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The Bulletin

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Welcome to The Bulletin, our quarterly newsletter covering U Bank's innovation and research work.

With this newsletter we seek to highlight our own work as well as deep-dive into global and local financial sector trends and developments. It is meant to be an exploration of the various sectors and topics that intersect with banking, microfinance, financial inclusion and sustainable development in an effort to encourage dialogue on the key challenges and opportunities; while working on pushing forward the frontier when it comes to ensuring financial access & coverage.

In our latest issue we are discussing micro-insurance and its role as a safety net and financial inclusion tool, what has been happening to push for its greater adoption especially within the microfinance sector and what MFBs can be doing to improve the industry stats. In our special feature we also talk about another type of insurance as a risk mitigation tool – crop insurance.

We welcome thoughts and feedback, as well as suggestions on topics to cover in future issues. Our hope with this newsletter is to build a community of engaged readers interested in sincere discourse about the challenges and opportunities we face as a sector, the disruptions (technological or otherwise) required to serve our customers better and build an inclusive Pakistan. Wishing you all are staying safe and healthy.

Yours sincerely,
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A Study of the Role of Microinsurance when it comes to Financial Inclusion and How the Microfinance Industry Can Push for Greater Adoption

Often, some degree of onus is placed on the poor for their vulnerable economic, social and financial standing in society. However, it is important to look at the other side of this argument and consider poverty as the consequence of an unequal system rather than a cause and understand that certain risks disproportionately impact the poor, which is what lands them in this difficult position. Microfinance takes this world view and attempts to cater to the population which is left unserved by traditional financial institutions. Within microfinance, microinsurance in particular aims to mitigate risks for low-income individuals - in exchange for regular premium payments - through offering affordable insurance products. This piece aims to explore micro insurance i.e. an important albeit often neglected component of microfinance.

While traditionally microfinance has been looked at as just the provision of microcredit, this idea is now considered outdated. Microfinance today is meant to encompass much more, and both microsavings and microinsurance are essential components of the microfinance ecosystem. Research has proven that households availing microcredit in combination with microinsurance derive significant gains in terms of welfare improvement, as compared to households utilising just microcredit. This is because while microcredit can be essential to poverty reduction, it is rendered useless if poverty risks are not protected against. Furthermore, microinsurance directly contributes to microfinance's broader goal of financial inclusion as it offers financial services in the form of risk protection - to households which have limited income access and low-valued assets - through which they are able to protect their life, health and assets.

The Microinsurance Market

Even though the advantages of microinsurance as a component of microfinance are evident, the uptake has been slow. The International Labour Organization (ILO) estimates that only 3 percent of low-income people in the world's 100 poorest countries have a microinsurance product, therefore leaving approximately two billion people underserved. The slow uptake of microinsurance is due to a mismatch between demand and supply side factors. In low income markets, the successful performance of microinsurance should ideally be driven by a balanced integration of supply and demand factors in offering the service. Currently, the insurance industry is predominantly supply driven, with lesser focus on understanding the insurance needs and preferences of low-income people. Thus, there is an oversupply, met with low uptake of services.

Problem Areas

Demand side	Supply side
Insurance awareness, knowledge and skills	Product design
Liquidity constraints	Market positioning
Access to other risk protection methods	Perceived reputation
Client value proposition	Insurance exclusions
Lack of trust	Effectively understanding the client needs

Why managing insurance is difficult for MFBs

Microinsurance is offered through various distribution channels, among which are microfinance banks (MFBs). The mechanism of distribution for MFBs is the insurance company-bank partnership model which is the sale of insurance products through the bank's branch network. There are crucial differences that separate micro insurance from microcredit and microsavings which make the administration of microinsurance in MFBs complicated as;

1. The operations and functionality of insurance are far more complicated than credit and savings.
2. Insurance is an intangible product without immediate financial gain, and households are unwilling to invest in a product with no tangible results.
3. Microinsurance is characterized by reverse risk e.g. with microcredit the customer has to prove his credit worthiness to the lender, whereas in microinsurance the customer has to trust that the insurer will be reliable and pay out claims when needed.
4. There is a culture clash between MFB clients and the insurance company. The former are concentrated in rural areas and can only afford small premiums and are unlikely to understand exclusions (particular conditions or occurrences that are not covered by an insurance policy). Insurance companies on the other hand are concerned with charging as high premiums as possible as this is their main revenue source. In addition they tend to reduce their risk by defining exclusions.

