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The Importance of Microinsurance from a Poverty Alleviation Perspective

Craig Churchill
International Labour Organization

Distinguished guests and participants, good morning!

I would like to thank Financial Stability Institute and the International Association of Insurance Supervisors for the invitation to speak to you today. Nearly two years ago, in September 2008, I had the opportunity to speak at a similar event just as the financial crisis was beginning to pick up speed – in fact, I think revelations about AIG's perilous situation emerged while we were here. A lot has changed in the intervening period, both in microinsurance and the global financial markets.

How many of you attended that initial event in 2008? Ok, good, that gives me a sense of how much of this speech I can recycle from last time.

I want to cover two primary topics this morning. First, I would like to highlight five recent developments in the realm of inclusive insurance. Then I will directly address the proposed topic: "Microinsurance from a poverty alleviation perspective".

Recent developments

Perhaps I have been asked to speak to you today because I wear a variety of microinsurance hats, including the Chair of the Microinsurance Network. Someone recently called me a "microinsurance apostle". I am not sure about the religious connotation of such a moniker, but I suppose there is a grain of truth in it as I do spend a fair amount of time preaching the good news to promote more inclusive insurance markets.

When we last convened in Basel, the Microinsurance Network was known as the CGAP Working Group on Microinsurance, an informal grouping of organizations and individuals committed to the development of microinsurance. So the first recent development is that the Working Group transformed into the Network, with an elected Executive Committee and a three-person Secretariat based in Luxembourg. The formalization of the CGAP Working Group into a Network has set the stage for significant expansion as more and more companies and professionals acquire an interest in the subject, perhaps in part due to the proselytizing efforts.

Today the Network has more than 150 members from over 20 countries who are collaborating to advance the field of microinsurance. Now just because all of these persons and organizations are members of the Network doesn't mean that they always agree on everything. But that is the beauty of the Network. Its strength is its diversity – diverse ideologies, beliefs and practices. As a new field or subject matter, without commonly agreed models of success, debates and disagreements are welcome means to advance the agenda of developing better insurance products for more low-income persons.

The membership of the Network ranges from community-based organizations to commercial insurers; it includes persons working on social protection and financial inclusion. The Network serves as a big tent under which these diverse organizations are welcome because we believe the solution probably lies somewhere in between a social and a commercial approach. A purely social motive will disappear quickly if there is not an underlying business model that will support the efforts over the long term. Similarly, a purely profit maximizing approach is unlikely to succeed in promoting an insurance culture among the poor who are unlikely to trust insurers to begin with. The dialogues between these various Network members have resulted in significant contributions to the development of microinsurance.

The Network is organized into several working groups that collaborate and engage on their respective topics, such as agriculture insurance, consumer education and distribution. The Network's most active and productive working group, the RSP group which focuses on regulation, supervision and policy, has played a key role in bringing us all together today. The Network's RSP group led by the German agency for technical cooperation, GTZ, has maintained an ongoing dialogue with the IAIS for the past five years in the form of a joint working group. Together they have undertaken various studies and written a couple of papers that have substantially advanced the thinking about formulating an enabling environment for inclusive insurance.

Emerging from the collaboration between the Network and the IAIS is the second exciting development in microinsurance, last year's launch of the Access to Insurance Initiative, also known as A2ii. Sponsored by the IAIS, CGAP at the World Bank, the Foreign Ministry of the German Government (BMZ), FinMark Trust from South Africa, and my employer, the International Labour Organization (ILO), the Access to Insurance Initiative is designed to assist insurance supervisors and policymakers to support the development of microinsurance in their jurisdictions. Currently, under lead of different sponsors, the A2ii is active in a variety of countries, including Ethiopia, Zambia, South Africa, Kenya, the Philippines and Brazil...and will soon expand to China, Mongolia and Peru, among other countries. The experiences emerging from these very different environments will create a cohort of policymakers who are grappling with similar issues and can share their successes and challenges, which will hopefully expedite the learning process.

The sponsors of the A2ii believe that this is an important strategy for reducing poverty because insurance supervisors and policymakers can play a key role in promoting the development of more inclusive insurance markets, which can then have a critical function in mitigating welfare losses.

The third recent development that I want to mention is the launch of Leapfrog, the first investment vehicle designed to focus on the development of microinsurance. Over the past few years, the Leapfrog team has managed to amass a fund of nearly \$140 million from development banks and socially responsible investors, but also commercial investors from the insurance industry, including several reinsurance companies. Although Leapfrog is just beginning to switch gears and move from the capital formation to the investment stage, so it is premature to assess the real returns that it is able to make for its investors, its very existence sends a strong signal that microinsurance can be a profitable business line.

The link between the financial crisis and microinsurance that I mentioned before isn't purely coincidental. Many governments are recognizing that the high proportion of people without access to basic transaction accounts is retarding economic growth. An estimated 2 billion low-income people globally do not have access to bank accounts. In some low-income countries, more than 80 percent of the population is excluded from the formal financial system, including insurance.

