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Micro Insurance: An Emerging Financial Instrument in the Indian Insurance Sector

KEYWORDS: Insurance, micro insurance, low income

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ABSTRACT *The insurance sector in India is in growing stage and it has become a must for each individual to have his or her own insurance in order be ready with risk associated with life and property. Insurance functions on the concept of risk pooling, and also regardless of its small unit size and its activities at the level of single communities. In that micro insurance is playing a very important role. Micro insurance, the term used to refer to insurance to the low-income people. The emergence of micro insurance is not only to promote business activities but also, social development and protection to the poor people. From the research it has also been found that, out of the estimated four billion people world-wide, who live on less than $2 a day. Against this backdrop, the present paper explores various aspects of micro insurance.*

INTRODUCTION

India is moving very fast from a protected economy to an open market economy and becoming integrated with the world economy. Liberalization, Privatization, globalization and computerization has brought unprecedented changes in the trade, industry, banking and insurance sectors. Insurance has come up as a very important financial service in most part of the world. The insurance is considered as one of the segment in an economy for its growth and development. This industry provides long-term funds that are essential for the development of basic infrastructure.

Today, micro insurance has become an integral part of poverty eradication programs to strengthen both the development of the financial, health and social security systems. This is because development experts across the world have come to the agreement that the micro insurance is a potent tool for complementing micro credit in the fight against poverty by enabling poor households to pool risks, thereby, preventing them from falling deeper into the poverty trap at the occurrence of unforeseeable shocks. The occurrence of any emergency or risk has the tendency to easily erode the hard earned incomes of poor households. This is specially the case when the households have no formal cover over them. Micro insurance plays very important role like any effective risk management instrument and serves as a shock reliever to major risks and ensure that the household involved can continue on their route to escaping poverty. The importance of micro insurance, therefore, is to serve as a safe net, with the ability of ensuring that the poor household posses the ability to deal with a named risk and in addition ensure that these households are prevented from becoming poorer after the occurrence of a risk or an emergency. Micro insurance in summary has the ability to help boost the stability of the poor. The present study is an attempt to analyse, whether people have a positive or negative impression of micro insurance, what they mean when they characterize micro insurance. The study is also relevant from the point of analysing the awareness on micro insurance and its contribution towards risk coverage and savings of future investment.

OBJECTIVES OF THE STUDY

1. To understand the concept of micro insurance.
2. To know the various models of micro insurance.
3. To analyze the factors leading to the development of micro-insurance in India.
4. To suggest some implementable suggestions for facilitation of desired growth and outcome of the micro insurance sector.

CONCEPT OF MICROINSURANCE

Micro insurance, commonly called as insurance for the poor, has recently drawn the attention of practitioners in developing countries. In common parlance, micro insurance is the provision of insurance services to low-income households, which acts as an important tool to reduce risks for the already vulnerable population. There is no universally accepted definition of micro insurance despite its profound use and understanding across stakeholders and others. A simple definition of micro insurance is offered by Churchill (2006) is that it is an insurance that (i) operates by risk-pooling (ii) financed through regular premiums and (iii) tailored to the poor who would otherwise not be able to take out insurance. Micro insurance is defined as —insurance that is accessed by the low-income population, provided by a variety of different entities, but run in accordance with generally accepted insurance practices. Importantly this means that the risk insured under a micro insurance policy is managed based on insurance principles and funded by premiums (International Association of Insurance Supervisors, 2007). Micro insurance is different from usual form of insurance. A macro definition of micro insurance states that it is the provision of financial protection contingent on the occurrence of predefined risk in exchange for an ex-ante premium payment affordable to the clients. In terms of micro definition, micro insurance is more complicated as there are different approaches. —Micro as reference to low premium and low benefits may be affordable but it may not be effective enough to manage risks of different types of different categories of clients. Micro insurance is often believed to be an important component of a broader set of financial services under microfinance – making available financial services for poor households and enterprises to sustain their livelihoods. Basically there are two broad categories of micro insurance often commonly understood – one focused on extending social protection to the poor in the absence of appropriate government schemes and the other offering a vital financial service to low-income households by developing an appropriate business model that enables the poor to be a profitable (or sustainable) market segment for commercial or cooperative insurers. Micro insurance is also taken as group insurance that can cover thousands of customers under one contract. It requires an agent between the customer and the insurance company. This agent role has been played mainly by non-governmental organization (NGO) and microfinance institutions (MFI). The role of intermediaries in growth of micro insurance in India is well documented. Currently around 135 million, or 5%, of low income people in developing countries are using micro insurance products. But the size of insurance market for low income groups is large

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and it constitutes about 1.5 to 3 billion potential clients (Micro insurance Centre, 2007). According to a research carried out by Swiss Re in 2007, most growth in the insurance industry over the past decade has come from the wealthy and middle income markets in emerging economies. Premiums grew by 3.3% globally and by 11.8% in the emerging markets in that year. Though partly this was due to a growing number of clients moving into the wealthy and middle income brackets in these countries, it is also attributable to insurance expanding into new markets. The number of people covered under micro insurance is estimated about 78 millions in 77 countries out of 100 less developed countries.

MICRO INSURANCE DELIVERY MODELS

1. PARTNER AGENT MODEL OF MICRO INSURANCE

Partner agent model has become the dominant approach to micro insurance in India. In this model there exists a partnership between an insurer and an agent and in some cases a third party health care provider that provides some kind of financial service to large numbers of low income people. Micro insurance agent is a new concept in addition to insurance agent or corporate agent or insurance broker. Micro insurance agent can be appointed by an insurer by entering into a deed of agreement. Agent could be a micro finance organisation, an NGO, or a business that supplies products to large numbers of low income people. These agents sell insurance policies to the client on behalf of the insurance provider (usually) in exchange for a commission or a fee. The insurance provider utilizes the established distribution channels of this agent and its financial transactions with low income groups that would otherwise too costly to set up. Under this model, insurance provider takes the responsibility of designing and pricing the product, the final claims settlement, and the investment of reserves, and absorbs all the pertaining insurance risks. On the other hand, the agent offers infrastructure to product servicing which includes marketing the insurance product, collecting the premium, and assistance in claims management.

