

## Report of the 6<sup>th</sup> A2ii – IAIS Consultation Call

# Successful Business Models in Microinsurance

25 September 2014



The **sixth consultation call** focused on successful business models in microinsurance. Two calls attended by 62 participants from across Asia, Africa, Latin America and North America were held on Thursday September 25.

The calls addressed three big questions regarding successful business models in microinsurance. Firstly, what makes these new business models different from traditional approaches? Secondly, what are the major types of business models, and which have proven successful in practice? And finally, what effect do these changes have on the approach of insurance supervisors?

These questions were unpacked through expert presentations by Michael J. McCord, President of the MicroInsurance Centre, and Craig Churchill, head of the ILO's Impact Insurance Facility (previously known as the Microinsurance Innovation Facility). This was then followed by three practitioners sharing their experiences: Freedom Buthelezi from Hollard, South Africa, Mariana Torres from ATERNA, Mexico and Afua Donkor from Star Microinsurance, Ghana. The calls were moderated by Ulrich Hess, Senior Advisor, Access to Insurance Initiative.

Outlined below are the key insights regarding each of the three core questions. Where relevant, a box is inserted to indicate questions raised on the calls.

## 1. What sets microinsurance business models apart?

Microinsurance products are characterised by small margins, given the low value and relatively high expense load of most policies. This means that successful microinsurance business models have to be innovative, especially in their choice of distribution channel as a way of cutting costs. The traditional insurance distribution model relies on brokers and agents; newer business models leverage new groups and aggregators as an alternative. These newer approaches can result in longer distribution chains, and include a variety of new entities that are neither traditional insurance sellers, nor necessarily regulated by insurance supervisors (for example, mobile network operators or retailers). It follows that some of these models result in a greater degree of separation between insurers and their clients than was traditionally the case, and thus result in new consumer protection risks.

Michael McCord explained that a business model indicates how an insurance company intends to make money. Business models cover aspects such as the role of the insurer, distribution approaches, product design and how services are provided. In microinsurance, simplicity and distribution are key drivers of all business models.

### **Q&A: What is the experience with health and medical microinsurance products**

The experts' answer: There has been much experience, on many levels. Products range from comprehensive products that cover both in-patient and outpatient, to products that speak to only in-patient or out-patient specifically (depending on what governments are offering); we also find products that seek to fill gaps such as hospital cash (supplemental insurance – an example in Jordan covers lost wages of carers and out of pocket costs). The latter is much easier to manage as one does not need to wait for clinical evaluation, or be concerned about document fraud in the hospital. Some Mobile Network Operators (MNO) in Africa are beginning to offer these hospital cash products. As part of the Microinsurance Learning and Knowledge Project, it was found that comprehensive health care products for the low-income market are likely impossible without substantial government subsidies.

## 2. What are the major types of microinsurance business models?

Michael McCord and Craig Churchill<sup>1</sup> identified four general business models used in microinsurance. The first is that of the traditional insurer; the second focuses on the use of an intermediary; the third incorporates a non-traditional intermediary referred to as an aggregator; and the fourth is community-based:

**1. Traditional model.** The traditional insurance business model uses agency forces, either selling to individuals or groups. Volumes can be limited when dealing with individual sales and tend to be larger with group sales. Because margins are small in microinsurance, large volumes are vital as they deliver profitability and hence allow sustainable entities to be built. **Agent sales force.** Some microinsurance business models mimic traditional forms of insurance by using an insurance sales force. Here, the microinsurer has its own agents in collaboration with its partners or distribution channels and will often make use of call centres.

**2. Intermediary model.** The second microinsurance business model makes use of an intermediary as a distribution channel. Often these intermediaries will be financial service companies that offer microinsurance as an add-on to their core product offering. Sometimes these microinsurance products are mandatory to secure the financial company's core business, for example secure loan repayment, or help gain volumes and the benefits the service providers are looking for. At other times they are actively sold as stand-alone products, with staff explaining the product to potential clients or groups of clients. In the latter case, the cost structure will be based on commissions. This type of sales structure promises adequate potential volumes depending on the size of the intermediary selling the product. From a business model evolution point of view, the use of intermediaries has grown because insurers were looking for greater volumes. MFIs and banks were seen as ideal partners to deliver this volume. variation to the typical intermediary business model is "passive sales" (Churchill). This is generally in the form of off-the-shelf packages. This model re-engages the traditional use of agents to sell the product, but instead of using dedicated agents, will utilise agents of other products – called a proxy insurance sales force. In this case, insurance sales are not the core function of the agent, but something they offer as an ancillary product (for example the agent's main activity could be to sell clothing or white goods, or they could be microfinance loan officers).