As many of you are no doubt are aware, last week G20 leaders announced that they have developed a set of "Principles for Innovative Financial Inclusion" that will support efforts to accelerate the delivery of financial services to the poor using innovative approaches. This fourth recent development is welcome news indeed, heightening the significance of our deliberations over the coming days. The nine principles developed by the G20 Leaders emphasize, among other factors, the need for strong leadership, product diversity, proper incentives for financial institutions, and sound consumer protection in innovating for financial inclusion.

Without access to formal banking and insurance services, the poor are often forced to rely instead on a narrow range of sometimes risky informal financial services. Not all moneylenders are evil, and not all informal insurance schemes go belly up, but informal financial services are often inefficient and expensive, which can make it even more difficult for the poor to break the cycle of poverty.

A well regulated and sound financial sector that only serves a fifth of individuals and firms in a country will not be effective in promoting economic growth, facilitating business transactions and trade, and bringing transparency to private sector operations. While I suspect that the market might eventually move in this direction on its own, I think it will get there faster, accompanied by appropriate consumer protection measures, under the guidance and oversight of policymakers, including insurance supervisors. The G20 announcement providing political cover for efforts like the Access to Insurance Initiative should be helpful in this regard.

If I take off my Network hat and put on my ILO, it allows me to talk about the fifth exciting development, the Microinsurance Innovation Facility. Launched in 2008 with funding from the Bill & Melinda Gates Foundation, and housed at the ILO, the Facility provides innovation grants and technical assistance, conducts research and disseminates lessons learned to push the frontier to provide better products to more low-income persons. We are currently collaborating with more than 50 organizations – insurance companies and brokers, insurance associations, NGOs, cooperatives and others – from over 20 countries to develop new products or experiment with alternative distribution channels to extend insurance to un-served market segments. Some of those organizations are here with us today, and will be sharing their experiences with you later this week, so we can get insights into how you policy makers and insurance supervisors can support the innovation required to promote inclusive insurance markets.

So that is a quick review of five recent developments in the world of microinsurance in the past couple of years:

- The CGAP Working Group became the Microinsurance Network
- The IAIS launched the Access to Insurance Initiative together with international development agencies
- The launch of the first investment fund for microinsurance
- The G20 promotes inclusive finance in response to the financial crisis, including microinsurance
- And the ILO's Microinsurance Innovation Facility expands to collaborate with more than 50 microinsurance practitioners around the world

All of these developments signal that microinsurance is at the beginning of what promises to be a steep growth curve, fueled by the availability of investment and grant funds, encouraged by political support and an enabling environment.

Microinsurance and poverty alleviation

Now I want to beg your indulgence for a few more minutes to explain while all of this is important, to highlight the importance of microinsurance from a poverty alleviation

perspective. I am unlikely to say anything that isn't apparent or self-evident to you, but I think it is useful from time to time to reflect on why we are doing what we are doing.

Microinsurance is intended to protect the working poor, particularly those working in the informal economy. Often poverty alleviation efforts like microcredit focus on boosting incomes, building assets or creating jobs – all of which are important objectives. But these productive efforts must be balanced with a corresponding intervention on the protective side. Even families that are breaking out of poverty can be left destitute by the financial burden of serious health problems. The World Health Organization estimates that around the world 100 million people each year fall into poverty because of exorbitant health care expenses.

The poor, or even the not-so-poor, cannot cope with the costs of a major surgery or debilitating illness out of their cash flow or by relying on their social support networks. They may choose not receive the treatment and start the downward cycle into destitution...or they may borrow from a moneylender, which could end up with the same result. To pay for the treatment or to pay off debts they may need sell off productive assets, which reduces future income generating potential. They are stuck between a rock and a hard place. Any of these unattractive options will contribute to spiralling further into poverty, for themselves and perhaps for their offspring as well.

Risks are certainly not limited to health crises. The death of a breadwinner can force children out of school and into the labour market. Property damage and theft are rife in low-income settlements and slums. Floods and other natural disasters can overwhelm poor households, destroying homes and livelihoods, and leave vulnerable families destitute.

The characterization of the working poor depends greatly on the country or jurisdiction, but in general we can say that they are just above or just below the poverty line, often with irregular or unpredictable incomes which may make it difficult for them to maintain regular premium payments, they are possibly un-banked and excluded from social protection mechanisms, perhaps with limited education and unfamiliar with insurance. This is the population in your countries that is most vulnerable to risk and least able to cope when a crisis occurs. For this population, even a small loss in absolute terms can be devastating, often because losses do not occur in isolation, but in quick succession. So before the household has an opportunity to recover from the initial loss, they are hit again. But now their coping mechanisms are frayed and they cannot manage to get their heads back above water.

We are talking about the population with the greatest need for insurance, but the least access. But you can help rectify this conundrum. If products are properly designed and made widely available, microinsurance has the potential to help these families to cope with these and other risks for the cost of a premium.

