SAVINGS IN MICROINSURANCE: LESSONS FROM INDIA

Rob Rusconi
SAVINGS IN MICROINSURANCE

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This paper assesses four products that combine the benefits of insurance and saving offered by Indian insurers and targeting low-income customers. The assessment is timely, as many insurers have launched or are giving serious consideration to initiatives aimed at bringing insurance combined with saving to low-income customers.

The first section of this paper introduces the issues and presents a framework that is used for the product analysis. The products are then described in section two, highlighting the key characteristics that set each apart. This leads to section three, the heart of the discussion, which draws and explains a number of important lessons from this analysis. There are few easy decisions and prospective participants in this market need to think carefully about the most important needs of their customers, converting the needs into product design and then balancing out a range of difficult trade-offs.
Collins et al. (2009) highlight three needs that drive much of the financial activity of poor households: basic cash-flow management, coping with risk and raising lump sums. As tempting as it may be to equate these to borrowing, insurance and saving, the financial behaviour of these households – indeed the complexity and uncertainty of their challenging lives – makes such simplification unrealistic. Households often use a combination of financial tools to meet their financial needs, highlighting a need for composite products that combine savings and insurance.

Saving helps low-income households protect themselves against shocks and stabilize their lives, yet it has limited potential to shelter people from catastrophe. Adding an insurance component usually means that saving must occur on a regular pre-determined basis over an extended period. Like loan repayment instalments, this requirement can be onerous, yet it also provides a mechanism to instil discipline and encourage customers to save consistently. As the success of commitments to save shows (see Ashraf et al., 2003 and 2006), low-income households often welcome some structure in their savings mechanisms. Policyholders also benefit from the provision of long-term savings products by insurers because it offers alternatives to suit customer needs and convenient access to other forms of insurance cover.

These types of product are also relevant because they address a reservation that the low-income market has in respect of insurance. For insurance products that do not build value over time, such as term life or property covers, if an insured event does not occur, low-income policyholders often feel that they have wasted their money because they do not have anything to show for the premiums they have paid, whereas products that combine savings and insurance, like endowment products, cover the risk of death and accumulate value over time.

However, standard endowment products are notorious for providing poor value to customers compared to other saving options, partly due to the high commissions paid to agents. Because of their irregular cash flows, low-income customers may have difficulty paying regular contributions, and therefore the surrender value of the product can be quite low (see Roth et al., 2006). Thus, the main thrust behind this paper is to assess whether the next wave of products that combine savings and insurance has found solutions to overcome the limitations of traditional products, and whether the new products provide better value to low-income customers than the previous generation.

1.1 A FRAMEWORK FOR SAVINGS-Linked INSURANCE
The paper presents a framework that insurers can use to design and assess their savings-linked insurance products. These products compete for attention with a wide variety of alternatives (formal and informal) and need to be competitive, in the sense that they meet customer needs clearly and effectively. To design such a product, the insurer needs to consider a set of fundamental principles:

- **Primary objective:** What key need does the product seek to meet? To do this, needs must be identified and prioritized. Furthermore, the extent to which customers actually recognize these needs must be estimated or measured.
- **Secondary goals:** What are the other goals for the product and what are the priorities across these goals?
- **Flexibility:** How much can the customer vary the standard terms of the contract to meet a variety of needs, such as unanticipated changes to personal circumstances?
- **Understanding and trust:** What features need to be in place to ensure that the customer understands all of the terms and conditions of the arrangement? The importance of customers understanding this promise must

1 It is important to avoid casting an inflexible payment schedule – whether for saving or loan repayment – in doggedly negative terms. Just as compulsory saving has benefits, households frequently take on credit with fixed repayment instalments precisely because they appreciate the discipline imposed.
not be underestimated. These are long-term products, so keeping customers is just as important as convincing them to purchase the policies in the first place. In addition, helping these customers to understand why the product is good for them - through simplicity of design and frequent communication, for example - is the first step towards gaining their confidence and retaining them.

1.2 PRODUCT DESIGN

Insurers need to consider the four principles outlined above when defining the following components of savings-linked insurance products:

- **Allocation to savings and insurance**: It is difficult to value the respective contributions of saving and insurance equitably, but the allocation of contributions between the two helps to show the relative significance of each. In this paper, contributions refer to the total amounts paid by customer for both the insurance and savings benefits. Contributions can be contractual, depending on the product. Premium is the amount of the contributions that is specifically assigned by insurers as the cost of the insurance cover. The provider should always be able to make this allocation between savings and insurance. For the customer, this is less often possible, so the insurer should make every effort to explain this allocation - and the corresponding benefits from insurance and savings.

