THE OPPORTUNITIES AND CHALLENGES OF MICROINSURANCE

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Microinsurance is a term increasingly used to refer to insurance characterized by low premium and low caps or low coverage limits, sold as part of a typical risk-pooling and marketing arrangements, and designed to service low-income people and businesses not served by typical social or commercial insurance schemes.
As a relatively new field, few studies evaluating the impact of microinsurance projects exist. Of these, even fewer have a rigorous methodology leading to reliable results.
Our research aimed to:
- examine the viability of microinsurance as a mechanism of risk transfer and tool for risk management in developing countries;
- provide a state of the art analysis of microinsurance for a better understanding of currently operational microinsurance schemes;
- reflect on the opportunities and challenges of microinsurance in developing countries, highlighting both the potential benefits and limitations of microinsurance as an instrument for transferring risk;
- consider the interests and perspectives of different stakeholders and the incentives and disincentives for participating and investing in a micro-insurance scheme;
- enhance dialogue and collaboration on this topic between and within the commercial insurance sector and the disaster risk reduction communities;
- assess the opportunity of introducing microinsurance in Romania.
Reflecting on the opportunities and challenges of introducing microinsurance in Romania, there is absolutely necessary to understand both the supply side (current insurance market) and the demand side (risks faced by low-income persons and the coping strategies used to manage these risks). The majority of the primary research was conducted on-site in Romania, in Oradea and its environs, during the month of December 2010. Qualitative research techniques were utilized, including focus group discussions (FGD) and guided individual interviews with members of both the public and private sector, as well as with international non-governmental organizations, such as the World Bank, and IMF.
The research revealed the main risks faced by low-income households, and the fact that microinsurance is a mostly unknown concept in Romania. There is a clear need and demand for microinsurance in Romania. The potential market is estimated to include approximately 4.3 million persons in 2008.

Keywords: microinsurance, microfinance, low-income, direct sales, performance

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1. Definitions of microinsurance

Microinsurance is part of the broader concept of microfinance, which includes a variety of "micro" financial services targeted to lower-income households.
In definition, microinsurance is not very different from traditional insurance, except that it targets a different segment of a population. In reality, however, this entails an entirely different way of thinking about insurance: new, simpler products, alternative distribution channels and marketing instruments, as well as a focus on efficient operations.

Microinsurance is a financial arrangement to protect low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved (Churchill C. 2006: 2).
This definition is essentials the same as one might use for regular insurance, except for the clearly prescribed market: low-income people.
The author of this definition adds that microinsurance does not refer to: (i) the size of the risk-carrier (some are small and even informal, others very large companies); (ii) the scope of the risk (the risks themselves are by no means ”micro” to the households that experience them); (iii) the delivery channel: it can be delivered through a variety of different channels, including small community-based schemes, credit unions or other types of microfinance institutions, but also by enormous multinational insurance companies, etc.
Though the concept of microinsurance is gaining in popularity across the globe, there is no commonly accepted definition. We can define microinsurance by the following characteristics:

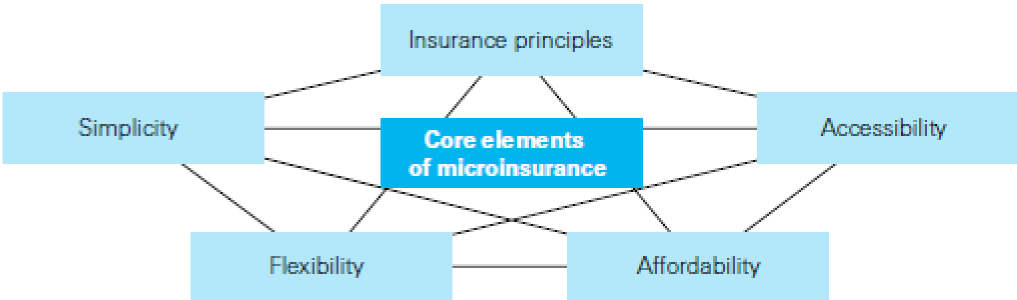

Figure 1. Core elements /characteristics of microinsurance

Source: Swiss Re Sigma No.6/2010 –"Microinsurance-risk protection for 4 bilion people", p.2