The ATERNA case study from Mexico is an example of the intermediary business model:

### Case Study: ATERNA, Mexico

ATERNA is a broker that focuses on microinsurance products. ATERNA is part of two important groups in Latin America: Grupo Compartamos (who have 25 years of experience in microfinance) and Grupo CP (one of the most important brokers in Latin America). They specialise in product design and are also responsible for the implementation process, including training, incentive structures, marketing and streamlining operational structures to ensure that the channel remains focused on its core activities. They have established a special programme called Contigo (which means "with you"), which they use to establish service level agreements and to ensure that they deliver on the promises made to the clients. They aim to settle claims payments within 24 hours.

Their suppliers are mostly Mexican insurance companies and some assistance companies. They also work in Guatemala and Peru and have started a pilot targeting immigrants in the USA. At present, they have four million active policies and pay out more than a million dollars in benefits each year. They sell mostly life products and find the introduction of new products (such as accident, or health) challenging, mostly due to regulatory issues. ATERNA handles more than three million dollars in premiums annually, and is very active in financial education to ensure that clients understand the value of the products they hold.

<sup>1</sup> Craig Churchill uses slightly different terms focusing on different angles, however for the sake of simplicity and clarity we use one set of terms based on both expert's contributions.

ATERNA started in 2010, although an agent model had been in use in Compartamos since 2004, which meant that a significant client volume was already in place by the time that ATERNA started. Initially, volumes grew on the back of basic products of a mandatory nature, which fostered clients' familiarity with the service provider and microinsurance. Since then, ATERNA launched voluntary products, which have begun to sell more quickly in the last year. These voluntary products have tangible product features to make them more attractive to clients. ATERNA products have a 75% penetration rate in the Compartamos channel. A recent challenge in Mexico has been that mandatory products are no longer permitted, so more effort has to be made to get clients to understand the value of their product, in order to maintain sustainable volumes.

Crucial in product development is simplicity and a clear focus on meeting customer needs. Close attention is being paid to create accessible client documentation and processes, for example minimising the amount of documentation needed to be able to claim.

**The most frequently used form of this business model is "Insurance bundled with credit".** Microinsurance often emerges in a market in a bundle with a loan or another service. Many consumers and insurers are introduced to microinsurance as an accompaniment to credit products offered by microfinance institutions. This allows both insurer and customer to test and experience microinsurance.

Star Microinsurance is an example of the bundled business model:

### **Case Study: Star Microinsurance, Ghana**

Star Microinsurance was established in 2008 by the Star Group. In Ghana, a life company must be separate from other classes of insurance company, so the Star Group contains a number of different insurance companies that serve various product classes. In 2008, the Star Group made the strategic decision to launch a separate entity to develop a microinsurance market, even though there was no regulatory framework for microinsurance.

Initially, Star Microinsurance focussed on individual life products, but growth was slower than anticipated. This precipitated a shift in strategy. In 2010, Star Microinsurance began collaborating with other groups, such as Opportunity International Group, ARB (made up of 135 rural banks), and groups in the informal sector such as associations of microfinance companies to provide mostly credit life insurance. This change in strategy allowed Star Microinsurance to accelerate its growth

### **Q&A: What are the consumer protection risks to be aware of in the voluntary group model?**

Apart from compulsory products, the intermediary model can also extend to voluntary group products, whereby the insurance company overcomes some of the adverse selection risk by requiring a certain percentage of the group to agree to the product, before allowing anyone in the group to gain access to the product. This model is most commonly associated with health insurance products. In this case, individual clients may be compelled against their wishes to buy the insurance product by the rest of the group. An extreme variation of this models is when the group has opted in, all members must participate.

**3. Aggregator model.** The third microinsurance business model works with aggregators other than the “traditional” intermediaries referred to above to achieve volume. This has become a more popular approach in recent times. Aggregators include organisations such as retailers (whose target clients are in the low-income market), utilities or mobile network operators (MNOs). Working with the latter two may be more complicated because they are technology providers and tend towards passive (non-advice) sales, but they can provide access to a very large client base. MNOs in particular generate further challenges because they see microinsurance as enhancing their core business model by reducing churn (when clients switch to other providers) and increasing average revenue per user. If these benefits are not realised, the MNO may cancel the partnership.

This model perceives microinsurance as a loyalty benefit, or as an auto-enrollment benefit. This business model is commonly utilised by service companies such as MNOs to increase usage of their current core (non-insurance) products. Other examples of this business model include agro-dealers (extending insurance cover to customers when buying bags of fertilizer) or banks incentivising customers to put more money into the account by offering an insurance add-on to the account.