- **Product features**: Characteristics like premium or sum assured minima and maxima are captured here, along with age and term restrictions.

- **Insurance benefit**: This describes the contingencies that are covered, life, health or assets, for example, and how benefits are paid (e.g. lump sum or income, fixed amount or indemnity).

- **Saving benefit**: This covers the flexibility of the product, limitations on the timing of withdrawal or the opportunity for partial withdrawal during the term of the contract. Other features like the potential or guaranteed investment return may also be important to customers, but the relevance of the return may depend on the sophistication of customers. As lower-income customers are generally more exposed to financial stress, they may value flexibility of design - giving them a break from contributions or access to their savings in an emergency - more than the potential for investment return.

- **Charges**: A record of fees, where these are explicit, should form part of a detailed typology.

- **Exclusions**: This includes pre-existing conditions or suicide, for example, on life insurance, or limits on claims under asset insurance.

- **Special features**: Additional characteristics not covered by other headings.

There are a number of difficult issues hidden in the detail of these components that insurers must resolve when putting together their products. These trade-offs, a number of which are considered in this paper, strongly define the essence of the product and the nature of the promise to customers. For example, it is clear that not all saving is for fixed periods and known future events.

2 All products covered in this study provide life cover only, although other types of protection are possible.

3 Some products provide a pre-defined set of benefits that include all charges; others levy charges separately. Comparing these offerings is not straightforward, a problem that affects the analysis described in this paper.

4 In the three studies reported by Collins et al. (2009) in Bangladesh, India and South Africa, over half of all savers reported their primary use of the large sums borrowed or accumulated as falling into the category of opportunity rather than emergency or life cycle.
1.3 FOCUS ON INDIA

The paper focuses on India for two main reasons:

- It proved challenging to find a range of products from other parts of the world that 1) provide meaningful elements of saving and insurance cover, 2) have achieved scale, and 3) are sold by insurers willing to provide insights into the dynamics of their portfolios.
- It is difficult to carry out a fair comparison of products from different parts of the world because these products can be specific to a context, particularly as regards constraints imposed by regulation.

India has seen considerable microinsurance development in recent years, including life insurance. Consequently, it has a critical mass of interesting examples with sufficient experience to warrant a specific investigation. Nevertheless, a study like this that focuses on a single country runs some risks. A number of the products included have been withdrawn from the market in response to regulatory changes that forced reconsideration of their design. The implications of this are outlined in more detail in Section 3. Furthermore, it is difficult to transfer the experiences gained in one country to other jurisdictions.

Finally, the study depended on insurers for the information provided. Data on customer choices is limited by competition considerations. The paper may appear to give preference to the view of the institution over that of the customer, but this has not been the intention and every effort has been made to overcome the limitations of the information available.
2 > PRODUCTS CONSIDERED

The market for savings-linked insurance products in India has been subject to a number of recent regulatory changes, which have affected those considered in this section. Some of them have been withdrawn from the market for redesign. Changes in referral guidelines have also affected distribution options.

The descriptions of the four products that follow, which predate these changes, are broad, highlighting the most important features of each product. This leads to the discussion in section 3 that draws a number of lessons from these similarities and differences. Table 1 summarizes the key features of these products.

### Table 1 Key features of products assessed

<table>
<thead>
<tr>
<th>Lives covered</th>
<th>Max New York Life Max Vijay</th>
<th>Bajaj Allianz Sarve Shakti Suraksha</th>
<th>SBI Life Grameen Shakti</th>
<th>ICICI Prudential Anmol Nivesh</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allocation to savings and insurance</td>
<td>Premium deducted from contributions</td>
<td>Premium deducted from contributions</td>
<td>Implicit allocation</td>
<td>Premium deducted from contributions</td>
</tr>
<tr>
<td>Contribution payment options</td>
<td>Contributions entirely at option of customer after initial purchase</td>
<td>Monthly, quarterly, half-yearly or annual</td>
<td>Annual only</td>
<td>Annual only</td>
</tr>
<tr>
<td>Minimum contribution</td>
<td>INR 1,000 (US$22) initial contribution, INR 10 (US$0.22) minimum thereafter</td>
<td>INR 45 (US$1) monthly contribution, INR 500 (US$11) if paid annually</td>
<td>No explicit minimum, but likely to be low</td>
<td>INR 1,200 (US$26), annual contribution only</td>
</tr>
<tr>
<td>Term limitations</td>
<td>Ten-year term only</td>
<td>No longer than seventieth birthday of policyholder</td>
<td>Five- or ten-year term options</td>
<td>Between 7 and 15 years</td>
</tr>
<tr>
<td>Guarantee at maturity</td>
<td>No guarantee, but returns declared cannot be removed</td>
<td>Total contribution less premium and administration fees</td>
<td>Explicitly and clearly guaranteed</td>
<td>Total contribution paid</td>
</tr>
<tr>
<td>Sum assured (death benefit)</td>
<td>Five times the contributions paid</td>
<td>Guaranteed at amount set per group</td>
<td>Guaranteed from outset</td>
<td>Greatest of sum assured, fund value and sum of contributions</td>
</tr>
<tr>
<td>Investment returns</td>
<td>Guaranteed at declared amount</td>
<td>Based on returns on low-risk assets</td>
<td>Implicit in the guarantees</td>
<td>Based on returns on low-risk assets</td>
</tr>
</tbody>
</table>

