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Microinsurance – Enhancing the Outreach and Sustainability of Risk Mitigation Services for the Poor

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Nature and Impact of risks faced by the rural poor

In a year marred at the beginning by the great Indian Ocean Tsunami and towards the end with Hurricane Katrina and the Kashmir Earthquake, it is appropriate to pay attention to the risks that all of us face. While catastrophes of this kind affect everybody, from the holidaying tourists at up-market sea-side resorts to those living in shanties, the vulnerability of the poor to risks is much higher. In this article, we will look at the various types of risks faced by poor people and what steps are and can be taken to mitigate these. We will then describe micro-insurance as an ameliorative measure for the poor. The issue of enhancing coverage while maintaining financial sustainability will then be discussed. Finally, we will look the role of various stakeholders, the community, governments, NGOs and the private sector, in enhancing outreach and sustainability of micro-insurance.

Households can fall in poverty when hit by sudden shocks such as untimely death of an earning family member, or of livestock, or crop failure, fire or floods. The impact is even worse for those households which are already below the poverty line. The impact of such shocks can be transient in the event of the household being able to sell assets or borrow or generate income from alternative employment opportunities that enable it to wait for income from the next harvest. However, if the household has no assets to sell or no access to credit, or is able to borrow only at exorbitant rates of interest and gets into a debt trap, shocks can permanently push households below the poverty line. There are several ways in which shocks lead to impoverishment and it is observed that households with greater endowments and greater returns tend to be less vulnerable to shocks. Within a household, men are less vulnerable, while children, women and the elderly are more vulnerable.

We can distinguish between severe and mild shocks and between idiosyncratic and covariant shocks. Severe shocks can be those which lead to the destruction of a significant part of a household's assets, and/or its ability to generate income on an ongoing basis. Examples of the former are a flood which leads to collapse of the house, which is a significant asset. If in the same flood, an earning family member is drowned, the financial effect is even more severe. Covariant shocks affect all households in a locality while an idiosyncratic shock is restricted to only a given household. A drought in a semi-arid region is an example of a co-variant risk, whereas a family member contracting tuberculosis is an idiosyncratic risk.

The poor adopt a mix of strategies to cope with risks, depending on the severity and co-variability of the shocks. For less severe risks, the predominant strategy is seeking help, often from neighbors and members of the extended family. However, this does not work well when the risk, though less severe, is co-variant, as in case of a drought, since those whom one can turn to for help are also affected. At such moments, poor people need to turn to NGOs, relief agencies, philanthropies and local government. When a risk is severe but idiosyncratic, insurance is a useful strategy, but since so few of the poor are covered by it, they tend to use a mix of other strategies including borrowing, reducing consumption, taking children out of school, undertaking temporary migration in search of work and diversifying income sources. Severe and covariant risks, like tsunami, can only be handled by national and international relief efforts, although there are instruments like catastrophe bonds now available on capital markets, but these are not accessible to the poor.

Untimely Death

Untimely death is one of the major risks faced by rural poor. The main causes of deaths are communicable and infectious diseases, non-communicable diseases and injuries. Untimely death of an earning member has major financial implications and can bring down the household income to a half or less of the original level. Thus families marginally above the poverty line may also be pushed below it. The impact gets compounded if death occurs after a prolonged illness since in that situation a family also incurs expenditure on treatment. The affected families borrow or sell assets to take care of contingencies, burial/funeral expenses, rituals etc. Yet, getting life insurance is not easy for the poor, given the small cover they want, their inability to pay premiums in a lump sum and also their inability to offer proof of age or undergo a medical test as is required for most individual life insurance policies.

Health and Accident Risks

For poor people, illness represents a regular threat to their income earning capacity. Beside the direct costs for treatment and drugs, indirect costs for the lost wage earnings of the ill person and those accompanying her/him to the hospital, have to be shouldered by the household. Almost 80% of the diseases are water borne or are caused by water bodies – cholera, diarrhea, typhoid, hepatitis, malaria and filaria, most of which require prolonged treatment and sometimes hospitalization In India, for example, the average expenditure on health care among various income groups varied from 7.8% for poorer households to 2.3% for households with larger incomes, as per a household survey of healthcare utilisation and expenditure by the National Council for Applied Economic Research in 1995. Thus it makes sense for the poorer households to buy health insurance, but this is not easily available in most developing countries, including India.

