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DISTRIBUTION CHANNELS FOR MICRO-INSURANCE PRODUCTS IN INDIA

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ABSTRACT

Micro-insurance is a key element in the financial services package for mass people, particularly, for economically weaker sections of people. The poor face more risks than the well-off, but more importantly they are more vulnerable to the same risk. Building on the recommendations of the consultative group, IRDA notified Micro-Insurance Regulations on 10th November 2005 with some key features to promote and regulate micro-insurance products.

In this respect, the question come to mind is, how can micro-insurance products be sold and serviced cheaply? It is a low-value, high-volume business. The following approaches have emerged in India to provide insurance to low-income populations:

- Partnership model
- Agency model
- Micro-agent model

In this paper, an attempt will be made to discuss the performance, practices and problems related to distribution channels of micro-insurance. The study has been made on the basis of secondary data, considering all relevant materials, that includes books, journals, e-journals, magazines, various reports, etc.

KEY WORDS: Micro-insurance, high-volume, IRDA, poor, low-value.

INTRODUCTION

Micro-insurance means the insurance products that offer coverage to low-income households. A micro-insurance plan provides protection to individuals who have little savings and is tailored specifically for lower valued assets and compensation for illness, injury or death.As a division of microfinance, micro-insurance looks to aid poor families by offering insurance plans tailored to their needs. Micro-insurance is often found in developing countries, where the current insurance markets are inefficient or non-existent. Since the coverage value is lower than a usual insurance plan, the insured people pay considerably smaller premiums.

The evolution of micro insurance business in India

The evolution of the micro-insurance business in India can be gleaned from three sources:

i) The Life Insurance Corporation Act, 1956 which, for the first time, enunciated the concern of the government towards the disadvantaged, low income population, especially those living in rural areas. The Act's statement of objects and reasons declared "To ensure absolute security to the policyholder in the matter of life insurance protection, to spread insurance **much more widely and in particular to the rural areas** and as a further step in the way of more effective mobilization of public savings, Government have decided to nationalize life insurance business in India".

ii) The Insurance Regulatory and Development Authority (Obligations of insurers of rural social sectors) Regulations was promulgated by IRDA in 2002. Under this regulation, the insurance companies were compelled to obtain insurance business on a quota basis from pre-defined rural areas and social sectors.

Rural areas are defined by the Census of India as places which simultaneously satisfy or are expected to satisfy the following criteria:

• A minimum population of 5,000
• At least 25% of the male working population engaged in agricultural economic pursuits and
• A population density of at least 400 per square kilometre (1,000 per square mile). In these areas, life insurance must account for 5-16% of total policies from Years 1-5 of the operation of a new life insurance company, and for general insurance 2-5% of the total gross premium underwritten in Years 1-5.

The **social sectors** are defined as "unorganized workers, economically vulnerable or backward classes in urban and rural areas". Here, each insurer has to maintain at least 5,000 policies in Year 1 rising to 20,000 in Year 5, for both life and general insurance. This is regardless of the size of operations.

The result of these quota requirements is not clear. Companies failing to fulfil the targets in this area could face financial penalties and in the event of repeated violations, the insurers could lose their license. Since the uninsured population to be reached is really vast, these obligations could be considered more in the nature of creating greater awareness than imposing an onerous obligation. Some of the private insurers have, as a result, worked on strategies based on the notion that the poor are a viable business proposition which would give them the reach and potential business in the future. The state insurers, having been in the field for a long time, do not seem to face any problems in fulfilling their quotas.

iii) The latest in this process was the introduction of the micro-insurance regulations in November 2005. The anxiety of the regulator was to make appropriate products available for low income families as was also reflected in the IRDA report for the year 2005-06. A discussion of these regulations forms the core of this report.

The Micro-insurance Regulations, 2005

Regulations on micro-insurance were officially gazetted by the IRDA on 30 November 2005. Some salient features of the regulation are:

Micro-insurance products – as per the Micro Insurance Regulations, 2005

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-I 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-II 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 fulfilment both for rural as well as social sector obligations.

Micro-insurance - intermediaries

The micro-insurance regulations promote extensive use of intermediaries by the insurers for selling and servicing various micro-insurance products. The regulation also creates a new intermediary called the micro-insurance agent. The regulation clearly defines MI agents and has imposed minima in terms of the number of years of experience (at least 3) of working with low income groups. It also emphasises the need for such agents to have appropriate aims and objectives, a good track record, transparency and accountability stated in the bye-laws with demonstrated involvement of committed people. This has been done in order to prevent the engagement of unscrupulous operators in the activity. However, the onus for the selection of appropriate MI agents and their capacity building lies with the insurance company.

The micro insurance agent can be a Non-Governmental Organization (NGO), MFI or other community organization such as Self Help Groups (SHG) appointed by an insurer to distribute micro-insurance through specified persons. Micro-insurance agents enter into a "deed of agreement" with the insurer. They abide by the code of conduct defined by the IRDA and attend 25 hours of training (down from 100 hours originally required for conventional insurance agents but now reduced to 50 hours) in the local language at the expense of the insurer. There is no qualifying examination, unlike the case of ordinary insurance agents.