5 The most important of these regulatory requirements for unit-linked investment products are that:
- customers must be locked in for a period of at least five years, reinforcing the fundamental principle that these are long-term financial instruments providing risk protection,
- premiums must be regular and at a constant level,
- charges must be evenly distributed over the initial five years,
- death benefits must meet minimum requirements and
- a guaranteed minimum investment return must be granted.

For universal life products, renamed variable insurance plans, the combined investment and commission limit is prescribed, and for both sets of products, referral activities have been curtailed in the interest of customer protection.

6 Quality assessments mentioned in this table provide a comparison of product features from the perspective of the customer and are therefore subjective rather than technically precise.

7 Contributions refer to the total amount paid by customer for both the insurance and savings benefits. Premium is the amount specifically allocated by insurer as the cost of the insurance cover.
2.1 MAX NEW YORK LIFE’S MAX VIJAY

The venture of Max New York Life (MNYL) into a microinsurance product, Max Vijay, combining savings and insurance and available to individuals rather than only members of groups has shown, above all, that it can be done. From a product sale perspective alone, the results are good. From the product launch in 2008 to the end of the first quarter of 2010, Max Vijay sold 90,000 policies, a good number, but significantly less than the more than one million policies sold by each of the next two products considered. The project has allowed the insurer to gain first-hand experience in determining customer needs, incentivising behaviour, and identifying the success factors for such a venture.

Max Vijay offered a savings product with remarkable contribution flexibility, a death benefit that grows with contributions and fair withdrawal terms. The most important features of the product are the following:

- **Contribution flexibility**: Following the payment of a one-off initial contribution, defined by the product subtype but no less than INR 1,000 (US$22), the policyholder is completely free to contribute to the account when able, with no rules on frequency or amount, except for a minimum contribution of INR 10 (US$0.22), an extraordinarily low threshold.

- **Sum assured linked to contributions**: The benefit payable on death is equal to the value of the accumulated customer account plus five times the contributions paid, ten times in the case of accidental death, encouraging contributions but also keeping under control the premium, which is deducted monthly to meet the cost of providing insurance cover.

- **Withdrawals are available from the third anniversary**: Policyholders may surrender or partially surrender the policy from three years onwards, with charges that are fair, though the facility to partially withdraw free of charge on a limited number of occasions is a useful addition to policyholder flexibility.

The most ambitious feature of the project is its distribution model. This is the only product in this set that is available to individuals and marketed to the general public. This limits the potential to achieve economies of scale, as the per-unit distribution costs are significantly higher than if the product were distributed solely through groups, all else being equal.⁹

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⁸ The mid-market exchange rate at the end of February 2011 is used throughout the paper, approximately INR 45 to US$1.00.

⁹ Max New York Life launched this product specifically to learn about its potential and the nature of the market need. It invested a considerable amount of money, recruited a dozen or so senior managers and outsourced the information technology requirements to a major provider.
Key observations on this product are:

- Sales have been good, particularly given the ambition of reaching individuals rather than limiting access to members of groups.
- Without the support of the (voluntary) on-going contributions, the product does not provide particularly good value to the customer and is less likely to generate profit for the insurer. A key imperative, apart from the need to develop a diverse range of efficient distribution channels, is to find ways to motivate this continuous commitment to the saving process, essentially a form of partnership with the insurer (this is explored in more detail in Box 1 in the next section).

Through lessons on understanding saving behaviour, reaching customers, designing and pricing products, and running an efficient operation, Max Vijay has provided invaluable experience to MNYL.

2.2 BAJAJ ALLIANZ’S SARVE SHAKTI SURAKSHA

Sarve Shakti Suraksha is a savings product that provides a guaranteed maturity benefit, low surrender penalties and an insurance cover that pays a fixed amount on death due to natural or accidental causes.

The product is available to members of targeted groups only. The minimum size of the group is 50 and pricing of the insurance is based on the risk profile of the group. The product is targeted at groups of women who are reached through the non-government organisations (NGOs) and microfinance institutions (MFIs).

