## **Opportunity Knocks**

Microinsurance represents a major opportunity for LIC member companies.

Here's why.

By Jeffrey S. Shaw, CLU, ChFC, Executive Director, LIC

In the early 1900's, industrial life insurance played a critical role in the insurance industry as well as in American society as a whole. Small policies sold in factories and collected weekly provided a foundation of stability and protection that minimized the impact of tragic events and allowed subsequent generations to continue moving forward toward an improved quality of life. Metropolitan Life Insurance Company was at the forefront of this boom, ultimately becoming not only the largest insurance company, but also the biggest company of any kind in the world at that time.

Eventually, agents expanded their focus from the factories to families, forging the beginnings of the home service market and giving rise to the monthly debit. The insurance agent became an integral part of family history, showing up each month (usually at dinner time) to collect insurance premiums and occasionally a good meal. As a result, insurance agents were a visible and valued part of the communities where they lived.

As the standard of living has improved in the U.S., most companies have shifted their focus to the upper income and affluent markets and our products more resemble financial instruments for the purpose of wealth accumulation and transfer than vehicles affording basic protection.

The reasons for this shift are many and quite rational. Quite simply, in the famous words of Jesse James, companies flocked to the affluent because that's where the money is. The size of the modest income market just isn't large enough to interest most companies. In addition, it's not easy to make money on small face life products. High volumes of small premiums translate into high expense ratios and a focus on efficiency that demands dedicated discipline. Small face amounts further complicate the risk selection process, requiring innovative simplified underwriting strategies that assume a certain amount of anti-selection. Poor placement ratios, high lapse rates, and sometimes alarming rescission ratios further erode what are already thin margins.

## **Purchasing Power**

Fortunately, the rest of the world isn't nearly as rational. In fact, one of the fastest growing market segments in our industry is microinsurance, where the market potential is large enough to satisfy even the largest company's appetite for growth. According to a joint report by the International Finance Corporation and the World Resources Institute, low-income consumers in developing countries have US\$ 5 trillion in annual purchasing power globally, with insurance being especially desired by an estimated one billion people. Recent estimates suggest that this market remains largely unpenetrated, with only three percent of people in the world's poorest countries having access to any type of insurance. Fueling further optimism to the microinsurance fire is the fact that it follows close upon the success of microfinance, which has experienced tenfold growth over the past 10 years and now serves 150 million customers.

The challenges associated with profitably developing, distributing and managing insurance products to the world's very poor make most of the very rational reasons I just listed for abandoning the modest income market in the U.S. appear almost absurd by comparison. Imagine trying to introduce a health insurance product in a country ravaged by AIDS and where the physical and administrative condition of the health care facilities is insufficient and suspect. Or consider the case for crop insurance in India, where 22 percent of the country's GDP and two thirds of the population are agriculture dependent. In a presentation at the 2008 Microinsurance Conference in Cartagena, Pranav Prashad from ICICI Lombard General Insurance laid out the premise for his company's crop insurance policy, which required the installation of "automated weather stations on a block level"

so that weather indexes could be established and claims could be paid based upon deviations from the index.

By comparison, life insurance seems positively simple!

It's no wonder, then, that microinsurance sales are heavily skewed toward life products, according to *The Landscape of Microinsurance in the World's 100 Poorest Countries*, a 2007 report by the Microinsurance Centre, LLC. Out of 78.5 million micro-insureds, 39 percent purchased traditional life, 14 percent AD&D, seven percent health insurance, and nine percent property/casualty. There was an additional 31 percent covered by the All China Federation of Trade Unions that included all four primary types of coverage but is usually excluded from microinsurance statistics because the sheer size of the single entity can sometimes skew the numbers.

According to this report, "Of all insurance types, life coverage is, relatively speaking, the easiest to provide because:

- It is one of the most demanded forms of coverage.
- It is relatively easy to price compared to other types of insurance.
- It is mostly resistant to problems of fraud and moral hazard.
- It is not dependent, unlike many types of health insurance, on the existence and efficient functioning of other infrastructure like clinics or hospitals.
- It can be easily linked (at least with short-term life insurance) to other microfinance savings and loan products.
- The insured event is a clear-cut fact."

What a refreshingly different perspective that stands in stark contrast to the very reasoned rationale embraced by domestic insurers for abandoning these products. In fact, the creativity and innovation that micro-insurers have employed to successfully overcome their challenges is worthy of inspiration to all companies regardless of their primary market.

For example, in 1996 AIG Uganda partnered with a leading microfinance institution (MFI) to offer a group personal accident policy to the MFI's customers. Three years later, they expanded and partnered with other MFIs until the product was so popular that borrowers came to expect life insurance coverage as part of their loans. The popularity—as well as the profitability—of the program was so apparent that a number of other insurers moved into Uganda and now there are over 1.6 million people covered by loan-linked insurance products.

India provides a fascinating example of how regulation can both help and hinder the development and distribution of life insurance. In 1956 the Indian government nationalized the life insurance industry in an attempt to spread insurance coverage more rapidly all over the country. Unfortunately, insurance continued to be designed primarily for those in formal employment and sold mostly in large urban areas. Therefore, in 2002, the government liberalized its insurance markets but required ALL new insurers to sell a portion of their products to the *de facto* poor. As a result, India now offers over 130 microinsurance products and has more than 30 million micro-insureds.