Besides these potential protective functions, access to insurance can also unlock productive potential. For example, if the larger prospective risks can be managed through small regular premium payments, it will enable the poor to focus their energies on other challenges. Instead of putting cash under the mattress to protect against possible risks, they might be willing to make additional investments in productive efforts that help to break the cycle of poverty. This is the "peace of mind" effect. Knowing that they have the safety net of insurance to fall back on, in some circumstances the poor may be willing to engage in high risk, high return opportunities that could boost them out of poverty.

Another productive function of insurance is its potential to unlock access to productive inputs, especially credit. Many banks severely restrict their willingness to lend for agricultural activities because of the associated risks. But if the risk of too much or too little rainfall could be covered by insurance, for example, to what extent would financial institutions be willing to increase their agriculture portfolio? If the risk of death to cows or buffalos were covered by

insurance, would banks significantly increase their willingness to lend for livestock? If so, additional flows of credit could create jobs and stimulate economic growth.

Another exciting development impact emerging from inclusive insurance is that insurers have an interest in reducing claims costs and therefore are willing to invest in risk prevention programmes. For example, an insurer in Uganda found it much more cost effective to subsidize the costs of insecticide treated bed nets for its policyholders than to treat them for malaria. Similarly insurers in India are investing in health education activities to help policyholders to avoid succumbing to preventable diseases because the investment saves them money. Insurers could be persuaded to undertake more of these loss control strategies if researchers helped them to identify interventions that would pay for themselves through lower claims costs.

The benefits of microinsurance in terms of poverty alleviation are not only seen at the household level, but can potentially be found in the broader economy as well. Deep markets with varied participants can absorb overall risk better. By covering more insurable units, insurers are able to diversify their risks, increase their revenue streams, and hopefully accumulate greater pools of capital to invest in local economic activities. When you look at the insurance penetration in many developing markets, it is really quite astonishing how few individuals and businesses have insurance coverage. For example, in one African country where I have worked recently, only a few hundred thousand persons are covered by the formal insurers, whereas informal microinsurers, especially microfinance institutions, are providing basic life coverage to several multiples of the formal outreach. The potential is there.

I want to let you in on a secret. Microinsurance is not really new. Some of today's large insurance companies began in the 1800s as mutual protection schemes among low-income workers. In the early 1900s, many insurers built their business by selling industrial insurance at factory gates to low-income workers. Over the years, however, insurance became increasingly sophisticated and more relevant for complex risks, and wealthier policyholders.

In developing countries, the insurance industry inherited the more sophisticated insurance without going through the same development processes. Unfortunately, insurance is not like some industries where developing countries can leapfrog to more sophisticated technologies, such as in telecoms where we can forget about developing landlines and move straight into the development of mobile phone networks. By not building the industry from the ground up, developing countries do not have a consumer base that sees insurance as a viable risk management tool.

As such, microinsurance can be described as a back-to-basics campaign for insurers that enable them to reach an underserved market, reducing the vulnerability of the poor while strengthening their balance sheet and the broader economy in the process.

In conclusion

Is microinsurance a magic cure for all that ails the economy? Hardly. There are still many unknowns in the microinsurance space, but the potential is there, just waiting for us to grab it. The development of microinsurance is both a moral and an economic imperative, not only for the promotion of inclusive financial systems but also for the equitable mitigation of risks. This imperative is reinforced by the fact that many donor agencies are taking a keen interest in supporting its development as a complementary poverty alleviation strategy. One reason why the Gates Foundation and other donors are attracted to this topic is because it can be a partly self-financing development strategy. Once the product design and operational mechanisms are worked out, the coverage of some risks, for some segments of the low-income market, can be covered through the premiums paid by the poor....that is, if the environment in which the insurers are operating is supportive of such results.

This is where you come into the picture, and that's why this meeting is so important. Insurance is an intangible product. It is a promise. Policyholders are buying peace of mind that they will be protected should an insured event occur. But for the working poor, who have limited disposable income, it is hard to allocate funds to protect against an event that they hope won't even happen when they have more pressing short-term needs, like putting food on the table. Consequently, we need to make sure that they have access to appropriate products, and have a positive experience with insurance, otherwise we will muddy the waters for insurance for another generation.

As we will discuss in over the coming days, Insurance supervisors and policymakers can make a critical difference in facilitating access, using a variety of tools and approaches that could range from changes to licensing requirements for agents to fiscal incentives such as tax breaks. Or they might not need to do anything more than use moral persuasion and stakeholder dialogue to encourage the insurers to go downmarket.

But it won't necessarily be easy. Is it possible to promote inclusive insurance markets while ensuring financial stability? How can you strike a careful balance between consumer protection and the flexibility necessary to enable new and better ways to provide low-income households with new and better products. Should supervisors reach out to innovative informal insurance schemes run by civil society organizations and force them to comply with insurance regulations? These are some of the many questions that we will hopefully strive to answer, or at least debate, over the next two and a half days because the answers to these questions have the potential to improve the lives of millions of low-income persons.

I thank you for your attention and I look forward to deliberating with you on these exciting issues and opportunities.