The most important features of the product are as follows:

- Guaranteed insurance benefit: The sum assured is negotiated with the group and is unchanged throughout the term of the policy.
- Investment returns on the accumulated savings: The accounts attributed to individual policyholders are credited with the investment returns earned on the underlying assets, appropriately invested.\(^1\)
- Withdrawal flexibility: Policyholders may surrender the policy right from inception at very reasonable charges. This is a unique feature among the products considered in this assessment.

Though the product is available only to those who form part of an applying group, policy records after inception, accumulating policy values, for example, are held on an individual basis.

More than three million lives across India have been covered in the two years since launch and assets under management are approaching US$66m. It is too early to comment on profitability, though the insurer expects to break even soon. It is also too early to assess the extent to which the product meets customer needs, but other variations are already being considered, and customer satisfaction appears to be high, as supported by persistency through to the beginning of the second year (13 months from inception) of 82 per cent.

Modified versions of this product are now being adopted by Allianz in other regions, such as Indonesia (called Tamadera, launched in October 2010) and parts of South America and West Africa, to suit the distinct requirements of customers in different parts of the world.

\(^1\) No minimum return is specified, but the benefit on maturity is guaranteed at total premiums less cost of cover and administration fees, suggesting a minimum return for those who reach maturity of no less than zero, after costs.
2.3 SBI LIFE’S GRAMEEN SHAKTI

Grameen Shakti is a simple product provided by SBI Life Insurance designed to reach low-income customers that, while combining insurance and savings, keeps costs low by packing together:

- a term life product priced without any differentiation for age or gender, and
- a simple cash benefit on survival of the pre-defined policy term

The product is offered only to groups, primarily through banks, and has reached close to one million customers in the approximately three years since launch. While banks are the primary means of reaching customers as this helps to overcome practical difficulties such as contribution collection, the distribution channels—those that have the relationships with the ultimate customers—are MFIs and self-help groups (SHGs). All contributions are collected by debiting the customer’s bank account.\(^{11}\)

The important features of this product may be summarized under the principle of simplicity:

- Limited choice of term: only five- or ten-year terms are available.
- Limited choice of death benefit: the sum assured must be a multiple of INR 5,000 (US$110), up to a maximum of INR 50,000 (US$1,100).
- Explicit guarantee on maturity and death benefit: The death benefit attracts no investment return but is clearly set out, and the maturity benefit is equal to the sum of all contributions under the 10-year policy and half of this sum for its five-year counterpart.

The policyholder receives no investment returns, but also suffers no charges for the cost of providing death cover. Both of these are built into the product design and the assessment of the risks of the guaranteed benefits. One charge is explicit. It is the cost of the service tax on contributions, charged at a rate of 1.03 per cent of the contribution. This is added explicitly to the contribution amount so that it does not need to be taken into account later in the policy term.

The policy includes an element of risk-sharing that reduces the margins that the insurer would otherwise need to take into account in its pricing: the death benefit to an entire group is limited to INR 50,000 (US$1,100). If this threshold is exceeded, subsequent claims are declined and contributions net of service tax and stamp duty are returned to the nominees of covered members.

While the product may be criticized as providing a limited range of options and no more than fair value for money on early termination, its simplicity makes it easily understood and it appears to fulfill a significant need for pure protection with limited savings.

This is probably the most important lesson that may be learned from the SBI Life experience. The insurer has taken the view that customers appreciate the straightforwardness of the product, a simply defined sum assured with limited exclusions and a clearly defined cash-back payment at maturity. The volume of product sales appears to support this view. SBI Life has commenced a programme to roll out the product across India.

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\(^{11}\) While this implies that all of the customers have to have a bank account, the product frequently originates as a service to the members of the self-help group, with the bank operating as a distribution channel.
2.4 ICICI PRUDENTIAL’S ANMOL NIVESH

ICICI Prudential has developed a policy that combines saving and insurance in a design not far removed from a classic endowment contract: it is a regular-premium investment-linked policy that guarantees, on maturity or death, a benefit no lower than the value of the contributions paid, less the value of any partial withdrawals up to that point. It has been launched on a pilot basis to workers in the tea plantations of Assam, in India’s North-East, and is untested elsewhere.

Elements used from the design of the classic endowment include:

- the combination of a death benefit and a maturity benefit, both attracting investment returns, but with guarantees,
- a unit-linked approach to investment returns, with assets held in low-risk instruments,
- a range of policy terms (7 to 15 years) and sum assured options ranging from INR 6,000 to INR 30,000 (US$130 to US$650), and
- a conventional set of charges, a contribution allocation charge, policy administration charge and mortality charge that do not unduly detract from the effectiveness of the guarantees.

