MICROINSURANCE MATTERS IN LATIN AMERICA

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This note discusses the rapidly evolving issue of microinsurance in Latin America and how MFIs, insurance companies and donors can respond to its challenges. This note is part of a series summarizing the DFID-LAMIT eight-part distance learning program with South American microfinance networks and government officials.

This note addresses three critical questions about microinsurance in Latin America.
1. What is microinsurance?
2. Is microinsurance a very useful way for low income households to manage their risks?
3. What are the challenges for expanded coverage of commercial microinsurance in Latin America, and what can governments, donors and investors do to help?

What is Microinsurance?

Microinsurance is defined as the protection of low-income people against specific risks in exchange for regular premium payments. Microinsurance can be provided by a variety of entities, and should be run in accordance with generally accepted insurance practices (see www.iaisweb.org). Like any pro-poor financial product, microinsurance can only be effective and attractive if delivery and collection mechanisms are innovative, products are demand driven and affordable, and the risk management system protects the portfolio from adverse selection and moral hazard. MFIs can play a central role in microinsurance delivery, given their intimate knowledge of their clients and the similarities in the products and processes. In partnership with MFIs, traditional insurance companies typically underwrite the insurance contracts (see Box 1).

Helping the Poor Manage Risk

Over the past two decades, Latin America has witnessed rapid growth in microcredit (largely short term working capital loans). Despite the incredible progress in creating assets owned by the poor, MFIs have not addressed the risks faced by microbusinesses and low income households – whether from hurricanes, fires, accidents or other causes. The insurance penetration rate in Latin America is only 2.5 percent, compared to 4.3 percent in Africa and 3.1 percent in Asia. Only seven percent of the region’s 113 million people with annual earnings below US$3,000 have any form of insurance coverage. Because they only have a small amount of savings and other reserves, poor households are left with few risk management options. They are more vulnerable to unexpected events or disasters than middle-income or wealthy households. In the absence of insurance, they adopt expensive risk management options. For instance, data

Box 1 - The Elements of a Microinsurance Contract:

- Policies are for small amounts and are provided as a group policy, not individual.
- Documentation is simple and easy to understand.
- The client pays the premium in installments usually through an existing payment source like a microcredit or a consumer loan repayment.
- The underwriter may be a private insurance company, a cooperative, a mutual-based association or a community based organization like an NGO or a funeral parlor.
- A variety of intermediaries (MFIs, public utility companies, retail stores, and telecom companies) distribute the policies.
from the Living Standards and Measurement Study Survey demonstrate that, in response to an unexpected and devastating event, half of the poor households reduce their spending on food and clothing; 10 percent send another household member to work; and another 25 percent meet expenses with more debt. Microinsurance can address the need that these strategies represent by providing coverage when it is most needed. There are several types of insurance that are likely to be popular among low income households and microbusinesses (see table below).

<table>
<thead>
<tr>
<th>Type</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life</td>
<td>Credit, Education, Pension, Funeral, Endowments</td>
</tr>
<tr>
<td>Disability</td>
<td>Permanent, Temporary, Total, Partial, Dismemberment. Debt coverage due to disability</td>
</tr>
<tr>
<td>Health</td>
<td>Hospitalization, Out-patient, Surgical, Dental, and specific diseases</td>
</tr>
<tr>
<td>Property</td>
<td>Fire, Theft, Agriculture, Flood, Drought, Prices</td>
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Source: Michael McCord, Microinsurance Centre, presentation Feb, 27, 2007

From the supply side, the most common products include funeral, credit life (to pay off a debt upon the borrower’s death), accident and life insurance are more common, while property and health insurance products are rare (Microinsurance Centre Landscape study of May 2007). Evidence from demand studies in 11 countries shows that there are preferences for health and funeral/death insurance in most cases. (see Chart 1).

**Launching a Microinsurance Program**

The cost of underwriting coverage is directly related to the quality of information available about the client. In traditional insurance, a product’s price is based on the individual’s risk exposure. Insurance companies maintain complex databases to estimate the risks faced by specific individuals. Though this individual client analysis results in higher costs, the client’s risk priorities are generally met. Microinsurance providers have to operate with far less information because clients are often not served by formal financial institutions, have little disposable income, and are left out of market research studies. Few countries have databases with statistical information on the rates of mortality, illness, accidents, and asset losses of poor households and microbusinesses to calculate the risks as the basis of the premium, the level of benefits and the potential profits for the insurer.

