How Inclusive Insurance Supports Development

The Inclusive Insurance Factsheet Series, developed by the GIZ Sector Programme "Global Initiative for Access to Insurance", highlights how insurance as a tool contributes towards meeting the needs of vulnerable individuals, households and micro, small and medium-sized enterprises (MSMEs) in developing countries and emerging economies. It furthermore accentuates insurance's role in helping achieve goals of the following development agendas: sustainable development and poverty alleviation, gender and women's empowerment, agricultural development and food security, MSME development, and climate change mitigation and adaptation.

This guiding factsheet illustrates the main aspects of inclusive insurance and serves as an introduction to the Inclusive Insurance Factsheet Series. It explains how insurance can strengthen the resilience of individuals and enterprises as well as protect the livelihoods of people in general. It further elaborates on lessons learnt from a decade of inclusive insurance market development and provides examples of emerging insurance services. Lastly, the factsheet provides options on how development cooperation agencies can support the development of inclusive insurance markets.

1. Risks mitigation and insurance

The vulnerable lack adequate protection strategies. Many people in developing countries and emerging economies are not adequately protected against the variety of risks they face in their daily lives, including personal and asset related risks. Among the main risks the poor face are the loss of a family member, an accident, crop or animal loss, a critical health incident, devastating consequences from natural disasters and weather events. They lack effective risk management strategies that can help prevent shock or that can help mitigate the financial consequences of a shock.[1]

Traditional risk mitigation strategies are often deficient. In the absence of insurance, people resort to sub-optimal risk coping strategies, including: selling productive assets, reducing or stopping business investments and household spending on food or schooling, depleting savings or taking out additional loans with often high interest.[2] These strategies are often more costly, generally only cover part of the loss and tend to contribute to inter-generational transmission of poverty. Insurance can reduce the dependence on these deficient strategies.

Insurance markets in developing and emerging economies face numerous challenges. They are characterised by limitations at all levels of the financial sector:

» Macro level: inappropriate policy, regulatory and supervisory frameworks that do not protect the poor and vulnerable or that discourage insurers to serve them, e.g. by not allowing innovative distribution channels.

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» Meso level: insufficient support infrastructure with lack of risk data (e.g. weather and mortality risk tables); and lack of technology service providers.

» Micro level: traditional distribution channels that are not reaching out to the poor and vulnerable; insurance products that are not adapted to the needs of the vulnerable and poor; strikingly low levels of consumer awareness regarding insurance; and low levels of trust in insurance products and providers.[3]

Microinsurance[4] coverage has increased considerably. The International Association of Insurance Supervisors (IAIS) defines microinsurance as insurance that is accessed by low-income populations but run in accordance with generally accepted insurance practices, which entails that the risk insured under a microinsurance policy is funded by premiums. It was estimated that more than 600 million people worldwide would be covered by microinsurance after two decades of microinsurance market development.[5] This figure is even higher if other insurance services such as index-based insurance or mobile-phone based insurance are considered, though, there is no global data on this. However, these coverages only account for a small fraction of those that are lacking formal insurance coverages globally, which is estimated at 4 billion people.[6] Inclusive insurance covers a much wider group, i.e. the unserved more generally.[7]

2. Formal insurance for livelihood and enterprise promotion and protection

Risks materialize in various forms, causing damage to the lives and health of individuals, to households or business assets, or to public infrastructure. The timing as well as the severity of the shock is uncertain. Insurance provides a mechanism to help mitigate personal and enterprise-related risks and, thus, contributes to improved livelihoods and sustained development. Insurance fulfils the following functions for people, enterprises and financial systems and governments:

» **From a livelihood perspective, insurance supports resilience:** Insurance can mitigate the financial losses the policyholders, family members or businesses are suffering after a risk event. It helps to recover faster once a shock has occurred. By receiving an insurance pay-out, they are not forced to rely on coping strategies such as depleting savings, selling assets, or abstaining from spending for health, food, education or business operations. Insurance offers an alternative to these strategies, which often have other negative repercussions on the household or business in the medium term. Policyholders and insured experience "peace of mind" since they know they are prepared for the case of a risk event. Moreover, insurance companies price the risk according to occurrence and severity, thereby nudging people's thinking to better assess their individual risk profile and also, induce taking preventive measures such as placing the stove outside the house, having fire extinguishers or using drought-resistant seeds. Inclusive insurance approaches enable people to manage the financial burden of unexpected risk events and life cycle events more efficiently. This helps prevent people from slipping (back) into poverty.

» **From an entrepreneurial perspective, insurance fosters economic activities:** Low-income people and MSMEs are often excluded from the formal financial sector. Receiving a loan from a financial institution for a business is often challenging. Insurance can foster economic activities in two ways: (i) it can spur investments in agriculture or in MSMEs. For example, banks or leasing companies may be more willing to provide loans for investment when the productive assets, entrepreneur and employees are protected by insurance; and (ii) insurance can increase the resilience of farms, enterprises along the value chain and MSMEs. In summary, an insurance pay-out after a shock can help business owners to revitalize their businesses more quickly and help them to refrain from economically costly risk coping strategies such as selling productive assets.