2. FULL SERVICE MODEL OR IN HOUSE MODEL

In the Full Service Model, an MFI runs its own insurance scheme for its clients using its normal agency office. The insurers (MFIs or NGOs) take charge of design and delivery of products to the clients, sales, services and claims assessment. They are wholly responsible for all insurance related costs and losses, at the same time they also retain all profits. This model is less in operation.

3. PROVIDER DRIVEN MODEL

Under this model, a hospital run by an NGO develops and runs a micro insurance scheme, usually for health insurance. Similar to the full service model, health care provider is responsible for all operations, delivery, design and service. MFIs such as ASA and Grameen use this model but manage their own clinics. There is an advantage in the amount of control retained, and disadvantage in the limitations on products and services.

4. SOCIAL PROTECTION MODELS

National governments often underwrite cover for certain risks through social insurance programmes such as with health care, crops and livestock, and covariant risk.

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 (IRDA 2000). As a result, increasingly, micro-finance institutions (MFIs) and NGOs are negotiating with the for-profit insurers for the purchase of customized group or standardized individual insurance schemes for the low-income people. Although the reach of such schemes is still very limited---anywhere between 5 and 10 million individuals---their potential is viewed to be considerable. The overall market is estimated to reach Rs. 250 billion by 2008 (ILO 2004).

The insurance regulatory and development authority (IRDA) defines rural sector as consisting of (i) a population of less than five thousand, (ii) a density of population of less than four hundred per square kilometre, and (iii) more than twenty five per cent of the male working population is engaged in agricultural pursuits. The categories of workers falling under agricultural pursuits are: cultivators, agricultural labourers, and workers in livestock, forestry, fishing, hunting and plantations, orchards and allied activities.

The social sector as defined by the insurance regulator consists of (i) unorganized sector

(ii) Informal sector (iii) economically vulnerable or backward classes, and (iv) other categories of persons, both in rural and urban areas. The social obligations are in terms of number of individuals to be covered by both life and non-life insurers in certain identified sections of the society. The rural obligations are in terms of certain minimum percentage of total polices written by life insurance companies and, for general insurance companies, these obligations are in terms of percentage of total gross premium collected. Some aspects of these obligations are particularly noteworthy. First, the social and rural obligations do not necessarily require (cross) subsidizing insurance. Second, these obligations are to be fulfilled right from the first year of commencement of operations by the new insurers. Third, there is no exit option available to insurers who are not keen on servicing the rural and low-income segment. Finally, non-fulfilment of these obligations can invite penalties from the regulator.

In order to fulfil these requirements all insurance companies have designed products for the poorer sections and low-income individuals. Both public and private insurance companies are adopting similar strategies of developing collaborations with the various civil society associations. The presence of these associations as a mediating agency, or what we call a nodal agency, that represents, and acts on behalf of the target community is essential in extending insurance cover to the poor. The nodal agency helps the formal insurance providers overcome both informational disadvantage and high transaction costs in providing insurance to the low-income people. This way micro insurance combines positive features of formal insurance (pre paid, scientifically organized scheme) as well as those of informal insurance (by using local information and resources that helps in designing appropriate schemes delivered in a cost effective way).

In the absence of a nodal agency, the low resource base of the poor, coupled with high transaction costs (relative to the magnitude of transactions) gives rise to the affordability issue. Lack of affordability prevents their latent demand from expressing itself in the market. Hence the nodal agencies that organize the poor, impart training, and work for the welfare of the low-income people play an important role both in generating both the demand for insurance as well as the supply of cost-effective insurance.

SUGGESTIONS

1. Many of the non government and non-profit organizations are working in the field of micro insurance. These organizations must form a cartel and government backing should be provided to the cartel so that they can work together with the support of the government for the upliftment of the poor and the weaker sections.
2. The IRDA must take necessary steps making it compulsory for the private players to have a target of doing a certain percentage of insurance as micro insurance which may be equal

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to some percentage of their sales.
3. The advertisements must be made in the local languages.
4. The micro insurance must be done in post offices and other government depots so that the transparency could be maintained.
5. Certain attractive rates of return schemes should be levied on micro insurance policies so that the money invested under the micro insurance policies could fetch good returns.
6. Micro insurance schemes can be made compulsory on the big corporate houses which can take insurance of their employees at a very cheap rate of premium.
7. The grievance handling cells must be made under the guidance and leadership of the gram and jila panchayats which can handle the queries, complaints, difficulties of the poor people and that too in a very short span of time.

CONCLUSION

Micro insurance in India is a new concept and is to be tested for conduciveness to the needs of the target segment. The most significant constraint is the lack of base line data on potential claims that can help the insurers to design the products. The consumption and saving patterns are also a critical aid to assess the insurance needs. The issue of moral hazard and adverse selection is a matter of concern for the insurer. Above all, spreading awareness among this segment of insurable population and capacity building of the delivery organizations are major challenges. So, it is becoming increasingly clear that micro insurance needs a further push and guidance from the regulators, MFI's, NGO's as well as the government. Moreover MFI's are playing a significant role in improving the lives of poor households and linking micro insurance with micro-finance makes better sense as it helps in bringing down the cost of lending.

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