

Microinsurance is a powerful tool in helping low-income households transition out of poverty, but it has not achieved substantial scale compared with microcredit. In India, microfinance institutions (MFIs) initially showed great potential in offering microinsurance through in-house provision (the mutual model) or as agents for mainstream microinsurance companies (the partner-agent model). Over time, however, both models revealed significant flaws. The mutual model appeared limited because the community absorbs all the risk, and the partner-agent model experienced severe implementation issues, causing many large MFIs in India to scale back its use.

The microinsurance industry is battling the challenges of an infant industry—challenges made more severe by the difficulty of providing high-quality services at a price that the target population is willing to pay. Yet slow progress and the experiences of a few MFIs offer hope that MFIs can become a suitable delivery channel for microinsurance products.

This brief examines the merits of providing microinsurance through MFIs in light of the challenges faced by the microinsurance industry. The brief highlights the experience of Indian MFIs, though a number of issues are globally relevant.

The role of MFIs in providing microinsurance

The microinsurance industry faces significant supply-side challenges despite the potentially large market for its products across the developing world. These challenges include high transaction costs, high upfront investments to reduce risk so that premiums are affordable, lack of reinsurers' interest in this market, and limited availability of risk capital and technical know-how, all of which make commercial viability a distant dream.

MFIs are well placed to deal with a number of these challenges, given their experience in scaling up microcredit. For example, MFIs can overcome information asymmetry issues given their close links to and superior understanding of the groups they serve. This understanding could reduce the incidence of fraud and adverse selection. With their successful delivery mechanisms and cash management expertise, MFIs are natural aggregators of clients. Moreover, bundling microinsurance with credit reduces overall portfolio risk, allowing MFIs to lower their interest rates on lending. Most important, MFIs need to reduce their credit focus and provide a broader range of financial services to remain relevant in a competitive environment.

Recent experience

The experience of Indian MFIs with microinsurance has not lived up to expectations. Although microinsurance delivery through MFIs is growing, several MFIs limit their microinsurance products to credit insurance, which actually protects the MFIs' portfolios, not their clients' (by covering the repayment of the outstanding microcredit loan in case of a borrower's death). In 2005–06 a number of Indian MFIs began to provide more comprehensive and complex health

insurance products through the partner-agent model, but they are now scaling back or terminating such programs altogether because of implementation difficulties and a high incidence of fraud.

In 2007, SKS, India's largest MFI, introduced mandatory catastrophic health insurance in one of its branches and rolled it out to 600 additional branches in one year. SKS partnered as an agent with a private insurance company to provide the product. By July 2009, the insurance scheme covered 1.7 million members across 1,056 SKS branches. In September 2009, SKS withdrew the product because of a high incidence of fraud and is now significantly redesigning it. KAS Foundation, an MFI that operates in northeastern India and covers about 700,000 households, experimented with offering insurance with a simple critical illness benefit payout. After substantial client servicing issues, where aggrieved clients refused to repay credit, as well as operational challenges in claims processing, it moved from a partner-agent model to a mutual model before ending its health insurance program. The Village Welfare Society, an MFI operating in the state of West Bengal, provided 260,000 individuals with mandatory health insurance through a bundled partner-agent group policy. After substantial operational problems, it is exploring mutual models of offering insurance.

Notable exceptions to these discouraging experiences include the partnership between the SKDRDP Trust and Grameen Koota. The SKDRDP Trust offers a voluntary health microinsurance program for its members and their families. The scheme enrolled 186,000 members at its inception in 2004 and presently reaches 1.3 million individuals. Since 2007 SKDRDP has offered insurance to Grameen Koota, another MFI. The comprehensive product covers cashless medical benefits, maternity benefits, personal accident coverage, death allowance, and coverage for damage to dwellings. The program combines features of the partner-agent and mutual models, with SKDRDP retaining part of the risk and undertaking a major part of the insurance servicing. It acts as an in-house third-party administrator (TPA) for managing both hospitalization and special claims.

Another successful example is BASIX, a livelihood promotion institution set up in 1996 and headquartered in the southern state of Andhra Pradesh. In 2002 BASIX rolled out a credit life insurance scheme for its borrowers that provided insurance for 1.5 times the value of the loan, thus protecting BASIX and providing borrowers' families with some liquidity in the event of borrower death. BASIX now offers a wide range of products, including life, health, livestock, and weather insurance. A centralized in-house TPA receives claims, records client data, checks standardized claims adjudication processes, engages with the insurance company, and services the claims.