» **From a developmental perspective, insurance sustains development efforts:** Insurance can sustain development efforts in case of a crisis which the person, the enterprise, the community or the government faces. Without insurance, one single crisis such as a death, illness or accident in the family, or a disaster such as a fire, flood or drought can lead to severe financial consequences and eliminate the gains of many years. In these circumstances, the achievements of the individual as well as the community can be ruined.[8] Ideally, insurance enables people and enterprises to consolidate the development efforts of their families and businesses, and helps them, as well as communities and governments, to mitigate the financial consequences of a shock or disaster. The advantages of insurance as part of an integrated risk management approach are key from a development perspective: It is precisely the combination of insurance with risk awareness measures, incentive effects for risk reduction through preventive measures, such as the development of early warning systems, the possibility of developing contingency plans, etc. that creates positive effects in terms of resilience and the management of the financial burden of catastrophes.

Distinguishing direct and indirect modalities for insurance protection. Policyholders of direct insurance are at the micro level individuals (e.g. farmers), households, labourers, or at the meso level companies such as financial institutions, cooperatives, MFIs or agribusinesses. Policies are often sold at the local level and retailed through different channels, including microfinance institutions. Direct insurance can catalyse opportunities that increase productivity, e.g. supporting to increase savings as well as investments. In indirect insurance schemes, policyholders are governments or municipalities. Indirect insurance can be implemented on a macro level, insuring national or local governments. Pay-outs to those affected by extreme weather events are intermediated by the policyholders. The final target group thus benefits indirectly, e.g. from food distribution financed by insurance pay-outs following a drought, or from the timely reconstruction of infrastructure in affected regions. Indirect insurance thus reaches a large number of people within a short period of time, e.g. by channelling emergency funds through existing social protection programs.

3. Lessons from a decade of inclusive insurance market development

The focus has shifted from supporting the development of microinsurance products to creating inclusive insurance markets. The concept of microinsurance has been extended to "Inclusive Insurance", which now also includes people who have a higher income but no access to adequate insurance. This concept recognizes that even non-poor households with low incomes can be thrown back into poverty without insurance cover, this might be the case for vulnerable groups which are particularly exposed to climate risks. They may fall below the poverty line again due to extreme weather events. Both direct insurance schemes, and indirect programmes can reach out to them. In inclusive insurance, the focus is on all vulnerable households and enterprises that are un- or underinsured.[9] This covers a wide variety of person- and asset-related risks for various types of policyholders and beneficiaries. It also encompasses the idea of a consumer-centric approach offering quality insurance protection that is adapted to the needs of households, businesses and governments. The following lessons have emerged from two decades of promoting micro, and more recently, inclusive insurance:

» **A holistic financial systems and market development approach:**[10] Fostering the provision of inclusive insurance requires a holistic approach in financial systems development that supports all three levels: macro (enabling policy, regulatory and supervisory environment), meso (support infrastructure) and micro (insurance providers and clients). A market development approach means starting with a sound diagnostic, building the capacities of all public and private stakeholders and measuring achievements to leverage the opportunities of making the insurance market more inclusive in the longer term. Integrating insurance in national strategies and measuring improvements along performance indicators is also key for effective market development.

» **Insurance as part of an integrated risk management approach:** To be most effective insurance should be part of an integrated risk management approach. This entails that consumers are sensitised to the material risks they are facing and how they can reduce the probability and/or severity of these risks. Insurance addresses the residual risks that remain even when preventive actions have been taken.

» **Insurance as instrument for contributing to a variety of development agendas:** The protection of people and assets is a key enabler of sustainable development. There is potential to make greater use of inclusive insurance to deliver on a variety of development agendas, including private sector development and employment, agricultural development, women's economic empowerment, climate change adaptation and green investments. Against this background, the contribution of insurance to the sustainable development goals (SDGs) is increasingly recognized at national and global levels.[11]

» **Insurance provision should be sustainable and achieve scale.** Focusing on insurance schemes that are scalable and have the potential to reach a critical number of consumers is a prerequisite to establishing sustainable and inclusive insurance markets. Smart subsidies[12] can be a tool to reach scale if they are designed to address a market failure or equity concern. To prevent market distortion and to ensure the sustainability of the insurance scheme, subsidies should always come with a clear exit strategy or long-term financing strategy in place.

» **Consumer-centric insurance coverages:** The achievements of the past years in microinsurance have sensitised policymakers, insurance supervisors, providers (insurers and distribution channels) and development agencies to the idea that insurance has to provide value for clients. Consumer value in insurance is measured by performance ratios such as the renewal rate of an insurance policy that shows a follow-on purchase, or the claims rate that shows that pay-outs are being made. Hence, the sheer number of insurance coverages is not the only indicator that should be used to prove inclusive insurance market development; instead, qualitative indicators will allow researchers and supervisors to measure the extent to which consumers understand the insurance products and their ability to make use of them.

