philippines	2,255	96	631	1,024	1,542	2,394	5,684
Egypt	2,922	79	1,309	1,847	2,345	3,052	6,057
Morocco	3,162	32	1,031	1,652	2,298	3,258	7,569
Indonesia	3,469	240	1,327	1,953	2,618	3,655	7,794
China	5,184	1,348	1,485	2,540	3,800	5,702	12,392
Thailand	5,281	64	1,632	2,570	3,713	5,474	13,019
Peru	5,614	30	1,095	2,355	3,828	6,040	14,749
Colombia	6,980	46	880	2,080	3,728	6,541	21,675
South Africa	8,342	51	1,022	1,693	2,953	5,923	30,120
Venezuela	10,409	30	2,560	5,017	7,634	11,344	25,483
Brazil	12,917	195	2,157	4,631	7,712	12,588	37,498

Sources: World Bank, International Monetary Fund, A.M. Best Co.

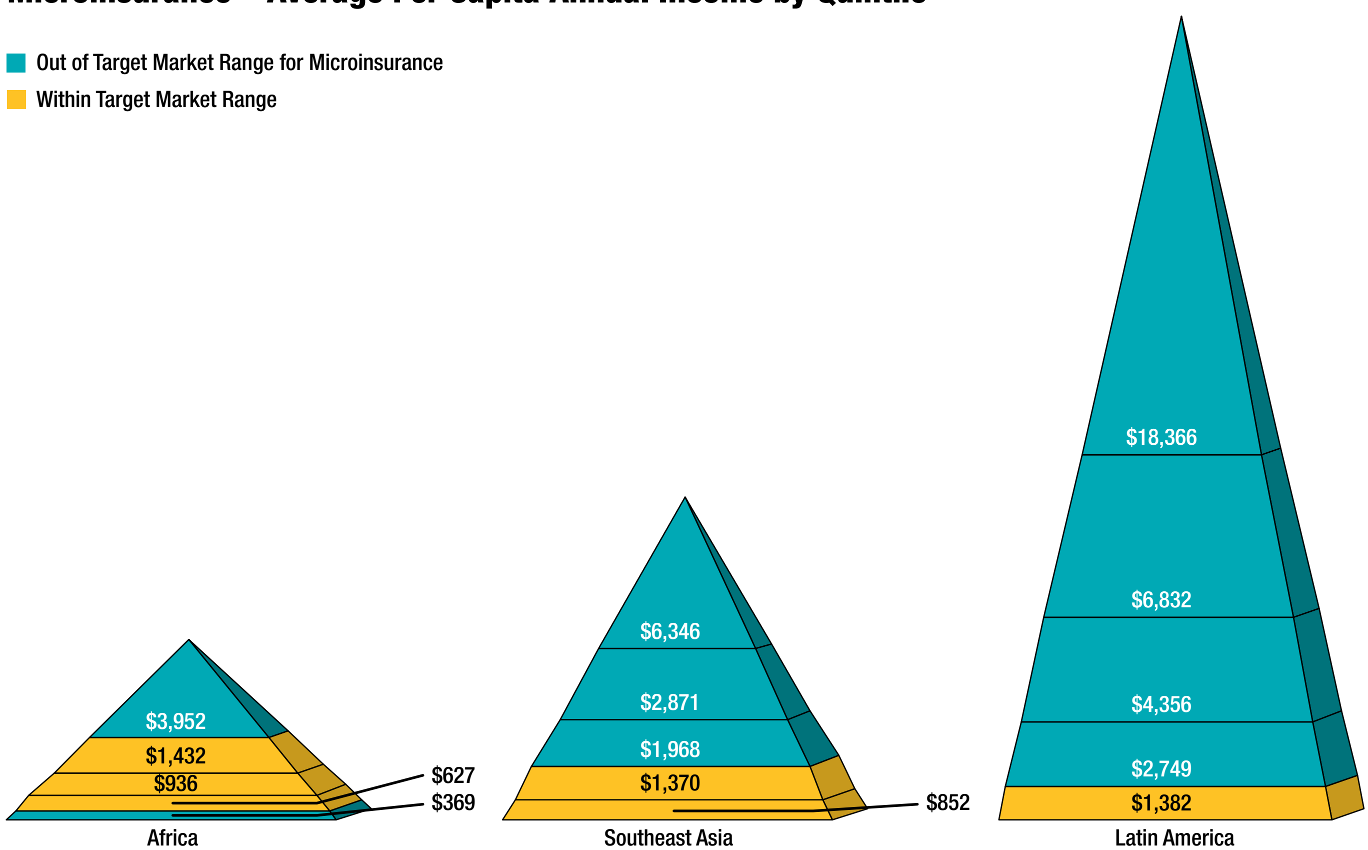
Potential Market Size

Largely consistent with previous studies, Accenture recently published a study that identified the market as between $30 billion and $50 billion in annual premium revenue. If we assume the target customers are those whose incomes are approximately between $500 and $1,500 per year, then we can asssemble a list of emerging market countries that have current or future potential for microinsurance policies. A partial listing of these countries (see **Exhibit 4**) shows the current or potential domiciles for microinsurance in terms of GDP per capita. The shaded areas represent those quintiles of the population whose average income is within, or close to, the income target range for microinsurance.

