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MICROINSURANCE- HELPFUL TOOL FOR THE POOR

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Abstract:

Microfinance refers to small savings, credit and insurance services extended to socially and economically unfortunate segments of the society. In the Indian scene small and marginal farmers, rural artisans and economically weaker sections have been used to broadly define micro finance customers. The recent Task Force of on Microfinance has defined it as provision of insurance, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas, in helping them to increase their earnings and as a result the standard of living will be improved.

Key Words: Micro Insurance, Demand, Supply, Legal Framework & Challenges

Introduction:

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. 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 micro credit without micro-insurance is self-defeating. There is, therefore, a need to emphasise linking of micro credit with micro-insurance. The country has moved on to a higher growth trajectory. To sustain and accelerate the growth momentum, we have to ensure increased participation of the economically weak segments of population in the process of economic growth. Financial inclusion of hitherto excluded segments of population is a critical part of this process of inclusion. We hope that the recommendations made in this Report, if implemented, will accelerate the process of financial inclusion.

The provision of financial services like savings or credit for the poor is well recognized as an effective instrument to address poverty, especially the economic well-being of the poor. However, despite savings and credit services, the population of India faces many risks or shocks in the form of natural disasters that make the poor vulnerable. Implicitly, attempts by poorer households to cope with severe hazards, often leads them into debt and ultimate impoverishment—a challenge that the World Bank refers to as the "poverty trap". The insurance penetration and density ratios are used to measure the width and depth of the market. The Indian market is thin and shallow when compared to more mature markets. While penetration is better in the Asian context, the density is not comparable even with countries having a lower penetration. Risk and vulnerability reduction have been the core issues in dealing with the poor. Even minor disruptions to their livelihoods in the form of loss of life, loss of limbs, loss of income-generating assets and unforeseen large expenses relating to recurring and non-recurring events impose a heavy burden on the poor. The risks that are posed by even minor disruptions are fairly large; as in the context of their asset and income levels, the financial implications are pretty tough. In order to address this issue, this newsletter will focus on the concept of risk transfer for achieving risk reduction. One microfinance tool which allows risk transfer is the relatively new instrument of micro insurance. Essentially, many individuals or groups are capable of sharing the cost of a risky event when applying micro insurance. The rationale behind the concept of risk transfer lays in the fact that by forging relationships with other community members,

low income households can achieve a greater reduction in vulnerability than through individual strategies. Thus, the risk is transferred from the individual level to the community or inter-community level with groups in different geographic locations which are not equally disaster-prone.

As we will learn, micro insurance products have the potential to offer more complete protection against many risks and therefore against significant loss. This service is provided at an affordable cost, the so called premium.

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, e.g., drought, epidemic, etc.). To combat these risks, the poor do pro-active risk management – grain storage, savings, asset accumulation (especially 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. 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.

Supply of Insurance Services:

The supply of insurance services to the poor has been increased substantially over the 2000, and there are a large number of low premium schemes covering them against death, accidents, natural disasters and loss of asset due to fire, theft etc. However the usage is limited by low awareness among the poor. Crop and livestock insurance, however, are quite expensive and their reach the poor is negligible.

Insurance Regulatory and Development Authority:

Micro Insurance Life:

A life micro insurance product means any term insurance contract with or without return of premium, any endowment insurance contract or health insurance contract, with or without any accident benefit rider, on individual or group basis.

A life micro insurance product provides a minimum cover of Rs.5000 and a maximum cover of Rs.50000 with a term cover of 1-15 years.

Micro Insurance General:

A general micro insurance product means any health insurance contract, any contract covering the belongings, such as hut, livestock or tools or instruments or any personal accident contract, either on individual or group basis.

A general micro insurance product provides cover in respect of dwelling and contents of livestock, tools or implements, crop insurance against perils, health insurance and personal accident cover for individuals or for a group. The minimum amount of cover is Rs.5000 and extends to a maximum of Rs.30000 and term cover is 1 year.

Micro Insurance Agent:

The act provided that in addition to insurance agents, corporate agents or brokers, micro insurance products may be distributed by micro insurance agents who shall not distribute any products other than a micro insurance product. A micro insurance agent means,

- NGO

- SHG
- MFI

Who is appointed by an insurer to act as a micro insurance agent for distribution of micro insurance products. The act also provides the tie-up between life insurers and non-life insurers for jointly offering micro insurance products. All micro insurance policies may be reckoned for the purpose of fulfillment of rural and social sector obligations by an insurer pursuant to the provisions of the act.

Rural and Social Sector Obligations:

In exercise of the powers confined by sections 32B and 32C of the Insurance Act, 1938, the apex body IRDA has made amendments with respect to rural and social sector obligations of insurers. IRDA has from time to time made suitable amendments in the IRDA act with respect to rural and social sector obligations made by insurers in 2000, 2002, 2004, 2005 and twice in 2008.Amendments have been made in respect to definitions of rural and social sector and the percentage of business to be covered by insurance companies in each financial year. Salient features of micro insurance market in India:

1) **Product Characteristics** – micro insurance products in the market have short policy contract terms and are generally underwritten on group basis.
2) **Health prominence**- health insurance is prominent in community based systems because health risk is generally seen as potentially the most devastating type of systematic risk likely to upset the lives and economic livelihoods of the low-income population.
3) **Low outreach of community- based insurance-** community –based health insurance systems managed by NGO's are available but, except in couple of cases, has miniscule outreach.
4) **Dominance of loan linked product-** this is the largest product in the market driven by the compulsion of borrowers to purchase insurance schemes mainly to protective cover to MFIs.
5) **Micro insurance category-** the advent of separate micro insurance guidelines provided by the insurance regulator has seen the launch of new micro insurance products in the formal market.
6) **New distribution models-** rural and social sector obligations imposed on formal insurers by the market regulator have compelled insurance companies to experiment with new distribution models through NGOs, MFIs and the rural banking network.
7) **Advice less selling-** micro insurance is sold overwhelmingly without advice while the higher end of the insurance market is served by brokers providing advice. Micro insurance agents are specifically restricted to working with a single life and single non-life insurer.