According to the regulation,

(a) Non-Government Organization (NGO) means a non-profit organization registered as a society under any law, and has been working at least for three years with marginalized groups, with proven track record, clearly stated aims and objectives, transparency and accountability as outlined in its memorandum, rule, by-laws or regulations as the case may be, and demonstrates involvement of committed people.

(b) Self Help Groups (SHGs) means any informal group consisting of ten to twenty or more persons and has been working at least for three years with marginalized groups, with proven

track record, clearly stated aims and objectives, transparency and accountability as outlined in its memorandum, rules, by-laws or regulations, as the case may be, and demonstrates involvement of committed people.
(c) Micro-Finance Institutions (MFIs) means any institution or entity or association registered under any law for the registration of societies or co-operative societies, as the case may be, inter alia, for sanctioning loan/finance to its members.

IRDA has recognized four categories of intermediaries: **brokers, agents, corporate agents, and Micro-insurance (MI) agents**. Categories other than MI agents may sell micro-insurance but they do not benefit from the concessions allowed for the MI agents. However, a micro-insurance agent shall not distribute any product other than a micro insurance product.

The regulation provides for MI agents to perform the following functions
(a) Collection of proposal forms;
(b) Collection of self declaration from the proposer that he/she is in good health;
(c) Collection and remittance of premium;
(d) Distribution of policy documents;
(e) Maintenance of registers of all those insured and their dependants covered under the micro insurance scheme, together with details of name, sex, age, address, nominees and thumb impression/signature of the policy-holder;
(f) Assistance in the settlement of claims;
(g) Ensuring nomination to be made by the insured;
(h) Any policy administration service.

Micro-insurance product features

The key features of micro-insurance products in India that distinguish these from other insurance products are:
Simplicity: The micro-insurance regulations specify that contracts for products demarcated as micro-insurance have to be issued in vernacular language that is simple and easily understood by policyholders. Even for group policies separate certificates have to be provided to each member of the group providing proof of insurance and details of the terms. Further, these products may also be distributed through micro-insurance agents (in addition to insurance agents, corporate agent and/or broker licensed under the Act).
Range of prices: The regulation has set limits for micro-insurance products and the maximum cover cannot increase more than Rs. 50,000 under any circumstances. The policy term also cannot exceed 15 years for non-life and for life the term is annual. Pricing depends on the types of risk covered, savings based or pure risk products and group based underwriting. There is a range of products available for the low income segment ranging from relatively costly health insurance to low priced group-based credit-life/asset insurance for members of MFIs.
Group-based underwriting: At present, the micro-insurance sector mainly caters to the enormous client base of MFIs and members of SHGs formed under various government programmes. Since most of the clients/members are in groups, group-based underwriting provides very cheap cover to them, though in most cases this does not exceed the loan amount.
Limited benefit values: Since the products are for low income households the size of benefits is kept as limited as possible to limit the premium. Group-based underwriting also propagates limited benefits. The regulations limit the size of benefits by restricting the cover to Rs. 50,000.

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Some additional non-financial benefits offered by insurance companies include various payment options (annual, half-yearly, quarterly, monthly), a free-look period of 15 or 30 days and surrender value for policies that have been in force for even a limited period.
Standardized government products with a large subsidy component: Most government programmes on insurance offer standardized products for the low income population irrespective of their geographical location and inherent risk profiles. An example is the Universal Health Insurance policy announced by the government and implemented by the four public sector insurance companies. Similarly the Janashree Bima Yojana succeeded by Aam Admi Bima Yojana are also standard products implemented by the LIC.

Features of the micro-insurance market in India

• Product characteristic: Micro-insurance products in the market have short policy contract terms and are tremendously (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 very small 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-à-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 significantly without advice while the higher end of the insurance market is served by brokers providing advice. Micro-insurance agents are specifically restricted to working with a single life and single non-life insurer.

DISTRIBUTION CHANNELS

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 incentivise the insurer to venture into this segment viewing it as a genuine market opportunity. Micro-insurance is a low-value, high-volume

business. The following three approaches have emerged in India to provide insurance to low-income populations (only regulated channels are included here, not in-house schemes):

- Partnership model
- Agency model
- Micro-agent model

Partnership model (The partner-agent model)

As the name implies this model involves a partnership between an insurer and an agent that provides some kind of financial service to large numbers of low-income people. This could be a microfinance organization, an NGO, or a business that supplies pre-cuts to large numbers of low-income people, such as a fertilizer supplier. This party is an agent, selling insurance policies to the clients on behalf of the insurance provider (usually) in exchange for a commission or fee. The insurance provider utilizes the established distribution channels of this agent and its financial transactions with low-income groups that would otherwise be too costly to set up.