To overcome such barriers, microinsurance requires an institutional provider with experience in risk management, product development, and efficient information management systems. As such, the institutional options are similar to microcredit—ranging from cooperatives to non-governmental financial institutions, and banks. Given the distribution networks required to reach large numbers of clients, experience shows that the most efficient and effective way to achieve large scale microinsurance coverage is the partner-agent model. This model pairs commercial insurance companies with MFIs, public utility companies, or telecom companies. The insurance company provides the coverage and the partners provide local knowledge, local networks, and services that can lower costs.

To launch a microinsurance product, insurance companies must be aware of the rules of the game established by the government through legal and regulatory frameworks and supervision arrangements. They should be able to deploy the extensive delivery networks of their partners to develop an efficient and large scale program. Insurance companies can enter the microinsurance mar-

![Chart 1 - Risk management needs prioritized by the poor in 11 countries](chart1.png)

Source: Cohen and Sebstad, 2006
ket niche based on strategic decisions, competitive pressures, or new market opportunities.

By providing policy leadership and using incentives, governments can encourage the growth of a strong microinsurance sector. In Colombia, for example, the program for financial inclusion—Banca de las Oportunidades—strives to provide access to microinsurance among other financial services. The government has also recognized the importance of offering microinsurance to protect the gains made by poor people through improved access to financial services like savings and credit. Competitors in the traditional insurance business can also influence a company’s decision to enter the microinsurance market. The Colombian competitive insurance market drives microinsurance growth and is largely responsible for the sale of 3.1 million policies, according to the national insurance association FASECOLDA.

Colombian microinsurance has also benefited from a supportive regulatory environment. The regulator does not set any price controls on premiums or commissions. In addition, the regulator supports the distribution of microinsurance products through innovative channels like utility companies. Technology like smart cards, electronic debit cards are allowed by the regulator for collection of premium payments. The supportive norms help reduce the cost of distribution and products become easily accessible and affordable to low income clients.

Finally an innovative delivery channel partner like Codensa (see Box 2) drives the Colombian insurance companies to offer better quality microinsurance products at a reasonable price. The Colombian case highlights an important feature—the integration of all four actors (government, regulator, intermediary and competitors) is a pre-requisite for a successful microinsurance market development.

Successful Partner-Agent Models in Latin America

In Latin America, several MFIs have taken the lead in creating a microinsurance sector. For example, in Mexico, the leading MFI Compartamos calls for microinsurance bids each year. The insurance companies compete to offer voluntary insurance schemes to more than 600,000 clients of Compartamos. The bidding process has led to increased competition among insurance companies and resulted in more demand-driven products at an affordable price.

In 2002, a group of financial sector investors created Financiera FINSOL, a regulated limited objective financial company (SOFOL) in Mexico. FINSOL began operations in August 2003, and by mid-2007 was serving more than 200,000 clients through 105 branches in 28 states. As the institution evolved, FINSOL’s management noticed another gap in the market—a lack of insurance coverage for borrowers.

The high costs of promotion and operations as well as the geographic isolation of many potential clients had made these clients unattractive to traditional providers. The microfinance institutions did not have the specific insurance design and delivery skills. Yet, in combination, they could come up with a product that would be attractive to FINSOL clients and marginally profitable for the institutions. Within one year of start-up, FINSOL life insurance had reached more than 180,000 of borrowers. The terms of the insurance include: i) no medical examination required for coverage; ii) policy costs kept low; iii) US$3,000 coverage iv) immediate pay-out of 30 percent for funeral expenses; v) remaining pay-out is made within three days vi) coverage of people ages 16 to 65; vii) use of a collective policy format; and viii) double coverage for accidental death.

Successful Cooperative Models in Latin America

Two cooperative insurance providers demonstrate another model that has proven effective in Latin America: La Equidad in Colombia and La Columna in Guatemala. Both programs have achieved significant levels of cover-
The Future of Microinsurance in Latin America

While microinsurance shows enormous potential, it is not just a scaled down version of commercial insurance. It has special characteristics in design, delivery, claims processing and premium structuring that make it an important alternative risk pooling mechanism for the poor. Although co-operative models have shown success in some cases, in many countries the path to large scale microinsurance coverage will be through traditional insurance companies. These companies already have the skills, information and risk management systems required for microinsurance. Governments should develop an enabling environment for insurance companies to offer and for clients to purchase appropriate policies. Finally, donors and investors can help by financing training, technical assistance, market research, actuarial tables, and other support efforts.

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