However, the designers of this product have been innovative in a number of respects, all of which assist the policyholder. Examples of these include the following:

- Cover continuance option. The life insurance cover continues, for those who have selected this option, even if contributions are stopped, any time after the third anniversary of the product, avoiding an automatic surrender procedure.
- Bonus allocation of units. Policyholders are motivated to persist by an allocation of five per cent of one full years’ contribution every fifth anniversary. The policy administration charge also ceases at the end of five years.
- Reward for contribution persistency. Surrender may take place at any time after three years. A charge of 10 per cent of the fund is applicable, but this is waived if, at the time of the surrender, three full years of contributions have been paid.

These terms go a long way towards aligning the incentives of the policyholder with those of the insurer, though they do so at some cost of simplicity, increasing the risk of poorer understanding by the policyholder.

This product was designed specifically to reach low-income customers operating in a semi-organized sector. It has been piloted in north-east India to reach tribal tea plantation labourers, using the tea companies as financial intermediaries. Partnership with a tea company does not guarantee access to all of its workers, as this needs to be negotiated at the level of the tea garden falling under the jurisdiction of the company. Nevertheless, 2,300 customers, around a quarter of those targeted, were enrolled and further roll-out was negotiated.

Sales of the product were suspended in July 2010 following the introduction of the regulatory changes discussed earlier in the paper. A number of changes to product features are to be introduced to ensure compliance with regulatory requirements and to take advantage of the opportunity to respond to the emerging needs of customers. At the time of writing, details had not been finalized.

The initiative has survived thus far on financing by the ILO’s Microinsurance Innovation Facility, but the insurer is optimistic that with economies of scale available through wider distribution, this could become a profitable venture.
3 > KEY LESSONS LEARNED

Drawing on the analysis of these four products, this section focuses on the most important lessons to consider when designing savings-linked insurance products.

3.1 PRODUCTS MAY COME IN MANY SHAPES AND FORMS

The four products show different characteristics in a number of key areas as depicted in Table 1. Some of these may be described as design differences and are relatively easy to identify. These include:

- contribution flexibility,
- minimum contribution requirements and
- surrender terms.

Others are more subtle, but in many ways are more sophisticated. Two of these are considered in more detail in the discussion that follows:

- the balance between savings and insurance, and
- the balance between flexibility and simplicity.

**Contribution flexibility**

SBI Life and ICICI Prudential require policyholders to make contributions annually without variation. Bajaj Allianz permits contribution payment on one of four different programmes, but on a regular basis. Only MNYL allows a completely flexible approach to contribution payment, an almost unheard-of contribution-paying flexibility, at least in the context of long-term insurance.

It is not obvious as to what is best for the customer. Consider the issue from a number of different perspectives:

- Annual contributions are larger than those paid more frequently, so there is a material risk of surrender if the customer cannot afford them as they fall due.
- Annual contributions lead to lower collection costs per unit paid, permitting lower charges and better value for customers.
- Where products are sold through facilitating partners, the partners may assist in the aggregation of smaller amounts into annual contributions, deepening the relationships between insurer and partner, and between the partner and customer. SHGs and tea plantations play such a role for SBI Life and ICICI Pru, respectively.
- Permitting customers to choose their contribution frequency or allowing contributions to be paid entirely at the convenience of the policyholder may attract more customers and allow them more control over their financial management.
- Keeping the customer to a regular contribution, with appropriate periods of grace to facilitate recovery from times of hardship, may improve the policyholder’s commitment to saving. For Max Vijay, only around 15,000 of its 90,000 customers made contributions after their initial payment, despite the extraordinarily low minimum requirement. This suggests that the insurer may have overestimated the benefit of the flexible approach over the discipline imposed by a regular contribution arrangement.

These arguments demonstrate the challenge of establishing the right approach for a particular product and the need to consider the issue from the perspective of the customers targeted for the product, in addition to any intermediary entities involved. These decisions are seldom straightforward. Researching customer preferences, evaluating paying

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12 Bajaj Allianz and SBI Life allow 30 days premium payment arrears and all of the insurers in this study permit customers to revive arrangements under which premiums have been unpaid for some time.
capacity, and conducting cost-benefit analyses of different models are among the methods that would assist insurers to evaluate the trade-offs. Low-income households live sophisticated and complex financial lives; insurers should never assume that they know what their customers need.

