MICRO – INSURANCE: A VEHICLE FOR INCLUSIVE DEVELOPMENT

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ABSTRACT

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. The paper provides an overview of the micro-insurance scene in India and suggests strategies for its further extension so as to promote inclusive development. The billions of poor people who do not have a formal way of coping with risk must respond positively to the efforts of providers and regulators in accepting a culture of insurance and its capability to provide financial freedom, security and well-being and also accomplish inclusive development.

Keywords: *Micro-credit; product development; Non-governmental Organizations; Health Insurance; MFI.*

INTRODUCTION

India is one of the first countries in the world to have introduced micro-insurance regulation. By reaching many individuals, who were formerly excluded from insurance, and thereby reducing the vulnerability of low-income individuals and protecting their income streams, micro insurance helps to improve social stability and supports broad-based economic development. For insurers, Micro insurance creates an opportunity to tap new markets and yet another revenue and income stream. The micro insurance market is estimated to generate premiums of up to $50 billion. Over the last decade, insurers. NGOs, and community organizations have launched micro insurance programs across product lines and major markets. The key drivers supporting this activity's growth have been increasing micro-finance penetration, the active involvement of the government in certain markets and need-based product offerings. The Asia – Pacific region is the fastest growing and the largest micro insurance market. Micro-insurance has also grown considerably in African and Latin American countries despite these being relatively smaller micro insurance markets at present. Inspired by the Grameen experiment that started in Bangladesh around mid – 1970s, micro – credit has quickly spread in other parts of the developing world, including India.

Micro-credit in India really started in a big way in the early 1990's with the recognition of self - help groups as conduit for providing credit to the poor. In the late 90s, numerous agencies involved in micro-credit operations in India started adding other financial services, including micro- insurance to its micro-credit operations. Micro-finance is surely coming of age in India. The importance of Micro-finance must be looked against the fact that even with wide network of banks in India, the low-income people especially in rural areas, have been largely bypassed by the formal banking system. The government of India has been involved in its promotion in a variety of ways. This movement needs further guidance and direction from government. The paper provides an overview of the micro-insurance scene in India and suggests strategies for its further extension, so as to promote inclusive development.

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, eg., drought, epidemic, etc.). To combat these risks, the poor do proactive risk management — grain storage, savings, asset accumulation (specially 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.

CONCEPT OF MICRO- INSURANCE

The draft paper prepared by the Consultative Group to Assist the Poor (CGAP) working group on micro-insurance defines micro-insurance as "the protection of low income households against specific perils in exchange for premium payments proportionate to the 1ikelihood and cost of the risk involved”. The working group also agrees that the cost of such cover should be affordable. Consultative Group on Micro-Insurance Constituted by GoI in 2003; GoI constituted a Consultative Group on Micro-Insurance to examine existing insurance schemes for rural and urban poor with specific reference to outreach, pricing, products, servicing and promotion and to examine existing regulations with a view to promoting micro-insurance organizations with specific reference to capital requirements, licensing. monitoring and review, etc.

The report of the consultative group has brought out the following key issues:

i. Micro-insurance is not viable as a stand-alone insurance product.
ii. Micro-insurance has not penetrated rural markets. Traditional insurers have not made much headway in bringing micro-insurance products to the rural urban & poor.
iii. Partnership between an insurer and a social organization like NGO would be desirable to promote micro-insurance by drawing on their mutual strengths, and

iv. Design of micro-insurance products must have the features of simplicity, availability, affordability, accessibility and flexibility.

THE UNDP STUDY

A study commissioned by the United Nations Development Program (UNDP) titled "Building Security for the Poor - Potential and Prospects for Micro insurance in India" states that 90% of the Indian population — some 1,000 million people — are not covered by insurance and signify an untapped market of nearly US$2 Billion. This enormous "missing market" is ready for customized life and nonlife insurance, but first, serious mismatches between the needs of the insured and the insurers must be overcome, pitting priorities against profits. The UNDP report has analyzed six key issues pertinent to the growth of the micro-insurance industry in India, capturing the concerns of different stakeholders as indicated below:

i. There are specific reasons for low demand for insurance in spite of intense need. Suppliers have their own concerns, which helps to explain why there have been so little efforts at market development. Consequently, the rural market is characterized by limited and inappropriate services, inadequate information and capacity gaps.
ii. There arc challenges in product design, which has resulted in a mismatch between needs and standard products on offer. Efforts at product development / diversification have been limited.
iii. Pricing, including willingness to pay and the availability of subsidies influence the market. In the absence of a historical data base on claims, premium calculations are based on remote macro aggregates and overcautious margins. Building and sharing claims histories can help in aligning pricing decisions with actuarial calculations, thereby reducing prices.
iv. Difficulty in distribution is one of the most cited reasons for absence of rural insurance. The high costs of penetrating rural markets, combined with underutilization of available distribution channels, hinder the growth of rural insurance services. This adds to costs, both, managerial and financial. Like inclusive credit, inclusive insurance is expected to be a “low ticket” business, requiring volumes for viability.
v. Cumbersome and inappropriate procedures inhibit the development of this sector.
vi. Contrasting Perspectives of the insured and the insurers, lead to low customization of products and low demand for what is available.

The UNDP report further states that micro-insurance solutions should, therefore, attempt at addressing key issues that will improve customer satisfaction (demand-supply gaps, appropriate products and pricing), provide distribution efficiencies for better outreach and remove procedural hassles facilitating easier renewals and claim settlements. With a view to reduce costs, the report has also suggested that the premia payable on micro-insurance be exempted from payment of service tax, which will also enable greater penetration in rural markets. Enabling Environment for Micro-Insurance in the Indian Context helping the rural poor systematically manage financial risks to their livelihoods and lives through micro-insurance offers innovative ways to combat poverty in India. The timing of the UNDP study is strategic as policy interest has been renewed in energizing the rural insurance market in India.

The following factors could provide the needed impetus to push micro-insurance to the "next level" in terms of growth and outreach:

- The widening, deepening and up scaling of micro-finance interventions has provided the institutional precincts on which the edifice of micro-insurance could be built in rural areas.
- There are a wide range of developmental programs being supported by the Government like the SGSY, the NREGP, etc., which have facilitated the improvement of income levels of many rural households. The Gol-package of "Doubling Flow of Agricultural Credit" has also enabled greater institutional credit flow for agriculture and allied activities. However, what is of concern is that all these interventions, though ambitious in stated intent, only incidentally address risk, if at all. The most vulnerable rural population - in particular, women - are largely excluded from the insurance market. This only amplifies the felt need of this segment for protection of their lives / income-generating assets against various perils. At present, the Personal Accident Insurance Scheme (PAlS) which is being provided as a bundled offering along with the Kisan Credit Card (KCC) Scheme and the Rashtriya Krishi Bima Yojana (RKBY) for insuring crops, are, probably, the only borrowable-linked risk mitigation mechanisms available to rural households. Further, many State Governments are offering health insurance facilities to the rural poor (eg., Yeshaswini Scheme of the Government of Karnataka) which have also generated considerable acceptance and awareness about insurance products in the rural areas.
- In October 2004, the RBI permitted RRBs to undertake insurance business as a "corporate agent" without risk participation. As RRBs have a network of branches in rural areas, they could play an important role in increasing outreach.
- Though the 2005 IRDA regulations on micro-insurance have somc restrictive aspects, they have also a number of positive features, Its most innovative feature is legally recognizing NGOs, MFIs and SHGS as "micro-insurance agents." This has the potential of significantly increasing rural insurance penetration.
- Many commercial banks have partnered foreign insurance companies for providing life insurance policies. Thus, banking outlets (which number close to 70,000) and more than 1 lakh cooperative societies could provide the needed outreach to purvey micro-insurance facilities, without any further addition to transaction costs.

DEVELOPMENT OF MICRO-INSURANCE IN INDIA

Historically in India, a few micro-insurance schemes were initiated, either by nongovernmental organizations (NGO) due to the felt need in the communities in which these organizations were involved or by the trust hospitals. These schemes have now gathered momentum partly due to the development of micro-finance activity, and partly due to the regulation that makes it mandatory for all formal insurance companies to extend their activities to rural and well-identified social sector in the country (1RDA 2000). As a result, increasingly, micro-finance institutions (MFJs) and NGOs are negotiating with the for-profit insurers for the purchase of customized group or standardized

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individual insurance schemes for the low-income people. Although the reach of such schemes is stil1 very limited—anywhere between 5 and 10 million individuals—their potential is viewed to be considerable. The overall market is estimated to reach Rs. 500 billion by 2015.