4. Advise for development cooperation agencies

Development cooperation agencies should support insurance solutions for the vulnerable and poor. Insurance activities can be integrated into financial systems projects as well as a variety of other development projects. Development projects would benefit from using insurance to protect the gains of their work, as well as their target groups, against a variety of insurable risks such as health-related risks (accidents, hospitalisation), life cycle risks (old age, child birth, death), business-related risks (fire, transport, employee group insurance, e.g. for accidents), or natural disaster-related risks (drought, flooding, storms, earthquakes).

Key entry points for development cooperation are diagnostic studies, implementation support for providers and advisory services at the policy and regulatory level.

Inclusive insurance diagnostic studies look at the financial sector and beyond. The main purpose of such a diagnostic study is to assess the current supply and demand, as well as the enabling environment of inclusive insurance in the target country. Therefore, this study should assess the following aspects:

» **Enabling Environment:** How can the regulatory and supervisory framework be changed to enable inclusive insurance approaches? Which regulations need to be adjusted to allow for innovative business approaches while ensuring consumer protection?[13] Into which national strategies can insurance be integrated (e.g. financial sector strategy, financial education strategy, private sector development strategy)?

» **Service Providers:** What support infrastructure is required? Are associations and service providers (e.g. training institutes, actuaries, and technology providers) prepared for supporting inclusive insurance? What capacity building measures do they need?

» **Insurers and Distributors:** Are current offerings (products, distribution avenues) suitable for the different segments of the market that have no access to formal insurance? What capacity development measures are required to develop innovative products and business models (e.g. small ticket sizes, flexible premium payment, and innovative distribution partnerships)?

» **Consumers:** What risk mitigation or coping measures are used currently? What insurance literacy measures are required to enable up-take and consumer protection? What types of products do the poor and vulnerable demand? How can insurance be provided in a gender-sensitive way?[14]

Implementation support for valuable inclusive insurance:

» **Insurers** should be encouraged to address MSMEs as consumer segments, e.g. by implementing demand research, developing adequate products, innovating with new distribution avenues and contributing to financial education campaigns with a focus on MSMEs.

» **Powerful distributers, such as banks and FinTechs, or agro dealers** should be encouraged to enter into partnerships with insurers and develop strategies to provide insurance services that are adapted to the demands of the previously uninsured.

» **Governments** of partner countries should be encouraged to promote inclusive insurance as part of financial sector development, and within other policies. They should also foster publically available risk data as well as relevant financial literacy measures. Policy and regulatory frameworks should be adjusted where necessary, e.g. considering low levels of financial and insurance literacy in consumer protection regulation or improving regulation that facilitates distribution.

In summary, development cooperation should support the insurance industry, its business partners and governments in their efforts to build partnerships and help promoting inclusive insurance markets. This can be achieved by providing support for public goods such as market information, or risk data, by promoting knowledge via global, regional and national level dialogues on the topic, by supporting product development and piloting their roll-out, by supporting capacity building for the various stakeholders, and by providing capital for insurance companies.

Endnotes

1 **Risk management strategies** can be classified as prevention, mitigation, and coping strategies. Insurance belongs to mitigation strategies. (i) **Prevention strategies** are applied before an event and reduce the probability of an adverse shock occurring. They include investment in irrigation infrastructure that reduces risk of droughts or engagement in hygiene and other disease prevention activities. (ii) **Mitigation strategies** are also implemented before a shock and reduce the potential impact if the risks were to occur, e.g. through diversification of livelihood strategies or insurance. Finally, (iii) **coping strategies** are used to deal with the effects once the risk has occurred and include dissaving, borrowing, or relying on public or private transfers, e.g. reciprocity based schemes and social welfare programmes (see World Bank (2013) Social Risk Management: The World Bank's Approach to Social Protection in a Globalising World).

2 Munich Re Foundation, ILO, Microinsurance Network (2012) Protecting the poor: A microinsurance compendium, Vol. II. http://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_175786.pdf.

3 GIZ (2015) Advisory Service Insurance https://www.giz.de/de/downloads/giz2015-en-insurance.pdf.

4 The term **inclusive insurance** covers a broader target group than microinsurance. The IAIS defines inclusive insurance denoting all insurance products aimed at the excluded or underserved market, rather than just those aimed at the poor. In developing countries, the majority of the population is often classified as underserved or excluded. Thus, inclusive insurance is a mainstream topic of relevance to the development of the retail insurance market as a whole (see IAIS (2015) Issues Paper Conduct of Business in Inclusive Insurance).

5 Institute of International Finance and Center for Financial Inclusion (2018) Inclusive Insurance: Closing the Protection Gap for Emerging Customers.

6 Swiss Re (2010) Microinsurance – risk protection for 4 billion people. Swiss Re, sigma No. 6/2010. http://media.swissre.com/documents/sigma6_2010_en.pdf.

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8 GIZ (2017) Inclusive Insurance and the Sustainable Development Goals.

9 IAIS (2015) Issues Paper: Conduct of Business in Inclusive Insurance https://www.iaisweb.org/page/supervisory-material/issues-papers//file/57850/issues-paper-on-conduct-of-business-in-inclusive-insurance.

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