Insuring the Livelihoods of the Poorest - Microinsurance as a tool against Extreme Poverty

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Background: Why Microinsurance?

A lot of people living in extreme poverty are people who had never been in extreme poverty before, but have fallen into extreme poverty because a catastrophic life circumstance, or people who had left extreme poverty, and were still extremely vulnerable, and after one or several unlucky events, have fallen back. Indeed, the data from the Chronic Poverty Research Centre highlights that between 20% and 60% of the people who escaped extreme poverty in six countries fell back within 10 years.[1]

Micro insurance does not create wealth, but, regardless of where people are on the poverty-prosperity spectrum, it avoids reversing the build-up of wealth.

How does Microinsurance work?

Microinsurance is particularly appropriate for shocks that affect individuals or households and are linked to unpredictable events, such as the death of a member of the household, damage affecting the house or goods (business-related or personal), illness, or accidents. Other financial tools, such as savings or credit, may also be used to cover the costs or the losses associated with these shocks, but are often insufficient, especially if the incidents run the risk of being repeated or generate substantial losses. Microinsurance has therefore a unique role to play.

Under the right circumstances, microinsurance can also address shocks can hit groups of households, a community or a whole village. Such shocks are said to be covariant, i.e. they are common to all households within a given geographical area. They include for instance natural disasters, or ill health due contagious diseases. Here again, microinsurance may play a special role.

Microinsurance is like a normal insurance scheme in developed countries or for more affluent markets, EXCEPT it involves tiny premiums and small payouts. The fact that premiums must be kept at a low level rules out any product that might involve complicated administrative processes or in-person, case-by-case verification. In practice, microinsurance can cover the following lines of products:

-Life insurance: this can take several forms

- Simple life insurance : Cash payout to the beneficiary
- In-kind funeral services: coverage of funeral costs

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[1] Chronic Poverty Advisory Network, 2014. *The Chronic Poverty Report 2014–2015: The road to zero extreme poverty*. ODI, page 2, Figure 1.

- Cancellation of the outstanding loan balance of the insured in case of death (credit life)

-Health Insurance:

Health insurance is typically a more complex product, usually covering a broad variety of risks that can happen repeatedly. The way to simplify its administration to make it eligible for microinsurance is to:

- Limit the coverage (for example, to outpatient care only, or to a specified list of services)
- Include co-payments (to restrict health consumption to the more urgent cases)

-Agricultural microinsurance

Agricultural damages are typically complex to assess, resulting in long insurance claim processes. One key innovation, index insurance, allows to cut through these hurdles: it allows quick fixed payouts to farmers if the index falls below or rises above a pre-determined threshold (say X mm of rain over a given period, observed at a pre-agreed weather station), rather than indemnifying them for crop losses actually experienced, thus avoiding the need for costly (and often impossible) verification of damage.

Climate loans can be stand-alone or credit-related (for instance, credit to small farmers in Uganda comes with compulsory insurance, with premiums as low as 1% of the loan); in the latter case, loans become much less risky to the farmer and this becomes an incentive to improve production.

Impacts of micro-insurance

In general terms, microinsurance reduces the negative effects of shocks through:

- More predictable savings: with microinsurance, savings do not have to be depleted in case of adverse events
- No intergenerational transmission of vulnerability because of funeral costs or outstanding loans
- Bolder investments: micro-business owners or small farmers who are insured are more likely to borrow for their ventures, knowing that in case of adverse events, they are protected; lenders are more likely to find borrowers to be an acceptable risk with microinsurance
- More generally, agricultural insurance increases food security.

Quantitative studies allow more specific conclusions:

-"Robust findings proving that health microinsurance reduces out-of-pocket expenditures and increases the utilization of healthcare services"[2]

-Mathieu Dubreuil and Arianna Tabegna of the World Food Programme (WFP) highlight that while most of the world's hungry people live in countries prone to weather-related risks, which disproportionately affect their lives, microinsurance can help them tackle food insecurity when combined with other

[2] **http://www.munichre-foundation.org/dms/MRS/Documents/Microinsurance/2012_MICompendium_VolII_English/MicroinsuranceCompendium_VolII.pdf**

interventions for climate risk management. [3] For instance, results of trials in Malawi show that food-insecure farmers who had access to climate insurance (with support for financial services like microcredit) saw the proportion of those whose food consumption level was not acceptable reduced by 75% in 2 years, and during the same period their consumption on non-food items increased as did their savings. There is also proof that insured see their consumption increase faster when compared to non-insured.