THE MICRO-INSURANCE REGULATIONS, 2005

Regulations on micro-insurance were officially gazette by the IRDA on 30 November 2005.
The salient features of the regulation are presented below.

THE REGULATION DEFINES MICRO-INSURANCE PRODUCTS

The regulation provides definitions of micro-insurance products covering life and general insurance "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, as per terms stated in Schedule-l appended to these regulations. "Life micro insurance product" means any term insurance contract with or without return of premium, and endowment insurance contract or health insurance contract, with our without an accident benefit rider, either on individual or group basis, as per terms stated in Schedule-ll appended to these regulations.

a. "Micro-insurance policy" means an insurance policy sold under a plan which has been specifically approved by the Authority as a micro insurance product.
b. "Micro-insurance product" includes a general micro-insurance product or life insurance product, proposal form and all marketing materials in respect thereof.
c. Every insurer shall be subject to the “file and use” procedure with the IRDA.
d. No one other than insurer - be it a micro-insurance agent or anyone else – can underwrite a micro – insurance proposal.
e. Rural business transacted under micro-insurance by an insurer will be counted for quota fulfillment both for rural as well as social sector obligations,

KEY FEATURES OF THE MICRO-INSURANCE MARKET IN INDIA

Micro-insurance products in the market have short policy contract terms and are overwhelmingly (but no longer exclusively) underwritten on a group basis. A number of the new products offered by formal insurers may be individually underwritten but the numbers of such policies is still minuscule even relative to the low overall outreach of micro-insurance.

Demarcation

Formal insurers are required either to provide life or non-life insurance exclusively though health insurance may be provided by either category of insurer. Community-based insurance systems are largely limited to health cover.

Health Prominence

Health insurance is prominent in community-based systems because health risk is generally seen as potentially the most devastating type of systemic risk likely to upset the lives and economic livelihoods of the low-income population. Formal micro insurance schemes are yet to cover health in any significant way on account of the difficulties of ensuring service delivery and the dangers of moral hazard in a highly informal health service provision network.

Low Outreach of Community-based Insurance

Community-based health insurance systems managed by NGOs are available but, except in a couple of cases, has minuscule outreach. The limited prudential risk vis-a-vis payments made by the covered population means that the regulator has not yet taken a significant interest in these.

Dominance of Loan Linked Products

This is the largest product in the market driven by the compulsion of borrowers to purchase insurance schemes mainly to provide protective cover to the MFIS.

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.

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.

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 arc specifically restricted to working with a single life and single non-life insurer.

Delivery Mechanism

A key concern in the pricing of an insurance product is the element of cost of acquisition and its delivery. Obviously, the delivery costs have to be contained to keep the cost of insurance sufficiently low to attract the poor and to incentivize the insurer to venture into this segment viewing it as a genuine market opportunity. The Committee studied four different models for delivering micro insurance services to the targeted clientele:

Partner-Agent Model

Insurers utilize MFIs' delivery mechanism to provide sales and basic services to clients.
is no risk and limited administrative burden for MFIs.

There Full Service Model

The provider is responsible for all aspects of product design, sales, servicing, and claims assessment. The insurers are responsible for all insurance-related costs and losses and they retain all profits.

Community Based Model

The policy holders own and manage the insurance program, and negotiate with external health care providers.

Provider Model

The service provider and the insurer are the same, i.e., hospitals or doctors offer policies to individuals or groups.

CONCLUSION

The following Conclusions are drawn from the following present paper:

1. Overall, while there is much in the Indian micro-insurance regulation that is designed to promote such Products through its liberal and developmental approach, there are crucial omissions and design glitches that limit its efficacy. Specifically, the exclusion of corporate MFIs, the restriction of collaborations to one life and one non-life insurer and the limitations placed on pricing have a dampening effect on the Micro-insurance market.
2. Policy-induced and institutional innovations are promoting insurance among the low-income people who form a sizable sector of the population and who are mostly without any social security cover. Although the current reach of 'micro-insurance' is limited, the early trend in this respect suggests that the insurance companies, both public and private, operating with commercial considerations, can insure a significant percentage of the poor.
3. Serving low-income people who can pay the premium certainly makes a sound commercial sense to insurance providers. To that extent imposing social and rural obligations by insurance regulator (IRDA) is helping all insurance companies appreciate the vast untapped potential in serving the lower end of the market.
4. Given irregular and uncertain income stream of the poor, flexibility in premium collection is needed to extend the micro-insurance net far and wide. Moreover, MFIs are playing a significant role in improving the lives of Poor households. Quite apart from this, linking micro-insurance with micro-finance makes better sense as it helps in bringing down the cost of lending. Given this, there is a case for strengthening the link between micro-insurance and micro-credit. At present micro-finance business in the country is unregulated. Regulation of MFIs is needed not only to promote micro-finance activity in the country but also to promote the linking of micro-insurance with micro-finance.
5. The billions of poor people who do not have a formal way of coping with risk must respond positively to the efforts of providers and regulators in accepting a culture of insurance and its capability to provide financial freedom, security and well-being and also accomplish Inclusive development.

