NEWSSTAND

Microinsurance Going Macro, Especially in Latin America

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In the days after the January earthquake in Haiti, some staggering numbers were reported in the media. There was approximately $14 billion in property damage, most of which occurred in Port-au-Prince, the largest city in Haiti, and 250,000 people were killed, either directly or indirectly, by the earthquake. The total amount of insured losses, however, was expected to be less than $20 million, or only 1% of the total loss. By comparison, more than one-third of the losses suffered in Hurricane Katrina were insured.

Even before the earthquake, Haiti was one of the world's poorest nations, with a gross domestic product of about $2 per person, per day and approximately 80% of Haitians living in poverty. Because of this, the insurance market in Haiti never developed as it has in wealthier nations; Haitians rarely purchased life insurance or coverage for their personal belongings or business assets and few, if any, purchased business interruption insurance or other insurance to protect their income stream.

Haiti was always a prime candidate for microinsurance and now, after the devastating earthquake, the need for such cover is magnified both in Haiti and other less-developed countries. Microinsurance, somewhat analogous to but less understood than microfinance, refers to insurance products characterized by very low premium and/or low coverage limits. Other than the size of the policy, microinsurance operates in very similar manners to standard insurance sold throughout the world. Outside of public and private foreign aid, each fraught with their own problems and inefficiencies, microinsurance may be one of the only ways to improve the ability of low-income populations in underdeveloped nations to recover from natural and financial disasters.

Microinsurance Today

During the last few years, several international insurers have begun to sell microinsurance products, very often through a philanthropic arm of the corporate entity. They are not, however, the only providers of microinsurance, as there are many non-governmental organizations, community-based organizations and informal microfinance groups that sell microinsurance products. Microinsurers are writing several types of insurance, including funeral product insurance, agriculture insurance, health insurance and life insurance.

There are some notable differences between microinsurance and standard insurance. Microinsurance policies are generally written in simple language and have few, if any, exclusions. Microinsurers generally attempt to simplify the claims handling process so that there are rarely disputes or complex investigations before claims are paid. Premiums are often paid in sporadic installments because of the potentially volatile cash-flow of the insureds. Microinsurance products are often sold in locations where they are guaranteed to garner the attention of the market. For example, some supermarkets in South Africa sell funeral insurance and insureds can pay the first premium as they pay for their meat and produce.

A number of international insurers, including Chartis, Zurich, Allianz and Swiss Re, sell microinsurance products in various parts of the world. According to various reports, these insurers have created microinsurance products to give the companies a broader platform in the various markets and in order to be the primary provider of insurance to the individual microinsureds as they move into the middle class and begin to purchase more traditional insurance products. It is too early to tell, however, whether this strategy is proving successful and whether microinsurance itself can become a profitable business line.

Latin America – Hundreds of Millions of Microinsureds?

There is a market, and a need, for microinsurance in hundreds of poor, underinsured nations across the world. One region, however, provides a microcosm of recent developments in the microinsurance world. In Latin America, approximately one-fourth of Latin America's 569 million residents live on less than $2 per day, and many Latin Americans do not have any type of insurance. Recent trends involving microinsurance, however, may change that in the near future.

Earlier this year, the International Development Bank approved a $3.3 million loan to the Federacion Interamericana de Expresas de Seguros (FIDES) to increase the use of microinsurance in Latin America. Ten different companies will participate in the project with the goal of designing and commercializing life, casualty and health microinsurance products. Approximately one-sixth of that amount will be dedicated to Mexico, where the potential microinsurance market is estimated to consist of approximately 60 million people.

Late last year, Peru's insurance regulator, the Superintendencia de Banca, Seguros y AFP, announced that it had completed its drafting of new proposed regulations regarding microinsurance, which were then opened for comment. Armando Caceres, the Adjunct Superintendent of Insurance, reportedly stated that "the intention [of the project] is to generate a more flexible regulatory structure that permits the spreading of group risks, for example, by the general public without cost restrictions." Among other things, the new regulations remove maximum costs restrictions for microinsurance and permit additional modes of distribution for microinsurance products. It is hoped that the new regulations will result in millions more Peruvians purchasing microinsurance beyond the 600,000 that already own such policies.

Additionally, we are likely to see new microinsurance legislation in Brazil during the next few months as the government has prioritized its passage. A recent study indicated that there could be between 22 and 33 million new Brazilian microinsurance customers. According to the study, only 30% of Brazil's households currently have insurance, with the major reasons cited for not having insurance being cost, distrust of the concept of insurance and lack of a philosophy of saving.

Given the existing need, and the commitment of local regulators and international companies to the development of the sector, the sale of microinsurance products is expected to grow in other Latin American nations as well during the next few years.

Future Developments

Microinsurance currently exists largely as a charitable and/or marketing tool. For that reality to ever change, and for microinsurance to truly become a profitable line of business for insurers, a few changes must take place, including the following: (1) as the reach of microinsurance products expands, the overall premium and risk volume will grow exponentially; (2) this will likely lead to a developing sophistication of the microinsurance industry, partly because more global insurers will be issuing microinsurance products; (3) these global insurers will need to begin treating microinsurance as more akin to other types of insurance that they are writing, finding ways to develop more sophisticated underwriting, actuarial analysis, claims and other functions despite the small sizes of individual policies; (4) as more international insurers issue microinsurance, they will need to begin pooling the microinsurance risks and ceding them to reinsurers just as they cede other risks, something largely absent in the current microinsurance market.

If these changes come to pass, the microinsurance market will eventually operate more like the standard insurance market, and “microinsurance” will simply become another branch of insurance companies’ “insurance” operations. If these changes do not occur, microinsurance will remain a largely charitable endeavor, greatly reducing the possibility that it will ever expand to an extent sufficient to fund significant recovery from a disaster such as the earthquake in Haiti.