In terms of volume, “free”-style products are the most significant because they reach a large volume of the aggregator’s clients almost automatically and immediately. For example, the MNOs feature three levels of insurance premium payment models:

- **Free** – where the MNO pays the full premium focused on getting microinsurance to all those subscribers whose call fees exceed a certain threshold to reduce churn and increase “average revenues per user” (ARPU).
- **“Freemium”** – where the MNO pays for the base amount of cover, and the client pays for an additional value of cover
- **Paid or voluntary** – where the client pays the entire premium.

In comparison to the “free” product, voluntary products have tended to start very slowly.

**Q&A: What are the key supervisory challenges in relation to mobile insurance and what are the key challenges in relation to KYC (know you customer) requirements for mobile microinsurance?**

The experts’ answer: Key challenges around mobile insurance revolve around payments, receipt of premiums, client management and the ability of MNOs to sell insurance products. It is not always clear that clients are getting enough information about what they are buying. The lack of information for the client is also one of the main KYC challenges, not just specifically in mobile microinsurance, but across the board in microinsurance. In Belize, for example, even the smallest insurance policy has to pass all KYC regulations; many other countries have implemented a waiver of KYC requirements under a certain level of coverage. This facilitates the ability to supply microinsurance products without the difficult administrative issues stemming from KYC. The guidance in the IAIS Application Paper on Regulation and Supervision Supporting Inclusive Insurance Markets suggests that KYC-treatment should be in line with the risk posed, which is typically low for microinsurance.

**4. Community-based model.** The fourth microinsurance business model operates directly with consumers, in a mutual fashion, in that a group of people pools risk amongst themselves. This model is where insurance originally developed.

**Evolution of market development.** A number of facets can be considered when assessing market development. The graphic below offers a way of understanding the evolution of a microinsurance market across two axes – quantity (number of policyholders) on the horizontal axis and quality of service provision and client value on the vertical axis:

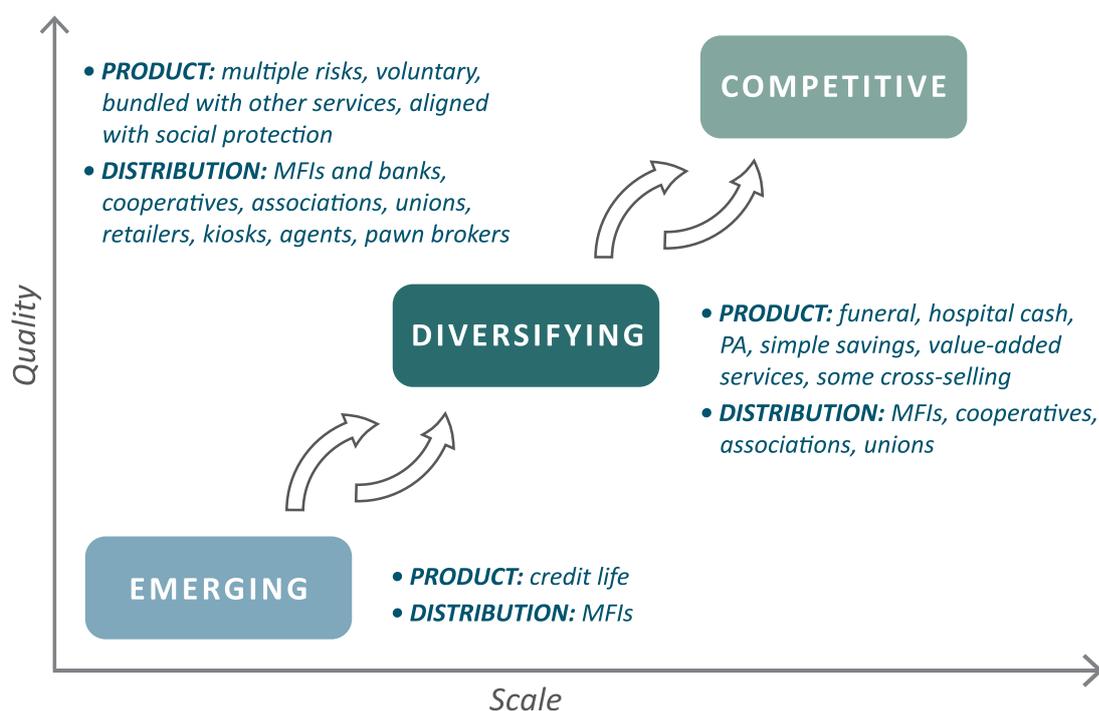


Figure 1: Stylised evolution of microinsurance market through expansion in product and distribution approaches, to achieve high quantity and quality  
Source: Craig Churchill presentation

The first stage, indicated in the bottom left of the diagram, is the **emerging** stage, where there is a limited product suite, typically credit life distributed through MFIs. This is followed, in more developed microinsurance markets, by the **diversifying** stage where microinsurance expands to other products with a simple claim trigger, such as funeral insurance, personal accident insurance or products paying a stated amount upon hospitalization. During this stage the range of distribution partners is broadened to also include other types of credit providers and groups such as cooperatives and associations.