The Microinsurance Compendium published by Munich-Re Foundation[4] also includes studies which invite us to be cautious with over-generalizing the positive effects of microinsurance: for instance, on reducing out-of-pocket expenditures, out of 12 studies, 6 found a positive impact, 3 mix of positive and insignificant impact, and 3 an insignificant impact. This shows that, to be truly effective, microinsurance products need to be well tailored to the needs of the market they intend to serve.

Going to Scale: Coverage Matters

According to ImpactInsurance, a venture by the International Labour Organisation, around 4 billion low-income people remain excluded from appropriate insurance products. [5] The potential of microinsurance is therefore enormous.

In the view of MicroEnsure, a leading microinsurance provider, it is "emerging consumers (that) face the highest level of risk but have the least access to microinsurance". [6] In fact, this leading institution only serves 56 million customers, which shows the magnitude of the task ahead.

What is encouraging, however, is the speed at which coverages is beginning to increase: out of MicroEnsure's customers, 18 million joined in the previous year.

The Microinsurance Network (MiN) has been tracking the evolution of microinsurance since 2007, starting with the publication of The Landscape of Microinsurance in the World's 100 Poorest Countries. Back then, the MiN project team had identified 7.8 million people who were covered by microinsurance in Latin America and the Caribbean (LAC). Based on their latest report, coverage in the same set of countries stood at 17.6 million individuals by the end of 2016 – an increase of 126%. If one adds Argentina, Brazil, Chile and Mexico, which were not part of the original 2007 study, the total reaches nearly 52 million people.

The Microinsurance Network concludes that technology should be poised to sustain this acceleration in coverage: "In many parts of the world, and especially in Sub-Saharan Africa, mobile insurance has already provided access to insurance for a large part of the previously uncovered population. Mobile

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[3] https://www.gbgfund.org/category/world-food-programme/

[4] [4] **http://www.munichre-foundation.org/dms/MRS/Documents/Microinsurance/2012_MICompendium_VolII_English/MicroinsuranceCompendium_VolII.pdf**

[5] http://www.impactinsurance.org/about/what-is-facility

[6] https://microensure.com/

and other digital technologies are now introducing new business models, but regulators sometimes struggle to reconcile customer protection with innovation." [7]

Key Challenges

A) Climate-risk insurance is dependent on data:

Governmental investments in the provision of reliable weather data will substantially boost the insurers' activities in developing climate risk insurance. Insurers need a single-stop solution to source weather data. Establishing independent institutions providing reliable weather data is key.

B) Special Efforts must be made to reach the very poor

According to sector specialists, there is a way to identify the typical potential client for microinsurance. "Over the years, both project teams working on the Landscape Studies and commercial players seeking to come up with a measure for target market size, have concluded that consumers spending between US$2 and US$10 a day, in terms of purchasing power parity, are likely microinsurance customers.[8]" Another way to look at this is that there appears to be two types of clienteles: those just barely hovering over the extreme poverty threshold (US$2 a day) and those who have made it largely above the extreme poverty line but need to develop resilience in the face of risk, so that when bad things happen, they do not simply fall back into deep poverty.

This could point to two types of strategies:

- A communication strategy for the slightly better off to convince them of using a portion of their meager income to protect their families from economic downfall.

- A more elaborate strategy to support the very poor in obtaining microinsurance coverage. The microcredit experience teaches us that the market segment most likely to be bypassed or overlooked, especially when billions of potential customers are underserved, is the very poor. Reaching out to the poorer customers requires adapting to a downscale market: developing a simple, understandable and relevant product design, coming up with marketing relating to their circumstances and making premium collection as simple as possible. More importantly, reaching the extreme poor requires introducing a substantial subsidy element: living in extreme poverty is already living a life of catastrophes, in particular from the perspective of food security; cutting on an already insufficient food budget to pay for insurance premiums is essentially unthinkable. This, in turn, clearly points to the need to bring in aid agencies (private and bilateral donors) who can include these subisidies in their programming strategies.

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[7] https://microinsurancenetwork.org/community/blog/insights-and-perspectives/2018-exciting-year-challenges-and-microinsurance

[8] https://www.gbgfund.org/mapping-landscape-microinsurance/