Insurer Iffco-Tokio's fertilizer bag product in India is the world's most successful microinsurance product as measured by number of policyholders. As of year-end 2005, they insured 25 million people, according to an article in *The Hindu* newspaper. The policy automatically provides AD&D coverage to anyone who purchases a 50kg bag of certain brands of fertilizer. The receipt for the bag provides proof of purchase and the amount of coverage is US\$ 90 for accidental death and US\$ 45 for certain types of dismemberment. Multiple policies can

cover one insured for up to US\$ 2,260. Although this program is successful in terms of reaching a high volume of insureds, the actual benefit provides very limited value.

Another successful—and more traditional—life insurance example can be found in Zambia, where funeral insurance is a core demand. Madison Insurance Company developed partnerships with a number of microfinance institutions to offer a one-year renewable term product that did not require any underwriting. The policy provided death benefits of US\$ 108 for the borrower, US\$ 86 for the spouse, and US\$ 54 for their children. Premiums were deducted directly from the loan proceeds before they were disbursed.

There are two additional microinsurance stories that are especially worth sharing because they illustrate the important role that insurance can play in impacting public policy. In Malawi, a number of groundnut farmers wanted to shift their production to a higher yielding variety of seed but didn't have the money to do so. The banks were unwilling to lend them the funds because of the credit risk associated with drought. In response, the Insurance Association of Malawi, with technical assistance from the World Bank and Opportunity International, designed an index based weather insurance contract. As a result, two banks agreed to make loans to farmers who were willing to protect their loans with the insurance and the farmers were subsequently able to purchase the high yielding seed.

In another example, the government of Ethiopia partnered with the World Food Programme (WFP) and AXA Re to offer an innovative solution to the lengthy periods of time needed to apply for donor funds to mitigate the impact of drought. In this instance, the WFP pays a premium to AXA Re and if rainfall is below a certain trigger amount, a benefit is paid to the WFP to provide immediate relief funds.

Surprisingly, the biggest hurdle by far facing the microinsurance market isn't product development or profitability—it's distribution. It is estimated that only 10 percent of microinsurance is sold through traditional agent distribution. The vast majority is sold through non-governmental organizations such as trade unions (33 percent), through microfinance institutions (22 percent), and through member owned cooperatives (18 percent). Just as in the U.S.'s small face life markets, it's extremely difficult to recruit and retain a qualified field force. As a result, a consistent conclusion that has emerged regarding microinsurance distribution is that the common model of selling insurance on a one-to-one basis doesn't work. It needs to be sold through partner groups or organizations that have aggregated large numbers of qualified prospects in order to be successful. As a result, the majority of microinsurance is some form of group insurance.

Tata-AIG in India developed an interesting agent recruitment tactic that begins with creating a Community Rural Insurance Group (CRIG) consisting of five low-income women living in close proximity that are involved in some religious or non-governmental organization. Tata-AIG identifies a leader among the women, helps her obtain her insurance license and effectively trains her to act as a general agent so that the other women can submit applications through her. The CRIG obtains a corporate license so that overrides can be paid to the sponsoring religious or non-governmental organization in return for lead generation and endorsement support.

Other examples of creative distribution include Opportunity International in Uganda and MTN in South Africa where they are considering using cell phones as a distribution network. Insurance premiums would be paid via prepaid cards, or through a bank account that is accessed through the cell phone. Ellerine Holdings has 1,220 furniture stores across South Africa and targets lower-income consumers. They bundle insurance policies automatically whenever goods are sold on a rent-to-own basis. In addition, two large supermarket chains in South Africa—Shoprite and Pep Stores—target low-income consumers and feature a "money market counter" inside each of their stores where customers can carry out a variety of financial transactions, including the payment of insurance premiums. This form of distribution is popular in more developed markets as well because the high volume of potential customers can lead to discounts. In fact, in the United Kingdom, supermarkets can often sell the cheapest life insurance policies for this same reason.

Another innovative method of distribution can be found in the UAE between Western Union and AIG. The World Bank estimates that workers and others sent US\$ 122 billion from developed countries to developing countries in 2004—far more than the total development aid for that year. As a result, AIG now offers an AD&D policy to low-

income migrant workers who come to work in the UAE from certain South Asian countries and send money back home via Western Union. They have an option to purchase AD&D coverage that is valid for 35 days after the transfer is made.

Microinsurance is a great reminder of the important role our products play in protecting against risk, and the societal impact this protection can have in shaping public policy and improving quality of life. Poor families are most exposed to risk, yet the least protected from the consequences. Realization of these risks jeopardizes economic and human development prospects and can lead to chronic poverty, which ultimately can drag down the development of an entire nation. When looked at from this perspective, it's no wonder that some of the largest insurance companies in the world were built upon the basis of industrial insurance. A similar opportunity awaits global minded companies with an appetite for innovation and a passion for persistence.

Domestic small face life companies' expertise with successfully recruiting and training individual agents is sorely needed in microinsurance markets. In addition, the partnerships that micro-insurers have initiated in order to creatively distribute their products is a strategy that remains largely untapped in this country by insurers in all markets. As a result, microinsurance represents a major opportunity for LIC member companies, many of whom have over 100 years experience serving this market, to synergistically share strategies and expand geographically. After all, AFLAC—another LIC member company—saw the opportunity in Japan in 1974 after a visit by then Chairman John Amos, 30 years later, insured one out of every four people in Japan—but that's a topic for a future article!