Comparisons of regional income quintiles show that the demographics of Africa and Southeast Asia are, as a whole, more relevant to the microinsurance model. **Exhibit 5** shows the per capita income for each quintile of the populations in Africa, Southeast Asia and Latin America. For example, it shows that the top quintile (top 20%) of people in Latin America have, on average, an estimated per capita income of $18,366 and the bottom quintile (bottom 20%) of people in Southeast Asia have, on average, an estimated per capita income of $852. The exhibit shows the demographics in terms of potential development of microinsurance. While regions such as Southeast Asia and Africa fit the traditional microinsurance mold, others such as Latin America do not fit the typical profile, yet microinsurance has taken a strong foothold in the domestic market. Specifically, India and the Philippines – which have large target populations–have the most innovative and most supportive environments and the highest growth for microinsurance in the world. MFIs are significant distributors in these countries. According to the Accenture study, India and

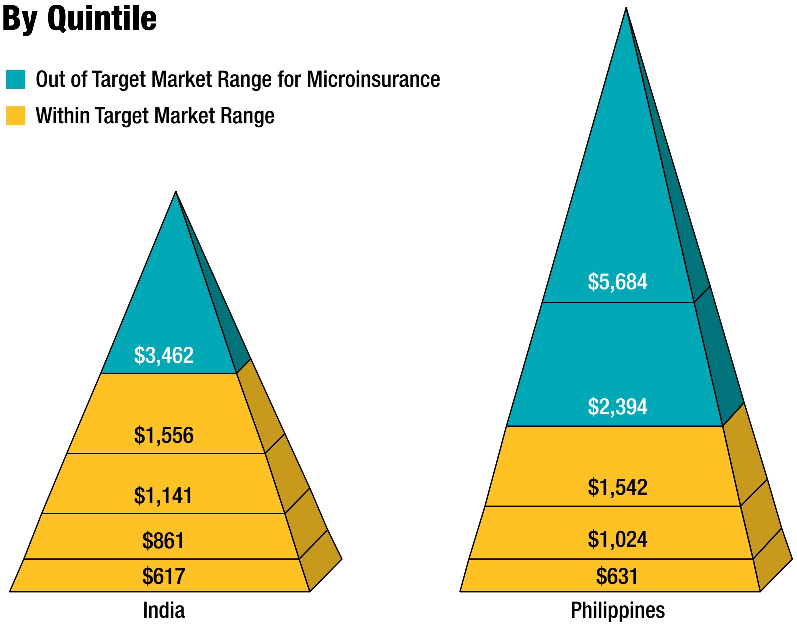
Exhibit 5

Microinsurance – Average Per Capita Annual Income by Quintile



Sources: World Bank, International Monetary Fund, A.M. Best Co.