https://blogs.worldbank.org/developmenttalk/no-70-world-s-poor-aren-t-women-doesn-t-mean-poverty-isn-t-sexist

Snapshot: Microinsurance and women

As microinsurance exists to reduce vulnerability for lower income individuals, none should be prioritized more than women. This is because while concrete data on the gender neutrality of poverty does not exist presently, anecdotal evidence suggests that the impact of poverty on women may be more severe than their male counterparts. Therefore for women in developing countries, microinsurance is an important safety net and a vital tool to protect their households against risk. This is especially true considering that traditional avenues through which poor women manage their risk can be harmful. For instance, they manage risk through selling assets, relying on their partner, putting children out of school to earn income etc. which can be helpful in the short-term but will perpetuate a cycle of poverty in the long-run. Furthermore, women have different needs, especially with relation to health insurance, which are often not met by standard insurance policies.

Snapshot: Microinsurance in the pandemic

Covid-19 has highlighted the fragility of developing economies, due to which it has been termed a 'developing country pandemic'. The United Nations estimates that income losses in developing countries are expected to exceed $220 billion, where 55% of the population has no access to social protection. Furthermore, there is risk of higher infectivity as up to 75% of people in the least developed countries have lack of access to soap and water.

The first line of defense for most governments across the world has been to impose nation-wide lockdowns. This strategy is not truly applicable to low-income groups – who face a dual issue as mostly their jobs cannot be done remotely and they are more likely not insured for healthcare. This raises the important question of whether microinsurance has been able to offer protection to its intended audience in these circumstances. Unfortunately, there is not much evidence that the global microfinance community has fully woken up to the extent of the crisis. A similar pattern is seen in Pakistan as the Pakistan Microfinance Network (PMN) estimates that from pandemic's inception (late 2019) to during pandemic (2021), the overall number of country-wide insurance policy holders decreased with the number falling from 8.47 million in Q4, 2019 to 7.6 million people in Q1, 2021.

Recommendations

01 - Microinsurance Products

In view of these realities, it's critical that products are designed and updated with the end-customer in mind.

Tailored to client needs

Creating a successful insurance product will ultimately depend on understanding the market it is designed to serve. Often, insurance companies are guilty of introducing scaled-down version of traditional insurance policies to microinsurance customers, even though the needs of the two are vastly different. Lower income clients are exposed to specific risks that disproportionately, impact them e.g. natural disasters, conflict, accidents and infectious diseases, which is why products designed for them should be made to address the risks that they face.

Affordable

Microinsurance is a low-ticket business that requires high volumes in order to become sustainable. However, the costs of issuing large volumes of small policies is high, which is why uptake of insurance at market prices is extremely low. One possible solution to this problem is customizing polices in such a way that individual policies are designed for those who are able to afford it, while consumers who cannot afford a policy on their own are able to avail it as a group and hence reduce cost per person. Another way insurance policies can be made affordable is if support is offered by governments in the form of subsidies.

Offer financial education for customers

Given that suitable insurance products are available, consumer education initiatives can help low-income individuals make better risk management choices and drastically increase product uptake. Appropriate delivery channels for disseminating should be decided as per local context. These campaigns can be delivered through individual insurance companies or through partnerships such as insurance associations, and public-private partnerships. For instance in Kenya, the Micro Insurance Academy (MAA) utilizes the most popular medium i.e. TV and has produced movies and interactive games to educate consumers and increase insurance uptake. In the local context a delivery channel that has proven to be effective is the lady health worker network.

As simple as possible

Extensive and complicated claim processes are a huge issue for low-income households who face risks and shocks such as natural disasters without any warning. Most insurance companies either take too long to disburse these claims or have pre-defined exclusions. As a work-around, there should be no exclusions for pre-existing conditions, and in case exclusions cannot be avoided they should be explained in detail to the clients in local terms which are understandable to them.

Offer viable business model to insurance provider

Provision of microinsurace is a win-win situation for insurance companies as well as for low-income people. For the former it unlocks an entire traditionally untapped market segment of the informal market. It is a viable business model as it leverages economies of scale through large volumes of small policies. However, setting premium prices that still remain profitable for insurance companies can be complex. One intriguing way to deal with this is to effectively bundle different microfinance product offerings. Bundling microfinance products into one packaged sale can be a cost effective distribution strategy and if paired the right way can also increase value for clients. An experiment in Columbia with farmers involved bundling a loan with a crop microinsurance product. The evidence suggested that bundling led to better understanding of insurance and higher coverage purchased. However, bundling needs to be done with caution as there is a risk of clients feeling overwhelmed and pressurized by two offerings.