From the experience of Indian MFIs, it appears that a major constraint to providing microinsurance is effective servicing capacity. To service insurance schemes, MFIs have two choices: (1) build capacity internally through a true partner-agent model, where risk as well as servicing is shared; or (2) engage the services of a professional external TPA. SKDRP Trust and BASIX opted for

the former model. SHARE Microfin, another large Indian MFI, opted for the latter and engaged the services of MicroEnsure, an external TPA. A nascent industry of TPAs is emerging in India that can work with both MFIs and other delivery channels for microinsurance. One growing TPA, for example, is Family Health and Planning Limited (FHPL), which works with Yeshaswini Trust in Karnataka (see Appendix 2).

Lessons on MFI provision of insurance

The experiences of MFIs so far offer a number of lessons for product design and service delivery:

- **Leverage trust.** Recent studies undertaken by the Centre for Microfinance in Chennai with members of the MFI the Self-Employed Women's Association show that households' willingness to reenroll in a commercial insurance program depends largely on trust and the program's perceived stability and longevity. The risk and trust relationships are reversed from microlending to microinsurance, making formal investment in client education a critical first step for insurance sales.
- **Consider partial solutions.** Although comprehensive products are ideal, partial solutions are a good first step. Despite the advantages of comprehensive risk-hedging solutions, most organizations can offer such solutions only at a high cost, allowing limited opportunities for replication and scale.
- **Bundled solutions.** The bulk of MFIs offer credit life insurance and are beginning to offer life and personal accident products, but some MFIs have created servicing capabilities and are attempting to play the role of full financial intermediaries by offering a range of financial and nonfinancial services to their clients. Bundling financial and nonfinancial solutions can work to create an ecosystem that allows comprehensive risk management solutions. Insurance is commonly bundled with credit or savings. BASIX, for example, bundles agricultural and livestock credit with mandatory weather and livestock insurance schemes. Although the bundling of nonfinancial products with microinsurance is rare, one experiment in reducing risk aims to provide agricultural advisory services from Weather Risk Management Services with weather insurance through a range of intermediaries.
- **Avoid going solo.** Frustrated by the difficulties in dealing with mainstream insurance companies, some MFIs are providing in-house insurance products using the mutual model. This arrangement makes the MFI the final insurer as well as the agent to its clients. Although this model may allow for more customer-responsive products, it exposes the client and the MFI to high levels of risk because of the MFI's limited risk management capacities and its inability to pool risks among a larger population.

A more prudent strategy may be to iron out the issues related to service delivery and negotiate with mainstream insurers to get products that are appropriate for an MFI's clientele.

- **Leverage technology and soft infrastructure.** Information technology could help significantly reduce costs and improve the viability of microinsurance, as it has for microfinance. In the Philippines, for example, insurance companies minimize the cost of collecting many small premium installments by allowing payment through mobile phones. In Malawi and Uganda, insurance providers issue smart cards to poor policyholders to confirm identity and provide instant access to information on coverage and payment of premiums. In India, Internet kiosks can be used to deliver insurance products to the rural population or provide back-end servicing, reducing the transaction cost for the insurer and the MFI. The Government of India, under its National e-Governance Plan, has introduced common service centers in rural areas, and agencies like BASIX have initiated efforts to use these channels to service insurance clients. Finally, agencies like Palmyrah Workers Development Society and Bharati AXA general insurance are collaborating to develop models using mobile phone technology to reduce fraud and transaction costs. Appendix 2 details a recent example of technology innovation in providing livestock insurance.

Conclusion

Microinsurance is a relatively new industry. Learning how to reduce transaction costs was a big part of microfinance successes, and a similar learning experience needs to take place in microinsurance, which is very different from and more complex than credit. Nevertheless, MFIs can be effective delivery channels for providing microinsurance, especially in India, where they have established a reputation for reaching the financially excluded. Given the poor's need for safety nets, insurance is perhaps a more valuable product than credit, and MFIs could well increase their penetration into unbanked areas by first offering appropriate insurance products.

Government has an important role to play in developing public-private partnerships for delivering ambitious state-funded insurance programs, and MFIs can be partners for these government-funded insurance schemes. Insurance regulators (and other government entities) can help create an enabling environment that facilitates the commercial viability of microinsurance by, for example, investing in financial literacy and consumer education about insurance, mitigating risk through preventative measures, creating data to enable actuarial analyses, and exploring new technologies that can reduce costs. ■

Rupalee Ruchishmita (rupalee@ifmr.ac.in) is executive director of the Centre for Insurance and Risk Management, Institute for Financial Management and Research (IFMR), Chennai, India. **Sona Varma** (sonavarma1@yahoo.co.in) is senior adviser, IFMR Trust, Chennai, India.



International Food Policy Research Institute

2033 K Street, NW • Washington, DC 20006-1002 • USA

Phone: +1-202-862-5600 • Skype: ifprihomeoffice • Fax: +1-202-467-4439 • Email: ifpri@cgiar.org

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