Crop Risks

A large number of the rural poor depend on agriculture as their main source of income and it is subject to great many uncertainties like drought, pest attacks and untimely rains. The land-owning rural poor are marginal land owners and income from farming activities constitutes only a part of their annual income. To that extent crop losses have less impact on their overall income levels. However, the largest proportion of the rural poor are landless laborers, whose income is indirectly affected by crop failures. Inadequate demand for farm labour leads them to borrowing to maintain minimum consumption levels and to temporarily migrate. Crop insurance programs in most developing countries are either non-existent or patchy, covering only a few regions and crops. Even with that, most government-run crop insurance programs lose money while leaving farmers dissatisfied.

Livestock

Livestock in poor households not only serves the purpose of augmenting income, employment, and food security, but also acts as a storehouse of capital and an insurance against crop shocks. In drought years, income from livestock can be a significant part of the total income of an average rural poor household. Diseases such as foot and mouth disease, hemorrhagic septicemia, black quarter, etc., occur frequently among livestock. Death of livestock due to such diseases can cause a setback in income and make the household more vulnerable to further risks. While livestock insurance is offered by several insurance companies, the process requires a qualified veterinarian to certify the health of animal at the time of insurance and also to certify the cause of death in case of a claim. This makes it difficult for poorer households to seek livestock insurance since they find it difficult or prohibitively costly to get a veterinarian's certificate.

Fire, theft, machinery failure etc.

The poor own assets such as huts, primitive tools, livestock, carts etc. Poor artisans may own work related machinery. These assets are susceptible to idiosyncratic contingencies such as fire, theft, breakdown etc, which may affect income levels. Many of these assets are low priced and easily repairable; thereby reducing possible impact. However, untimely occurrence of these events may substantially impact the income of the poor household. Impact of these events on borrowed assets is more severe. The availability of insurance coverage for such property insurance for the poor is virtually non-existent.

Enhancing outreach and sustainability of Microinsurance

Insurance is a financial arrangement in which the insured pays a small amount (premium) up front in return for the insurer's promise to pay a much larger sum (claim) in the event of a defined adverse event. Microinsurance is the same arrangement, applied to suit the needs of poor people, where both the premium and the claim amounts are small compared to mainstream insurance. Though the concept of insurance is intuitive and is a formalization of the concept of "mutual help" which exists in all cultures, the adoption of insurance by the poor is low due to lower literacy and awareness levels. Moreover, as a major portion of their irregular income is spent towards essential consumption, and interest and repayment of borrowings, there is no cash left for making insurance premium payments.

While microinsurance is a necessary financial service for the poor, it has to be sustainable if it has to cover a large number of poor people in the long run. There are several ways to do this – by improving the products and processes; by improving the distribution channels and by establishing partnerships between the user community, NGOs, public systems and private insurance companies. There are several steps that need to be taken to improve sustainability and thus outreach in the long-run.

Improve Products and Processes

Life Insurance

Life insurance for poor people on an individual basis can be expensive. Often insurers in developing countries do not have data about the mortality rates by income groups and thus make conservative assumptions to cover their downside. This leads the premium to be higher than it should be. Further the administration costs on an individual insurance can be higher due to the low level of insured amount, for poor households. Thus life micro-insurance products have to be designed differently. In case individual insurance is to be given, the premium may have to be split into several installments, to make it affordable. Moreover, standard requirements such as proof of age and medical examination may have to be waived.

Group insurance products automatically mean a better pooling of risk and less adverse selection against the insurance provider. The higher the rate of participation by the members of the group (and a certain minimum rate of participation is usually required), the less expense is needed for underwriting. Very important from a poor household's point of view, is that a significant number of risks that would be rejected by an insurer on an individual basis can be covered in group schemes. Access to insurance protection is thereby improved. Where little insurance exists and premium-paying resources are very scarce, group insurance products may be the best – and indeed only viable - way to proceed. An excellent group life insurance product could be Family Group Life insurance which is designed to cover all the family members of the insured and the premium amount would also be low as compared to the sum of the premium amount required for all individual family members. BASIX in India, jointly with Aviva Life Insurance Company, offers a life and loan insurance product which covers the life of its borrowers, the borrower's spouse and also ensures full repayment of any outstanding loan, since the insured amount is 150% of the full loan amount. This enables the survivors to get an amount and also enables BASIX to approve a fresh loan, so that the deceased borrower's family can carry on a livelihood activity.

Health Insurance

Since life insurance covers only death, whereas illness is a more frequent phenomenon, an insurance product covering both life risk and health risk is the next logical step. Health insurance products need to be customized to the requirements of the poor. For frequent but less expensive illnesses, self-insurance (dipping into savings) is desirable. This is also what is called a “deductible”. For the next level of illnesses, which may require hospitalization, insurance should cover treatment as well as related costs – transportation, attendants’ stay, etc. For catastrophic illnesses, full reimbursement of costs of treatment in a public hospital only may be affordable. Thus, for health insurance for the poor to work, it needs to be blended with savings schemes, preventive health care, and better management of public health facilities, in addition to pure insurance.