**Minimum contribution**

The lower the contribution threshold, the easier it is for low-income individuals to participate as customers, but the more difficult it is for the insurer to achieve scale efficiencies at the level of the individual contract. On the other hand, a lower contribution threshold may translate into a greater number of policies, which across the entire portfolio could be sufficient to create economies of scale.\(^\text{13}\)

ICICI Prudential and, to a lesser extent, Bajaj Allianz, have chosen relatively high minimum contributions, with policyholders at the former paying at least INR 1,200 (US$27) annually and at the latter, if they choose the annual contribution option, no less than INR 500 (US$11). Bajaj Allianz offers smaller contributions for those prepared to contribute more frequently. The implied minimum contribution at SBI Life is significantly lower than this, and MNYL offers complete flexibility of contributions starting at INR 10 (US$0.22) but the initial contribution is high at INR 1,000 (US$22).

It is difficult to say which approach has worked best, because the effects of the minimum contribution are obscured by other factors. Bajaj Allianz has sold a very large number of policies with Max Vijay selling significantly less, but this is not necessarily attributable to the contribution threshold.

**Surrender terms**

One of the most important design questions in products that combine saving and insurance is the flexibility to withdraw from the policy, partially or completely. Surrender terms under three of the products are similar. Bajaj Allianz stands out as it provides generous terms for policy surrender, particularly by permitting early surrenders. The other insurers permit surrender after three years; Bajaj Allianz permits it immediately after inception, although surrender in the early months is likely to produce a low payout.\(^\text{14}\)

As persistency with savings products is an important determinant of financial success, this approach is risky because it may see financial losses as significant numbers of policyholders surrender early. However, as a feature differentiating the insurer from competitors, it may pay off because it sends the message to customers that the product is flexible in their hands. Facilitating exit may stimulate higher levels of loyalty, a risk not easily evaluated prior to launch.

All aspects of product design require sensitivity not only to financial effects but also to the impact of incentives on human behaviour. The issue of permitting customers to leave more easily in the hope that, in return, they will not do so, is one that requires a particularly good understanding of the tendency of people to respond to incentives. It touches, also, on the issue of trust, discussed later in this section.

The balance between saving and insurance

One of the main challenges is meeting the cost of providing insurance, the death benefit, while demonstrating adequate commitment to the maturity benefit, the result of the savings effort for those who survive until the end of the policy term. Some might suggest that a minimum insurance benefit is required to meet basic customer needs. Others believe that saving plays an important role in meeting these needs and that the insurance is supplementary. Each insurer needs to take a view on this, based on their understanding of customer preferences.

\(^\text{13}\) Viability depends on a number of cost and revenue factors. The lower premium threshold facilitates easier access, resulting in higher take-up and the spreading of fixed portfolio costs across a greater number of contracts, but it may result in higher expenses overall if the costs associated with each new sale are high. Rules are not easily determined and there is no evidence that the four insurers in this study have followed any specific approach. There is no substitute for financial modelling of the alternatives, supported by research on the likely customer take-up at various levels of minimum premium.

\(^\text{14}\) It would be useful to understand how many customers take advantage of these surrender terms. The paper closes with some thoughts on possibilities for further research.
Four different approaches have been adopted to achieving this balance. These are illustrated with reference to a hypothetical product with a ten-year term, annual contributions of INR 1,000 (US$22), and the corresponding annual cost of cover and administration fees of INR 30 (US$0.66) and INR 50 (US$1.10) respectively.

- **MNYL**: Premium deducted from contributions, no guarantee. From the contribution of INR 1,000 (US$22), a deduction of INR 30 (US$0.66) is made to cover the premium. No guarantee on the maturity benefit is offered. MNYL deducts the cost of cover from the contribution and does not provide a guaranteed maturity benefit to balance this. However, the risk to the customer is balanced by describing and guaranteeing the insurance cost, and it incentivizes savings by setting the death benefit at a multiple of total contributions paid. The death benefit would be INR 5,000 (US$110) after year one, five times the annual contribution, and an additional INR 5,000 with every subsequent INR 1,000 (US$22) contribution. Furthermore, once returns have been declared, they cannot be removed.

- **Bajaj Allianz**: Premium deducted from contributions, guarantee based on contributions less cost of cover and administration fees. The guarantee is based on the sum of all contributions, INR 1,000 (US$22) in each year, less the cost of cover and administration charges, a total of INR 80 (US$1.75) in each year, giving a maturity benefit after ten years of not less than INR 9,200 (US$201). Bajaj Allianz deducts the cost of cover from the contributions. It provides a guaranteed maturity benefit, but does not guarantee the impact of the premium. This is the easiest guarantee to provide because it exposes the insurer to the least risk. Though it is not good for the customer, it allows the insurer to consider offering good value elsewhere in the product, which Bajaj has chosen to do through the surrender terms.