Insurance principles: it is based on insurance principles and involves payment of premiums by the policyholders (or on the policyholder's behalf by governments, developmental agencies) in exchange of the promise of indemnification by the insurer in the event of covered loss.
Accessibility: Microinsurance targets the segment of society with low and instable income who would not otherwise be able to afford conventional insurance.
Affordability: Premiums and coverage are kept at a low level in order to make products affordable for the target population. Premium subsidies provided by governments or developmental agencies also help to ensure products are affordable.
Flexibility: Since the low-income segment of the society is not homogenous cluster, microinsurance products require customization to meet the community requirements in a effective way. For instance, premium collections, can be tailored to suit the irregular income stream of policyholders.
Simplicity: Microinsurance should be structured simply in terms of product design, underwriting conditions, premiums collection, policy language and claims handling. This takes into consideration the lack of actuarial data in many cases and help to make the products easy to understand and more acceptable.
The low-income households are facing the following main risks by: death or serious illness of a breadwinner, loss of the year's harvest due to natural disaster, and property loss.

2. Microinsurance delivery models

Methods and models for delivering microinsurance products depend on the organization, institution, and provider involved. In general, there are four main methods for offering microinsurance. Each of these models has their own advantages and disadvantages.

-Partner agent model

A partnership is formed between the micro-insurance scheme and an agent (insurance company, microfinance institution, donor, etc.), and in some cases a third-party healthcare provider. The micro-insurance scheme is responsible for the delivery and marketing of products to the clients, while the agent retains all responsibility for design and development. In this model, micro-insurance schemes benefit from limited risk, but are also disadvantaged in their limited control.

-Full service model

The micro-insurance scheme is in charge of everything; both the design and delivery of products to the clients, working with external healthcare providers to provide the services. This model has the advantage of offering micro-insurance schemes full control, yet the disadvantage of higher risks.

-Provider-driven model

The healthcare provider is the micro-insurance scheme, and similar to the full-service model, is responsible for all operations, delivery, design, and service. There is an advantage once more in the amount of control retained, yet disadvantage in the limitations on products and services.

-Community-based/mutual model

The policyholders or clients are in charge, managing and owning the operations, and working with external healthcare providers to offer services. This model is advantageous for its ability to design and market products more easily and effectively, yet is disadvantaged by its small size and scope of operations.

3.The microinsurance market

A range of players and institutions are involved in the microinsurance supply chain. They include insurance regulators, risk carriers, administrators, delivery channels, technology platforms, and related service providers. The risk carriers are mainly comprised of insurance providers, including private and public insurers, non-governmental organizations, mutuals and community organisations

The microinsurance market can be categorized in two broad segments, based on the consumption level of the people and their ability to afford premiums (Re Sigma No.6/2010 : 9). Those living above the international poverty line of 1,25 USD/day, and up to 4 USD/day represent the target market segment for the commercially viable microinsurance. For this group, it is possible to have an independent market-based approach, whereby microinsurance products are sold at a price that is still affordable to the clients, but also commercial sustainable.

The other segment is at the bottom of the income pyramid, which includes people living below 1,25 USD/day, also referred to us as the extremely poor population. The population falling into this category earn so little that they find it hard to afford even basic necessities for their families, let alone the cost of commercially viable micro-insurance products. However there are other approaches to extend social protection and micro insurance programs to this group. For instance, government can introduce large scale social security measures on their own or subsidise microinsurance premiums through public private partenership programmes.

It is estimated that 2,6 billion people fall in the range of 1,25 USD/day and 4 USD/day (Re Sigma No.6/2010 : 9). This is the potential target for various commercially viable microinsurance products. On the other hand, some 1,4 billion people live on less than 1,25 USD/day and require support from governments and developmental agencies to access microinsurance products. In total, up to 4 billion people can potentially benefit from micoinsurance and/or public private partnership. This translates into 2 to 3 billions policies insurance products. In USD terms, the potential market is valued up to USD 40 billion. The current market size, however is far less. It is estimated that the current penetration of the microinsurance is close to 2%-3% of the potential market, which translates into around USD 0,8-1,2 billion of direct premium.