The final stage is the **competitive** phase, where multiple-risk products are offered and microinsurance is also bundled with other services and aligned with social protection. On the distribution front, this stage is characterised by the use of a variety of traditional and non-traditional distribution channels, including aggregators such as retailers and MNOs.

The Hollard case study illustrates the evolution of models over time:

### Case Study: Hollard, South Africa (presented by Freedom Buthelezi)

Hollard has had a ten year journey in microinsurance, illustrating the progression path outlined above. Their initial approach to microinsurance was to use telesales, targeting individuals in credit providers' sales database, to offer their microinsurance products (the most notable example being funeral insurance) as a voluntary add-on to compulsory credit life insurance. The product was sold by experienced sales staff who offered advice as per the traditional agent model. This sales model proved to be too expensive to be sustainable – so Hollard shifted to a non-advice distribution model (passive sales), where sales staff did not advise the clients as to which product was more suitable / better, instead staff only explained benefits and product features. As a next step, Hollard began selling its insurance product to the general public by advertising on TV, radio and other media.

In addition, Hollard started to pursue an aggregator model, selling its microinsurance products in retail stores, as an off-the-shelf, insurance-in-a-packet product. While the product sold well, Hollard realised that sales could be significantly boosted by moving to a hybrid model that reincorporates some of the traditional agent model features, by hiring sales agents that would point out the insurance-in-a-packet product to passing customers, and answer non-advice questions about product features and benefits. The experience has shown that face-to-face interactions generate trust in the product, in a way that the original telesales model was not able to achieve.

Most recently, Hollard entrenched the hybrid model by beginning to sell its product via “speed agents”. These agents operate out-of-store, for example by selling house to house. Potential clients are able to access information by calling a call centre, and final sign up for an insurance product is done by coming into a Hollard branch. This last step is required to minimise the incidence of fraud, and legitimises the product and roving agent in the eyes of the customer.

The implication of this evolution in business models is that Hollard has commercial relationships with retailers (for telemarketing and in-store sales), roving agents (that operate out-of-store) and both advice and non-advice based call centres. Thus Hollard strategically leverages a variety of partners' infrastructure and client base. The range of microinsurance products offered, along with the diversity of distribution channels, suggests that the microinsurance market in South Africa reached the competitive stage: Hollard sells credit-life, life (funeral – which is the best seller), personal accident, hospital cash plan, legal and non-underwritten life insurance.

## 3. What are the implications for supervisors?

The features and evolution of microinsurance business models in many ways confront insurance supervisors with the need for a different supervisory approach compared to traditional insurance.

The regulatory implications differ across the four business models:

- 1. Traditional model.** In the traditional insurance business model, regulation tends to focus on product and process, because insurers look to simplify both these aspects in microinsurance in an attempt to lower **costs**.
- 2. Intermediary model.** From a regulator's perspective, the type of partnership under the intermediary business model generates issues of agency. Often regulations have to be adapted to control cases of mis-selling. In the Philippines for example, the Insurance Commission and the Central Bank worked together to develop a set of laws that function in parallel to allow these types of intermediaries to supply microinsurance products, but in a way that ensures consumer protection.

**3. Aggregator model.** Supervisors' main concern in the aggregator business model is when clients are left adrift because the relationship between a microinsurer and an MNO discontinues at short notice. A further concern for regulators lies in the large size of commissions. For example, in Colombia commissions range as high as 45%; in Nigeria, some MNOs charge 70% in commissions and fees to cover their technology and marketing costs. The aggregator model also creates coordination challenges with other regulators or authorities (for example the telecommunications agency that oversees MNOs). Furthermore, it confronts the supervisor with the question of how to effectively control these products, and may create consumer protection and value concerns.

**4. Community-based model.** Mutual models carry a high potential for risk, especially in community-based insurance structures that are not regulated and are run by people without sufficient capacity. In West Africa and India, these have grown to a significant size, and have the potential to generate many problems for supervisors, for example when their premiums are not calculated correctly and coverage is unsuitable.