- **ICICI Prudential**: Premium deducted from contributions, guarantee based on total contributions. Though the insurer still meets the cost of cover by deducting the premium from the contribution, the guarantee is based on total contributions, in other words INR 10,000 (US$219) after ten years of INR 1,000 (US$22) contributions. ICICI Prudential provides a maturity benefit that, notwithstanding the premium, is guaranteed to be no less than the value of total contributions paid. It must meet this guarantee from the after-expenses return on the assets and risks failing to do so. It manages this risk by imposing a reasonably high minimum contribution and ensuring that the term of the policy is not too short.

- **SBI Life**: Explicit, simple guarantee on benefits; cost of providing the guarantee implicit. SBI Life has taken a different approach to this guarantee, providing a clearly defined outcome, but not disclosing the costs of providing this outcome. Though the level of risks that it incurs to meet these guarantees is not known – perhaps the combination is profitable – its advantage is that it is simple and more likely to be understood by customers. SBI Life offers, on its ten-year policy, a maturity benefit guaranteed at the total level of contributions less sales tax of 1.03 per cent annually, a little under INR 10,000 following contributions of INR 1,000 annually. The guaranteed benefit under the five-year policy is half of all contributions paid, just under INR 2,500 for the same contribution.

Each of these approaches is justifiable. Each may be described as fair to customers, striking a reasonable balance between savings and insurance in a context in which resources are limited. Each has advantages and disadvantages from the point of view of the insurer and policyholder. In addition, each allows the insurer to provide other benefits within the policy design to the customer. The insurer needs to consider the trade-offs and prioritize the most important needs of its customers. As is evident from the differences in product design and customer benefits, the four insurers have adopted different approaches to these priorities.
**Choice: The flexibility-simplicity balance**

Insurers need to balance the trade-off between simplicity (less choice) and flexibility (more choice). Simplicity is helpful to gain customer trust and improve understanding of the most important features of the product, while flexibility allows customers to respond to unexpectedly changing circumstances.

Insurers need to decide how much choice to give to their customers. It increases the potential for customer needs to be met, but it also increases the cost of administration. Choice may also decrease the level of customer understanding of the product, and is not always helpful. Furthermore, flexibility can lead to behaviour that undermines the protection, as seen in the low contributions for the Max Vijay product.

Each insurer has taken a view on the level of choice that it offers:

- **Bajaj Allianz** offers a range of terms, sums assured and contribution frequency options, but the decision must be made at the level of the group and all of its members must abide by this selection.
- **SBI Life** allows the group to choose the level of the sum assured and then assesses the risks in order to provide the maturity guarantee. However, it permits only annual contributions and only two options for policy terms.
- **ICICI Prudential** limits the term of the policy to a period of 7 to 15 years. It allows the policyholder to choose the level of cover required and the term from within this range. It accepts contributions only on an annual basis, but puts this restriction in place with the customers’ cash flow in mind.
- **MNYL** offers only a ten-year term, but allows its customers complete freedom of contribution amount and frequency.

These decisions have consequences for the financial viability of the product and the potential to offer positive features in other parts of the design. The Max Vijay product provides remarkable flexibility, but the insurer found it difficult to motivate customers to make these contributions on a regular basis. After paying their initial contribution, approximately five out of six customers did not pay any additional contributions despite the very small instalment amounts. This, in turn, has undermined the financial viability of the portfolio, which reduces either the insurer’s profitability or the investment return available to customers, or both.

**Need for persistency**

There is one characteristic of policies with savings elements that must be noted: the need for persistency. Lapse rates in all long-term insurance products can be high: 10, 20 or even 30 per cent per year. Persistency levels are a key marker of insurer success. A failure to keep customers for a sizeable part of the duration of the policy hurts the insurer in three ways:

1. A surrender takes away the marginal benefit of the fees that the policy provides to the insurer;
2. A surrender takes with it assets that are under the care of the insurer, reducing both the fees and the margins that the insurer may have been able to generate for policies on books;
3. And, most importantly for savings policies, a policy that is surrendered may result in financial loss because the insurer may not have covered all of its costs of issuing and maintaining the policy, or setting aside assets to meet guarantees.