Crop Insurance

For livelihood insurance, the two most important are crop and livestock. All over the world, crop insurance schemes have been unsustainable, due to lower than required premiums and high administration costs. One way crop insurance products can be improved is to make them weather index based, which helps in setting up objective parameters to arrive at the yield losses on account of weather fluctuations, thereby facilitating fast claim settlements. Further, weather insurance is re-insurable in international markets, which in turn diversifies the country’s co-variant weather risk across diversified geographical areas. BASIX, in India, has pioneered weather index based crop insurance with technical assistance from the commodity risk management group of the World Bank. The product was designed and piloted by BASIX , with under-writing by ICICI Lombard Insurance Company.

Livestock Insurance

Livestock risks are frequent and can be severe. In the context of the poor, where herds are largely unprotected from disease due to low level of vaccination and poor veterinary care, stand alone insurance is too expensive. An integrated risk management approach involving the adoption of better livestock management practices is required. The issue of moral hazard in livestock insurance can be improved with the use of technology. The use of microchips instead of ear tags to track livestock can prevent false claims. This would also facilitate integrated herd health management and reduce operational costs.

Improve/Develop Distribution channels

The second major issue with respect to enhancing outreach of microinsurance is the adoption of suitable distribution channels. The poor are numerous but dispersed, and often not members of any organised association or cooperative. In many cases, they live in remote locations, distant from cities, or if city-dwellers, then in slums and shanty towns which are not the favorite areas of most marketing networks. Building completely new distribution channels for microinsurance is unlikely to be cost-effective, but microinsurance can be distributed using existing channels to the poor at a reasonable incremental cost. These include

- Networks of existing micro-credit institutions
- Agent network of existing insurance companies
- Community organisations such as self-help groups, tontines and burial societies
- Credit and commodity cooperatives – such as milk producers’ coops,
- Post offices, which tend to have a widespread network in most developing countries
- Marketing network of consumer product companies

Collaborative Possibilities

Due to the complex challenges of enhancing the outreach and sustainability of microinsurance , it is important to recognise that no single actor – the user community, NGOs, government or the private sector, can by itself provide all the inputs that are needed to make it a success. Thus there is a need for collaboration or what is termed as ‘public-private partnership”. However, given the importance of other actors, we prefer to use the term community-NGO-public-private partnership or CNPPP.

CNPPP Possibilities – Health Insurance

A possible CNPPP for health insurance would work as follows: At the ground level, the user community would be organised into community healthcare groups (CHGs) by an NGO. These groups would provide basic solidarity as well peer information to prevent any moral hazard. The CHG members would pay a small amount, on a monthly basis, as membership fee, which would cover the premium and small administration charges. The federation of hundreds of CHGs would enter into formal memoranda of understanding (MoUs) with government healthcare facilities – both preventive and public hospitals, to provide services to their members with an agreed menu of services and fees. The use of public health facilities would reduce the expenses that are incurred in case of hospitalization. The same federation of such CHGs would also buy a "group insurance" policy from a private insurance company, which would be able to charge a lower premium because of the pooling effect, the use of public health facilities and reduced administration costs due to intermediation by CHGs.

CNPPP Possibilities – Crop Insurance

A CNPPP for crop insurance would work similarly: with farmers' groups formed by an NGO, since groups rarely form on their own. The farmers would pay a small amount, on a monthly basis, as membership fee, which would cover the premium and small administration charges for the NGO. The federation of farmer groups would enter into formal MoUs with the government agricultural extension department and/or private agri-input (seed, fertiliser, pesticide) companies to provide services to their members. The federation would also buy a "group weather indexed crop insurance" policy from a private insurance company. However, unlike health insurance, the problem of co-variant risk remains high in crop insurance. This can be solved in two ways – one is to pool the farmers' groups across several diverse agro-climatic regions, and if that is not possible, then to buy reinsurance in the international weather risk market which pools uncorrelated risk across several countries. For example, in 2003, BASIX insured its crop loan portfolio against rainfall failure with ICICI Lombard which reinsured with Swiss Re.

In conclusion, we can say that microinsurance is a necessary concomitant of microcredit, as the poor need help in reducing their vulnerability to various forms of risk. By improving on the products, distribution channels and by forging public private-partnerships it is possible to offer microinsurance to a majority of the poor sustainably. The examples of BASIX cited in this article are just a small step towards that goal.

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