The partnership model uses the comparative advantage of each partner so that each can focus on its core business: the insurance provider is responsible for designing and pricing the product, the final claims management, and the investment of reserves, and absorbs all the insurance risks.

In addition to selling the policies, the agent offers its infrastructure for product servicing such as marketing the product, premium collection, and assists in claims management.

Merits:

- The system works better than in-house because the synergies are maximized, enabling both organizations to focus on their core business and expertise;
- With a single partnership agreement it is possible to sell micro-insurance to over a quarter of a million low-income people;
- Requires fewer skills for the agent than an in-house model;
- Uses legally recognized insurance companies that have adequate reserves, adhere to capital requirements, employ certified insurance professionals, and operate under the insurance law;
- Insurer has access to reinsurance;
- The overhead costs of both the organizations, the agent and the insurance company, are reduced: the agent can use its infrastructure for collecting premiums, etc.; the insurer provides the expertise on product development, etc;
- It reduces the need to build the capacity of agents such as NGOs and MFIs to sell insurance because the insurer can do some of this;
- The insurer assumes all the risks;
- The agent earns commission without risk, while the insurer earns profits.

Demerits:

- Because of the quota system, the most well-known agents are already taken and have existing relationships with insurers. There are still many other organizations, however, that could act within a partnership;
- The insurance provider is dependent on the quality of the agent;
- NGOs in particular are often ‘here today, gone tomorrow’, relying on donor recognition and goodwill for their survival;
- Conflicts of interest may occur, especially when working with non-financial institutions.

NGO or MFI staff or management may develop compassion for a client and be lax about underwriting or claims verification. It should be noted that this is less likely to occur with an MFI partner that is used to financial discipline with its lending activities.

Agency model

In this model the insurer uses its normal agency office and sells micro insurance products directly. The client comes to the agency office for sales and servicing of the product. Insurers described this model but the authors could find no examples of it operating in practice.

Merits:

- Does not require much additional investment in infrastructure;
- Better control of the quality of the agent is possible than with the partnership model.

Demerits:

- Difficult to reach large numbers especially in rural areas where clients may be unwilling to travel to the office;
- Agents will need special training in dealing with low-income clients;
- Offices may intimidate poor clients;
- Individual policies only would be sold; generally such micro insurance policies have not proved commercially viable.

Micro-agent model

While the partnership model is relatively common, the micro-agent model described below is distinctive. It is the invention of Tata-AIG, specifically an employee of Tata-AIG. The central building blocks of the model are Rural Community Insurance Groups (CRIGs) supervised by rural organizations such as churches, NGOs or MFIs. CRIGs are a partnership firm formed of five women from a self-help group (SHG). The leader of the CRIG is licensed as an agent. The CRIG is a de facto brokerage firm (in the technical, not the legal sense of the term). All CRIGs in the same geographic area meet in a single centre, usually organized with the assistance of the rural organization, and receive training and assistance from Tata-AIG. This practice reduces training costs. Most CRIGs consist of four to five members. These members are usually women who are part of an SHG. A typical leader will be educated to the 12th standard or above, have a good track record of past social-sector performance and integrity, be systematic and organized, with leadership qualities, and public speaking and training skills.

The CRIG leader and members are involved in promotion, sales and collection of insurance proceeds and maintaining records. The CRIG leader will document all fortnightly CRIG meetings and all weekly meetings with the NGO concerned.

Merits:

- The model creates an insurance distribution infrastructure in low income neighbourhoods. In addition, it creates a new profession, that of micro -agent, with new livelihood opportunities in his/her vicinity;
- Sustainability: Because the position is a commercial one with financial incentives, it will last in the long term, facilitating the sale of long-term products.

As mentioned under the partner-agent model, NGOs and MFIs are often dependent on the goodwill and public recognition of aid flows, and so their long-term existence is precarious. Chances are good that CRIGs, being registered firms, will survive, in the event of a member or

leader dropping out. The leader could be replaced by another from the community, thus mitigating the risk of orphaned policies;

- In the event that a CRIG disbands, the orphaned policies can be taken over by another CRIG that operates under the same NGO.

Demerits:

- Training is costly, especially in relation to premium values;
- The transaction costs of the sales agent are cheap at first but increase as soon as the agent has sold to all the peoples/he knows and needs to sell to strangers, especially to those living far away;
- In many cases in the partnership model, when a claim is arises the MFI or NGO investigates the claim, pays the benefit immediately, and then claims it back from the insurer. Immediate payment of claims helps maintain client confidence, and this is not possible under the CRIG system;
- This model is new, and much more experience is needed before it can be reasonably evaluated.

Conclusion:

The discussions above have highlighted the characteristics of the micro-insurance market in India in terms of the parties involved, distribution models and challenges, products and outreach. It can be observed that the Indian micro-insurance regulation is designed to promote such products through its liberal and developmental approach, but 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.

However, it is becoming increasingly clear that micro-insurance needs a further push and guidance from the regulator (IRDA) as well as the government. 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 need for strengthening the link between micro-insurance and micro-credit.

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