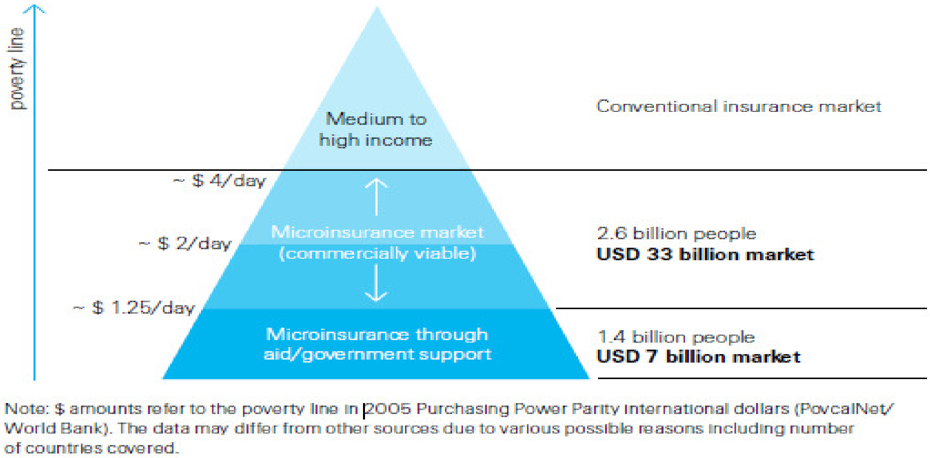

Figure 2. Potential market estimates of the global microinsurance market

Source: Swiss Re Sigma No.6/2010 –"Microinsurance-risk protection for 4 bilion people", p.9

South Asia has the lowest ratio of low-income individuals living under $4/day to the total population. The entire Asia-Pacific region represents 70% of the world's low-income population.

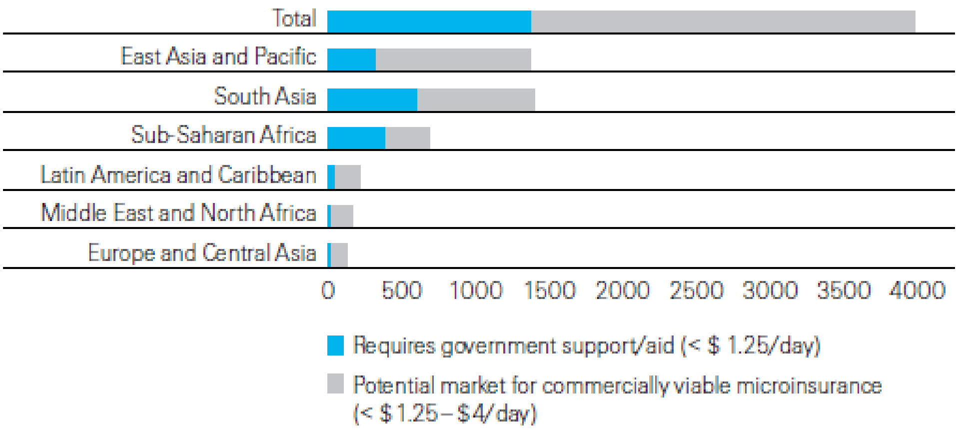

Figure 3. Low income population by region (data in millions)

Source: Swiss Re Sigma No.6/2010 –"Microinsurance-risk protection for 4 bilion people", p.10

Sub-Saharan Africa along with the Middle East and North Africa are the next major regional markets with 865 million low-income individuals. Latin America and Caraibean, where microinsurance is much more developed compared to Africa , accountred for some 5% of the low-income population. The incidence of extreme poverty is highest in a South Asia and Sub-Saharan Africa, totaling almost a billion people.