02 - Gender sensitive microinsurance

Provision of gender-sensitive microinsurance e.g. pregnancy coverage, or products that women value more should be ensured e.g. a common response to the death of a parent in low-income households is a child's exit from school – to combat this a Colombian insurance company 'La Equidad' offered a microinsurance program to protect children after a parents' death – paying monthly benefits that can only be used toward education for two years, including a monthly payout for food. In vulnerable households, since women are predominantly the care takers, home makers and household managers, they are more likely to purchase such a policy to ensure their children's wellbeing.

Another method to increase insurance uptake among women is to increase outreach through building trust in communities. The majority of insurance company sales agents are men, and women in rural areas tend to be uncomfortable interacting with them. Therefore, in order to reach this customer segment, insurance companies can nominate and hire women champions or influencers from local communities to increase local women's knowledge of insurance and potential benefits it can offer them in protection against risk. This will serve the dual purpose of increasing employment in local areas as well as increasing their protection against risk. Considering the bigger picture, the insurance industry can flourish by promoting gender diversity within insurance companies at all levels i.e. board, management and field, which will lead to better understanding, targeting and serving female clientele. A good model of public-private partnerships to achieve this goal could be to leverage the lady health workers force to be able to sell microinsurance products as well.

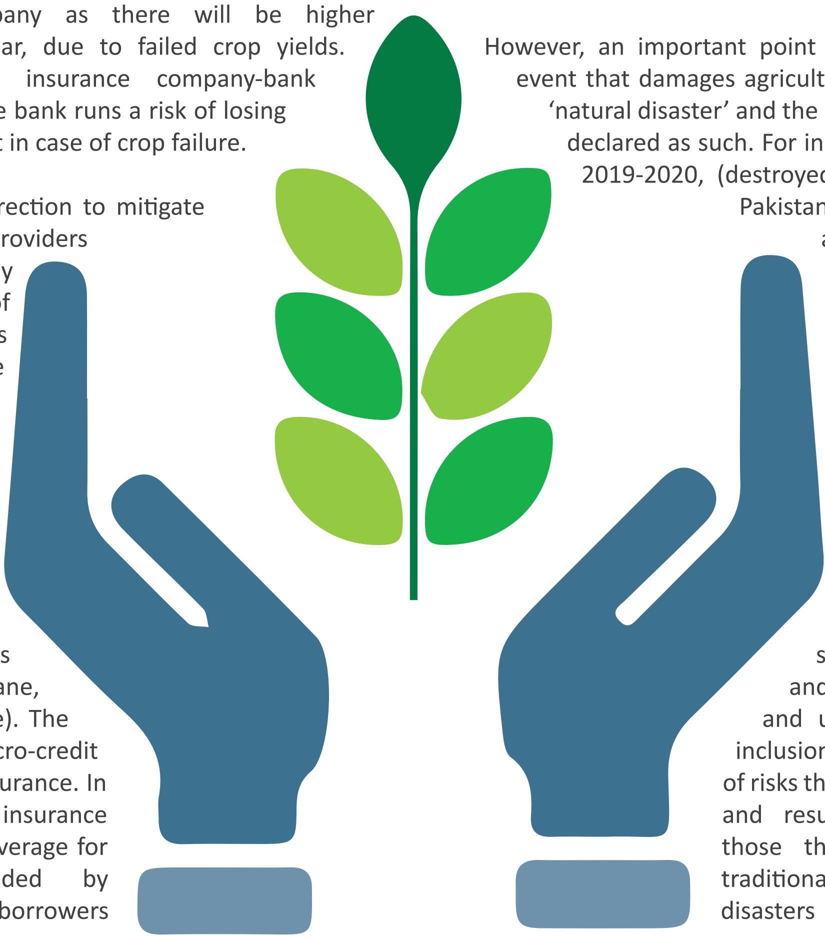
03 - Innovation in insurance

Insurance for the poor in Covid-19 is the need of the hour, however, it has proven difficult with strict lockdowns across the globe. An emerging and innovative solution to this problem is the digital delivery of insurance products. Not only this, but also if insurance is delivered through modern technology, there will be significant reductions in management and transactional costs – and therefore make it as cost-effective for the low-income population as possible. Otherwise, most of the premium amount would be allocated to covering administration, distribution expenses and only an insignificant amount would be allocated to paying claims. This has also been dubbed 'InsurTech' or Insurance Technology i.e. any technology used by an insurance company to increase the efficiency of its operations. Perhaps the most emerging InsurTech is Mobile Micro Insurance (MMI) the provision of which is through Mobile Network Operators (MNOs). The substantial penetration of mobile phones in Pakistan offers an ideal medium to increase the microinsured via telecom providers. To this end various innovative models and partnerships have been established. A relevant case in current circumstances is seen with 'Telenor Pakistan' who have launched the 'Corona Health Services' online insurance product. This insurance can be claimed from the ease of your mobile phone via premium payment through the USSD menu or 'Easy Paisa' mobile application. It offers corona tele-doctor facility, corona test coverage, and hospitalization fee for Covid positive patient. Recently, another step in the right direction taken in Pakistan in (June 2021) by the Securities and Exchange Commission of Pakistan (SECP) as part of its agenda to promote digital financial services has been provision of draft amendments to the Insurance Rules, which includes digital provision of insurance. The aim is to promote financial inclusion, cost effectiveness, accessibility and broaden product spectrum for the customer base.