**Q&A: How do informal operators in the distribution chain impact on consumer protection concerns?**

*The experts' answer:* While risk carriers have to be supervised, distribution partners can be informal operators (e.g. community groups or associations), which often have more trust with their members than the insurance company. This allows informal groups to access supervised and underwritten insurance products.

**How do regulators respond to informal insurance providers?**

*The experts' answer:* The key aspect to consider in relation to informal insurance providers is that of scale. Below a certain size, these providers are too small for insurance regulators to worry about them. In a number of places, for example the Philippines, informal providers have become very large, and carry potential risk to clients and even the market. The Philippines responded a number of years ago by instituting Mutual Benefit Association legislation, which allows these formerly informal providers a pathway to legitimacy (for example, run by microfinance institutions). They are now supervised and face requirements such as improved client protection. Rural banks were offering microinsurance on their own, and the Insurance Commission some years ago announced that this would no longer be legal. They were required to gain insurance company licenses, or to work with an insurance company and act as agents for an insurance company. The crucial take-away from this example is the importance of size. In India, informal insurance is widespread but has not been addressed by the insurance supervisor because of the massive capacity requirements to formally supervise the sector.

Supervisors also need to take into account the dynamic nature of the market in defining and evolving their regulatory approach, cognisant of the current stage of development in their domestic market. It is clear from the market progression outlined in Figure 1 that the key to achieving a well-developed market lies in distribution. Initially, the market will use channels such as MFIs, before moving on to cooperatives, unions, and then to any sort of aggregator of low-income households. This expansion of distribution channels means that regulators' perspectives on managing risks in the market have to evolve too.

As also indicated in Figure 1, the goal in market development is to achieve quantity (volume), while also providing quality (value) to clients. As markets develop, both of these goals are addressed. Regulators should enable the market to grow to large quantities and high quality, by giving both consumers and insurers the chance to acquaint themselves with microinsurance and its value proposition.

The following three case studies each illustrate how the supervisory approach impacts market development:

- Hollard emphasised that, because microinsurance is such a low-margin, high-volume business, the impact of regulatory compliance on the cost of doing business and acquiring clients can be substantial and increases prices to the end client. As the provision of advice triggers additional regulatory requirements in South Africa, Hollard is largely opting for a non-advice model. While credit-life insurance has traditionally seen super-profits due to low acquisition costs for bundled products and low claims ratios, there is price capping regulation in the pipeline to lower profits.
- Mexico does not have regulations specifically applying to intermediaries. This has meant that ATERNA has had to adapt its operations to fit into the traditional insurance regulatory mould. ATERNA regards diversifying microinsurance products beyond life as the key challenge for Latin America in the coming years. This will require suitable regulations that are sensitive to the difference between microinsurance and traditional insurance. Microinsurance expansion in Latin America is furthermore slowed because of the heterogeneity of various countries' regulatory approaches, implying that companies have to adapt their ways of working despite the similarities in client needs.
- In Ghana, microinsurance-specific regulation is underway. Star Microinsurance anticipates that this will allow the market to grow more quickly and on a more sustainable footing. Amongst other things, this regulatory setup will ensure suitable consumer protection, so that the client receives the product as expected, and will ensure that microinsurance companies are prudentially viable.

#### **Q&A: What statistical models are the most relevant for microinsurance sustainability and supervision?**

*The experts' answer.* There is a paper published by the Microinsurance Network ("[Key Performance Indicators for Microinsurance](#)" – the KPI Handbook), which lists a number of measures appropriate for microinsurance. They include capital levels, claims ratios, admin cost ratios, time to claim payment, all of which are important to track in microinsurance. The CIMA region in West Africa has committed to using these measures, as has Ghana, the Philippines, and others. The first step is to get insurance companies to segregate their microinsurance data specifically – a common behaviour is to lump the data with other product lines, such as traditional life. The KPI Handbook does not contain benchmarks. The Microinsurance Centre in the Microinsurance Network is now doing tri-annual studies in the various regions (Latin America data collection has just finished), so we have data from 2005, 2008, 2011, and now 2014. This should allow benchmarks for insurance companies to be developed.

#### **Further useful background reading on this topic**

- [IAIS Application paper on Regulation and Supervision Supporting Inclusive Insurance Markets:](#) Deals with proportional application of ICPs and provides guidance regarding the particularities of new business models in microinsurance
- The A2ii [Synthesis note](#) on business models, risks and regulatory responses based on Diagnostics of 25 countries
- [Achieving scale and efficiency in microinsurance through retail and banking correspondents](#) Impact Insurance PAPER No. 37, December 2014



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