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SUGGESTIONS

1. The following are some of the suggestions for effective risk protection coupled with efforts to enhance productivity, together they can make great strides towards alleviating poverty and achieving Millennium Development Goals. Explained technology where low income people havc easy access to Insurance products through computers, cell Phones and smart cards. For insurers this will dramatically improve access to the market.
2. Life micro insurance is the easiest cover to offer and also the most widely offered. An insurer would need to create a very attractive policy if they want to stay with life micro insurance. It is worth exploring other types of micro insurance as a means of attracting good partners. Crop insurance has by and 1arge,proved unsuccessful. Health insurance is difficult because of the lack of private hospitals in poor rural areas, Weather indexing is proving a possible insurance option designing micro insurance policies requires intensive work and is not simply a question of reducing the price of existing insurance policies. It requires among other things different Marketing, and different distribution and servicing channels.
3. The specter of global climate change, emerging disease and other potential catastrophic events will hang over all long term plans. To insure the poor, insurer's regulators, policymakers and social organizations must work together with a common purpose and unrelenting spirit. Insurers must strive to understand the customers' changing needs and adapt their products and services accordingly, continually improving the cost benefit ratio for clients.
4. There is a lack of tools to understand the gender -specific demand for micro insurance in India. It is important to know what women want from micro insurance and what they are willing to pay for. In particular, it is crucial to consider the benefit package, In life insurance, for example, it may be important for the beneficiary to be the daughter (held in trust for her jf she is a minor) rather than the husband. In health insurance, it may be important to ensure that the entire family is covered rather than just the women if the women are in a weak position in the household.
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6. Micro insurance in India can only legally be provided by regulated insurance companies. It tends to be an absolutely insignificant share of commercial insurers' total exposure (usually much less than 1 percent). Reinsurance of micro insurance portfolios of commercial insurers would make little difference to the stability of commercial Insurers.
7. Micro-insurance service providers can use the existing banking infrastructure and also adopt the agency-mode (NGOs, SHGs, NBFCS, etc.) for providing services, thereby leveraging on the existing physical branch network and reducing costs.

8. Keeping in view the diverse nature of market requirements, suitable mechanisms to collect market intelligence, collating and interpretation of the same, in a formally structured manner, is important for product development and process refinement. Insurance companies should go beyond devising new products to improving their processes or building awareness, marketing enrollment, premium collection, claim settlement and renewal. For this they need use innovative channels such as business correspondents, SHGs, NGOs and MFIs as also cooperatives and mutual associations. Further, the use of technology such as mobile phones and ATMs for premium collection should be encouraged to keep transaction costs low, Development of Data Base.
9. The technology platforms being envisioned to facilitate financial inclusion should enable micro-insurance transactions also. Towards this end, there is a need to integrate the various modules- savings, credit, insurance, etc. - into the technology framework so that holistic inclusive efforts are possible in the rural areas. Review of existing schemes
10. The state body that has largely driven micro insurance in India has been the IRDA. It would be helpful if micro insurance that worked with private -sector insurers could be explicitly part of the Government's social security plan. This suggestion in no way implies a reduction in the duty of the State to be responsible to its citizens for social safety nets. There are many ways in which this collaboration could work to the benefit of both parties. For example, if the State collected better actuarial data, insurers would be more likely to provide types of insurance they found difficult to price e.g., health insurance. With active state intervention there may also be new possible roles for state health-care facilities in private health insurance. The regulator should take the responsibility of creating awareness among low -income people of micro insurance, as it is for the public good. The regulator should take the responsibility of developing the sector more actively. The regulator could create publicity by developing audiovisual and other insurance literacy programs. If the IRDA wished to take up this role it could be assisted in doing this.

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