Micro Insurance Products:

Micro insurance may be offered for a wide variety of risks. These include both health risks and property risks. There are a variety of products to address these risks.

- Life insurance
- Health Insurance
- Crop Insurance
- Livestock/cattle insurance
- Asset insurance

Challenges:

The main challenges that must be addressed to successfully provide micro-insurance to poor households are as under;

(i) **Client Profile**: Insurance providers need to know more about potential clients, their specific risk management needs and the types of products for which they would be willing to pay. Insurance penetration in developing countries is very limited or absent often because formal insurance providers have not found ways to reach potential clients. Furthermore, customers may have difficulty paying premiums in a regular and/or timely manner. If the premium charged for micro insurance is a significant percentage of the potential client's income, customers may not demand the product. Premiums, while needing to be actuarially sound, must be carefully priced so that they do not compromise the ability of clients to pay for essential items such as food, energy, and shelter. Market research must be conducted to help formal insurers and other partners serve customers efficiently.

(ii) **Understanding of Insurance**: Potential micro-insurance clients appear to prefer savings over borrowing as a way to be prepared to cope with emergencies. Potential clients may feel that paying a premium is a form of savings, and expect to receive their premium back if a claim is not made within the coverage period. It can be difficult to conduct market research or serve clients' needs if potential clients lack the understanding necessary to articulate their demands for the array of possible insurance products.

(iii) **Information Asymmetries**: Formal insurance companies are accustomed to working in well-organized institutional environments with access to literate clients. These clients can provide data and verifiable documentation for underwriting and claims (such as certificates of health or death, or receipts or titles stating value of assets). In contrast, low literacy rates and asymmetric information in developing countries present a major challenge to the functioning of insurance.

(iv) **Provision through MFIs**: Formal insurance and finance institutions vary in structure and required management skills. While MFIs are generally not designed to manage disaster risk, MFIs may still engage in providing coverage for risks they do not understand well or for which little data is available. Such institutions require maturity to provide insurance products and should view provision of micro-insurance as a long-term business commitment, not a market to move in and out of quickly.

(v) **Covariate Risk**: While MFIs tend to provide to small groups in specific geographic areas, a large client pool is needed to spread the covariate risks of natural disasters. Micro-insurance, like all insurance, requires geographic and peril diversification for sustainability.

(vi) **Social Protection or Market Viable Product**: A significant challenge facing micro insurance schemes is the current lack of distinction between these schemes and social protection programs. There is a debate about whether insurance should be directly linked to social protection, or complement social protection through market products. Social protection projects often receive 'outside' subsidies and are motivated by humanitarian ideals that do not necessarily consider economic efficiency. Approaching insurance as a social protection program can relax market discipline. Without market discipline providers can overlook risk management guidelines and client demands, thus resulting in unsustainable business practices.

(vii) **Regulatory framework**: Regulations for micro-insurance currently do not exist in many developing countries. Regulators tend to focus their attention on conventional

insurance institutions, which can lead them to set capital requirements too high and place inflexible rules on agents. Policy makers need to obtain a better understanding of the benefits and demands of micro-insurance to promote increased professional, legal and expansive micro-insurance services. Current regulatory structures in some countries also may prevent MFIs from forming partnerships with insurance companies.

(viii) **Forming partnerships**: Institutions providing micro-insurance can clearly benefit from partnerships. Presently these potential partners often lack common platforms, vocabularies, time frames and objectives. For example, the private sector generally pursues profitability, NGOs and governments seek broader social objectives and the international community focuses on areas specific to the development process, such as poverty reduction. The challenge lies in establishing mutual goals and clearly defining appropriate roles for partners. A practical step would be to establish a clear memorandum of understanding among partners that would establish and delineate roles, policies, and procedures and expected outcomes and deliverables.

(ix) **Applicability of Various Insurance Schemes**: Innovative products such as local weather-based derivatives should be further investigated. On the other hand, mechanisms such as catastrophe bonds do not provide an optimal risk transfer solution for the lower intensity and higher frequency risks that tend to repeatedly affect low income households in developing countries.

Conclusion:

Micro insurance in the real sense is panacea for the poor. Considering the huge population base of the informal sector workers, the penetration level of micro insurance ion India has not been remarkable. These informal sector workers are still untapped which throws an excellent business opportunity for the insurers to tap this market through micro insurance. At the same time society at large will be benefitted as these informal sector works have limited social safety nets and micro insurance would provide an important means of managing the risk of the poor. Insurers may focus in sensitizing the masses on the factors affecting the demand for micro insurance as per this empirical study to enhance the take up. Today most of the regulatory activity is directed in general at the whole market, which is still dominated by the urban and commercial insurance business. Some of these regulatory directions actually work to the disadvantage of developing the rural market. Therefore it is essential for the regulator to come out with separate regulations, which would propel the developments of insurance services for the rural sector. Finally, micro insurance being a low price, high volume business, its success and sustainability depends mainly on keeping the transaction costs down.

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