The concept of microinsurance is relatively new in Central and Eastern Europe(CEE) and Turkey, even though there are an estimated 73 million people living under $4. The five markets (The Russian Federation, Turkey, Romania, Ukraine and Poland), account for nearly 90% of the low income population in the region, and can be considered major markets for microinsurance products. Moldova and Albania, on the other hand have the highest proportion of low-income population, with 4 million people.

4.The oportunity of introducing microinsurance in Romania

The purpose of the present study was to assess the oportunity of introducing microinsurance in Romania. To address this key question, an understanding of both the supply side (current insurance market) and the demand side (risks faced by low-income persons and the coping strategies used to manage these risks) was necessary. The majority of the primary research was conducted on-site in Romania, in Oradea and its environs, during the month of December 2010. Qualitative research techniques were utilized, including focus group discussions (FGD) and guided individual interviews with members of both the public and private sector, as well as with international non-governmental organizations, such as the World Bank, and IMF.

In Romania it is estimated that 4,19 million people fall in the range of 1,25 USD/day and 4 USD/day in 2008, conform to Development Research Group of the World Bank(World Bank). This is the potential target for various commercially viable microinsurance products. On the other hand, some 0,11 million people live on less than 1,25 USD/day and require support from governments and developmental agencies to access microinsurance products. In total, up to 4,3 milion people can potentially benefit from micoinsurance and/or public private partnership.

The research revealed the following main risks faced by low-income households: death or serious illness of a breadwinner, loss of the year's harvest due to natural disaster, and property loss. Currently, most households use self-insurance and informal insurance as their primary risk management tools; savings and the purchase of fixed assets are utilized ex-ante, while borrowing or migrating for work are used to cover expenses ex-post. Clearly, the effectiveness of such strategies is limited.

However, most low-income persons do not currently consider insurance as a viable risk management alternative. There are many ways to explain this: firstly, there is a lack of financial education among the population about the purpose and benefits of insurance. Secondly, there is a widespread lack of trust in institutions. In addition, most low-income households feel they do not have sufficient financial resources, perceiving insurance as an "extra" or even "wasteful" expense, or as a luxury product. Finally, most insurance firms do not offer any products targeted to the lower-income population, nor are making a marked effort to reach out to this segment.

Currently, most insurance firms offer a traditional product range, many relying on automobile and other compulsory insurances. Direct sales through intermediaries (agents and brokers) is very common, and marketing is primarily executed through traditional mass media (television, radio, print advertising). One of the main issues with the current product offering is that most products are not affordable, but also payment is required in full and upfront.

Microinsurance is a mostly unknown concept in Romania. There is no specific microinsurance legislation, although the government has expressed openness to the possibility of developing one in the future. Microfinance, however, is quite well-developed and regulated, which is often a pre-requisite for the successful launch of microinsurance into a new market.

5. Conclusions

Microinsurance supports the insurance sector's long-term development. With favorable trends, such as rising personal and household income, improving economic fundamentals and increased efforts on poverty reduction, it is expected that a high percentage of the low-income households will move into the middle income segment in the near future. This socio-economic transformation will offer huge business opportunities to the financial services industry.

There is a clear need and demand for microinsurance in Romania. The potential market is estimated to include approximately 4.3 million persons in 2008 conform to Development Research Group of the World Bank(World Bank). A microinsurance product would need to offer both quality and flexibility, at a reasonable cost and with a flexible payment plan. The recommended microinsurance products which are addressing to the low-income persons in Romania are personal accident, credit life, agriculture and property insurance. Furthermore, trustworthy and far-reaching distribution channels which would reliably provide access to the maximum number of people is important. For Romania, the recommended distribution channels are microfinance institutions and SCAs.

Premium payments and claims disbursements could also be handled through the Post Office, which has the widest and most accessible branch network of any institution in Romania. For operations, the partnership model is recommended, whereby Zurich would liaise with an on-site partner, who would in turn coordinate the respective delivery channels and manage regulatory compliance.

Finally, investment in financial education is necessary for the success of microinsurance. Raising the financial education and helping to build an insurance culture fosters a favorable environment for all parties involved – buyers and suppliers. Therefore, it is recommended that educational programs be implemented in collaboration with the government as well as international organizations, trade associations and rural organizations.

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