Crop insurance – understanding and mitigating providers risk.

Nearly half of Pakistan's labor force is employed in the agriculture sector, therefore it is a major source of earning for the economy. Moreover, majority of people making a living from the agriculture sector or occupations linked to agriculture are poor and therefore vulnerable to risk. In order to mitigate this, various agri-microinsurance products have been designed, but the market is dominated by crop insurance. However, the risk is not limited to the demand side, in fact, offering insurance to small-scale crop farmers is risky for insurance providers as insurance can change farmer's incentives and therefore their behavior. For instance, when farmers know that they are likely to receive a payout if their crop fails, they might take fewer steps to mitigate risk of failure or even choose to grow crops of lower quality with inferior seed quality or irrigation techniques. If this becomes a behavioral norm, this will prove costly for the insurance company as there will be higher claim/payouts per year, due to failed crop yields. Furthermore, in an insurance company-bank partnership model, the bank runs a risk of losing out on loan repayment in case of crop failure.

A step in the right direction to mitigate risks of crop loss to providers was taken in 2008 by the State Bank of Pakistan (SBP) in its 'Crop Loan Insurance Framework/Scheme'. Currently, 48 financial institutions are financing and 15 insurance companies are providing insurance coverage for Pakistan's five major cash crops (wheat, sugarcane, cotton, rice and maize). The framework covers micro-credit bundled with microinsurance. In this mechanism, insurance companies provide coverage for crop loans extended by banks/institutions to borrowers for the purpose of sowing, cultivating and harvesting of the five major crops. In exchange for a percentage of loan amount extended to borrower – in case of crop failure - the insurance company pays back the loan amount to the bank. Therefore, the bank is not at risk of loss of income from missed loan recovery and the customer is not liable to pay back loan amount. Furthermore, in order to avoid the behavioral issue of farmers utilizing cheaper techniques for lowering cost and thus experiencing failed yield, the SBP has explicitly only made this scheme applicable in case of occurrence of natural disasters. Hence ensuring that risk for all parties i.e. not only insurance providers, but also consumers is covered, i.e. for customer - risk of loan repayment; for bank – risk of loan recovery; for insurance company - risk of farmer's behavior change and resultant high claim payout for the year.



However, an important point of contention is whether an event that damages agriculture significantly classifies as a 'natural disaster' and the urgency with which an event is declared as such. For instance, in the locust attacks of 2019-2020, (destroyed crops in 60 districts across Pakistan) despite the first swarms arriving in Pakistan in mid-2019, it took the government a year to declare this as a national emergency in 2020. By this time, the damage had already been done, and banks, insurance companies and farmers alike could not protect their risk due to this crisis not falling under the SBP's scheme. In the future, the government and the SBP should remain more vigilant and allow flexibility to exceptional and unforeseen circumstances for inclusion in this scheme and coverage of risks that directly threaten agriculture and resultantly food security; even those that do not fall under the traditional classification of natural disasters