Exhibit 6
Microinsurance – Average Per Capita Annual Income By Quintile



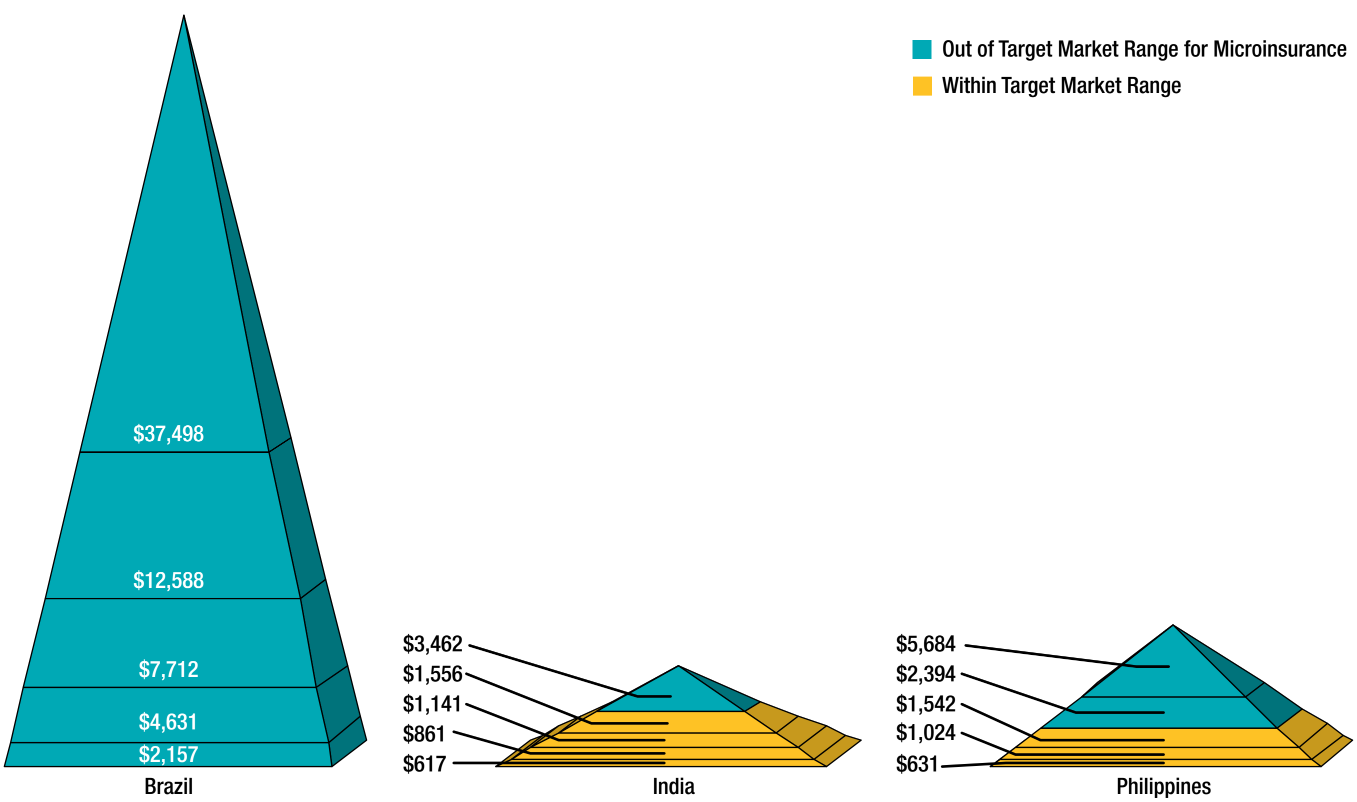
Sources: World Bank, International Monetary Fund, A.M. Best Co.

the Philippines, along with Bangladesh and China, are the world's fastest growing microinsurance markets (see **Exhibit 6**).

In contrast to India and the Philippines, Brazil's population is, on average, much wealthier. In fact, only a portion of the lowest income quintile falls into the target population for microinsurance (see **Exhibit 7**). Nevertheless, a large segment of the population is underserved by traditional insurance. As a result, in December 2011, the Brazilian insurance regulator, SUSEP, introduced new regulation to encourage the development of microinsurance in Brazil. Exemplifying methods of proportional regulation, SUSEP announced that base capital for insurers exclusively dedicated to microinsurance would be 20% less than the required base capital for traditional insurers.

In contrast to its Asian counterparts, Brazil has different business models and does not need to take advantage of donor capital to survive – as some other programs might – implying that areas of greater need tend to require more mixed models incorporating subsidies and support. Instead, recently

Exhibit 7
Microinsurance – Average Per Capita Annual Income by Quintile



Sources: World Bank, International Monetary Fund, A.M. Best Co.

established companies – aided by the more forgiving regulatory environment – are able to develop an interesting business model that is considered the next level up from microinsurance. Instead of distribution through MFIs, insurers are utilizing retail outlets, utility and telecommunications companies to identify customers, distribute their products and collect premium payments, as unit prices are high enough to cover costs.

Expanding Companies' Reach Into Emerging Markets

Insurance protection against death, accident, injury and property damage in small amounts is not a new concept to the insurance industry. Companies such as MetLife Inc. and Prudential wrote industrial policies more than 100 years ago for the working poor, and some companies in developed countries still write those policies. For companies, microinsurance requires scale, innovation and flexibility to be profitable. And, the business case for it is clear, especially to a company wishing to pursue long-term growth in a country or region that is actively increasing its population's access to insurance.

A wide array of companies has ventured into microinsurance, with mixed results. Some have lost significant investments in projects that ultimately failed. However, a number of companies have managed to be profitable in this space and are able to use the business model to diversify risks, increase brand awareness and enter a market at its most nascent stages.

A.M. Best expects the industry to evolve and will closely watch developments in microinsurance business models. This evolution, made possible by advances in innovation in technology, and in corporate and partnership structures, will allow insurance to penetrate deeper into the lower echelons of the income pyramids across the globe.

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