MicroSave India Focus Note 88

Challenges of Microinsurance in India

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The potential of microinsurance is beyond doubt. However, in India, as in many countries, the sector is yet to realise its potential. Beyond some donor funded projects, product development initiatives have not scaled up. Distribution systems also seem to be at a standstill, with the MFI based partner-agent model dominating other channels. None of the insurance value chain stakeholders appear to be working on innovative, sustainable and scalable microinsurance systems. The challenges, however, are more systemic than institution specific.

This Note focuses on the challenges faced by the players in the Indian microinsurance sector, including the insurance companies and their distributors.

Strategic Positioning Issues

Building and positioning a portfolio of microinsurance products is still not a priority. Both the insurers and their channel partners are struggling to analyse whether microinsurance can be an independent revenue generator or provide value add over their existing services.

Microinsurance is seen by insurers as a "obligatory necessity", rather than a profitable product category. The focus of the companies is towards achieving the IRDA-mandated numbers,[1] even at the cost of subsidising the products. As a consequence, companies develop simple term products (predominantly credit-life) with little innovation, and then wage price wars to somehow "push" the product to the low income segment.

Since insurance companies do not require huge numbers to fulfill their mandatory rural business, they often partner with small and medium sized MFIs[2] for their individual credit-life microinsurance products and with large MFIs for group credit-life policies.

The commission earned by the aggregators (mostly small MFIs or cooperatives) from the sale of credit-life products does not constitute a substantial fee income for them. This has limited the interest of the aggregators in microinsurance. For the large MFIs, the interest is limited to insuring the portfolio at the lowest possible cost.[3]

Figure 1: Challenges of Microinsurance Product Development in India

[1] Rural and Social Sector Obligation

[2] Refer to *MicroSave* India Focus Note 87: "Microinsurance in India: The Evolution of Market Trends" for details

Moreover, the MFIs do not see any potential benefit from the current microinsurance products, since these single benefit (life) products are inadequate to address the client demand for comprehensive insurance coverage. Also, the processes do not naturally "fit" with those of the agents.

As long as these stakeholders are not sure of the benefits from microinsurance, they will remain apprehensive about diverting resources towards microinsurance operations.

Product Issues

Insurance companies (and other players involved in microinsurance product design) lack the mortality and risk-related actuarial data for the target client segment. Moreover, in order to reduce documentation and simplify calculations,[4] they have adopted enrolment forms and formats that are unable to address all risk related queries. As a result, both actuaries and underwriters allocate higher risk weightage to microinsurance products, making them unaffordable and benefits unattractive to the clients.

Moreover, the lack of interest from insurance companies is complemented by the lack of demand for customised solutions by the aggregators. As a result, insurers as well as the aggregators have not invested in adequate market research to ensure market "pull" for microinsurance products.

Conventionally, insurance is sold as a long term risk hedging (or savings) tool through a combination of term insurance, annuities, endowments and unit linked investment funds. However, inter-organisational and inter-geographical migration is prevalent in the target market segment approached by the microinsurance aggregators (MFIs and co-operatives). Furthermore, the association of clients with the MFIs is also often transient and short term. These factors make long term product horizons a challenge for microinsurance. Moreover, the current regulation incentivises both aggregators and insurance companies to sell annual term policies, another reason for limited innovation in long term microinsurance products.[5]

Distribution and Process Issues

Insurance as a specific product category, requires dedicated resources and distribution channels. However, the variable revenue and projected income/client numbers cannot justify the fixed cost of administration and distribution of microinsurance in short term. Standalone microinsurance players, therefore, are practically non-existent. This is reinforced by the regulatory bias towards the partner-agent model, which promotes distribution through MFIs. This has culminated into two unfortunate trends:

1. The MFIs have started bundling their credit products with the microinsurance; and/or
2. Microinsurance has become mandatory (or semi-mandatory in instances) for the MFI clients, who are neither solicited about the real terms and benefits of the product, nor asked if they want it.

In a mature insurance market, differentiation is derived from the quality of service. In Indian microinsurance, however, marginal differences in price and commission remain the key differentiators. In the partner-agent model, firstly, the ultimate beneficiary and the nominee are different; and secondly, there is a huge imbalance in the institutional magnitude and negotiating power between the MFIs and the large insurance companies. The small MFIs lack the bargaining power and expertise to negotiate adequate product and process terms. Since, the large MFIs are interested only on low cost credit-life insurance, they negotiate with the insurers on the premium amount and cost sharing arrangements, rather than service quality. Hence, optimum service quality is neither negotiated nor ensured. The absence of customisation and standardisation of processes has led to high costs, absence of coordination between aggregators and insurers and poor service quality (e.g. turn around time for pay-in, issuance, claim servicing, renewal etc.). Clarity about the rights and responsibilities, risks and cost sharing among the channel partners is also opaque due to lack of standardisation in agreements.

Latent Demand and Financial Literacy Issues

The demand for insurance has remained latent across the globe. Insurance companies address the issue in three ways:

1. Invest heavily in product marketing (sometimes cloaked as financial education) for clients, as well as staff.
2. Bundle the insurance benefits with other attractive aspects, like savings, annuity and investment, to address the prominent demand for savings and investment.
3. Design effective staff incentive programmes, in order to ensure adequate penetration and service quality.

As the Indian microinsurance industry is young, it is still to realise and implement such focused product marketing, product design, and human resource management programmes. The small ticket size and insubstantial revenue (often resulting in short term losses) makes the players apprehensive of investing in such efforts.

Conclusion

The challenges faced by India offer learning opportunities for the countries where microinsurance is still in its infancy. To overcome the challenges, it is imperative that measures are taken to encourage regulatory modification, product development, distribution optimisation and financial education. Regulators need to move away from the prescriptive regulation towards a regulatory framework that incentivises innovation, so that insurance industry stakeholders can innovate flexibly.

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[3]Many a large MFIs used to charge 1% of loan amount to the clients as insurance premium and transfer the group premium to insurer (approximately 0.2-0.3% of SA). However, such practices have reduced in recent years.
[4]For example most microinsurance products do not charge age-based premiums and also do not insist on authorised age proof.
[5]Refer to *MicroSave* India Focus Note 86: "Microinsurance Product Types in India"