All long-term insurance policies are dependent for their financial success on persistency, but this is much more important for savings policies than for pure insurance policies because the incidence of profitability is heavily skewed towards the later years of the policy. Moreover, what is good for the insurer is frequently also good for the customer, who needs the product range to be financially sound and for this success to be shared with the customer.\(^{15}\)

\(^{15}\) How this success is shared varies from product to product. While financial sustainability is important to the policyholder as the insurer is more likely to honour its promises, the policyholder also has an interest in the profit margins of the insurer, which should be low enough to share success with the policyholder, but not so low as to undermine the soundness of the portfolio.
Price for scale

Insurers should make an effort 1) to price as keenly as possible, making every effort to provide value for money to their customers, 2) to test the willingness of the market to accept this price through a combination, if possible, of pre-design research and testing of market responses to the actual prices of products, and 3) to compare the price to the corresponding prices charged by competitors where possible. A significant number of policies sold is usually more indicative of profitability than the margin available on each product. In this environment of small units, costs simply cannot be covered without the numbers. This does not mean that there is no margin in pricing for products. First, customers may not be particularly price-sensitive if the primary needs are being met. Second, profit gained through unexpectedly successful selling can be shared with policyholders if the mechanisms to do so are in the product design. Third, these are long-term arrangements and margins are needed to protect against unexpected terminations.

3.2 DISTRIBUTION IS KEY

Effective distribution is especially important in microinsurance products that include savings components, because achieving scale is so crucial to the success of the product. In addition, participation in a long-term arrangement depends on customer understanding of the benefits of the policy, and the distribution channel plays a significant role in establishing and maintaining this understanding.

One important decision regarding distribution is whether to sell to the microinsurance public at large or whether to limit access to members of organized groups. The insurers reviewed have followed three different approaches:

1. Group membership only. Bajaj Allianz and SBI Life only make their products available to members of groups with the intention of selling to all of the members of that group. Bajaj Allianz sets the terms of the contract based on an underwriting exercise covering the group, suggesting that all or a substantial proportion of the members of the group must take up the insurance.
2. Targeted at members of groups. The ICICI Prudential product is targeted at workers on tea plantations, but participation is not compulsory for every member of the group. The group coordinators facilitate the transaction, but the decision to enrol is taken by each member individually.
3. Available to individuals. Max Vijay is marketed to and available to individuals through a range of distribution channels.

Selling only to groups has a number of advantages:

- It assists with scale efficiency by adding a larger number of policies with every successful sale.
- These groups play a substantial role in enhancing the loyalty of customers, through education, practical assistance, and perhaps even peer pressure.
- It brings into play an intermediary who has the interests of policyholders at heart and frequently also a willingness to encourage persistency and to help with saving for widely-spaced contributions.
- It contributes to solidarity between members, improving understanding of the product, celebrating payment of benefits and improving persistency.

Distributing to group members appears to be the key point of differentiation between the products and the scale achieved. The two providers that sell only to groups have reached significant scale, each covering more than one million lives. The other two insurers have had encouraging starts, but cannot be described as successful in terms of number of policies sold or profitability.

A key lesson from the Max Vijay initiative is the importance of the distribution channel (see Box 1). The distribution channel needs to have an interest in encouraging active savings from customers, but finding such a channel is not always easy. Retail stores, for example, have an incentive to encourage people to spend, not save. When selling through retail stores, the savings product competes with other products in the store, both for the retailer (in terms of commission to be earned from other high-margin products) and the customer. Conflicts of interest also arise when
savings-linked insurance is sold through banks, as banks have an incentive to make customers enrol in their own savings products. SHGs may have similar conflicts, but are fundamentally interested in the welfare of their members and hence may be better suited to encouraging a long-term savings product. Some untested channels such as schools and church groups might be better aligned and need to be explored further.

Box 1 Channel experimentation in Max Vijay

Max Vijay has tested a variety of channels, using “push” and “pull” methods. Push channels are those in which intermediaries actively persuade customers to purchase the product. These were used primarily to encourage the relatively high-contribution initial uptake of the product. The push channels utilized were a financial product distributor, MFIs, NGOs and government centres.

Pull channels are those in which product sales points are established and customers are encouraged to purchase products from these points. These were primarily local retailers, including “mom and pop” shops, which policyholders regularly frequented and were therefore convenient locations for customers to make additional contributions to their Max Vijay policy.

Experience across distribution channels has varied. The financial product intermediary generated the majority of sales, but at the expense of other MNYL products targeted at higher-income customers. This channel, however, produced poor results in the area of ongoing contributions.

Overall, additional contributions were made in only one-sixth of the policies. Success rates were highest in the retail channels, particularly in the city of Agra, where more than half of the policies sold were credited with top-up contributions by policyholders. It is clear from the experience to date that the product will provide customers with value – and probably the insurer with profit – only if regular saving behaviour is developed and sustained, which suggests that even marginal efforts to promote a culture of continuous saving could pay off well in terms of new sales, improved persistency and growth in savings.

3.3 DESIGN PRIORITIES

A careful analysis of four insurers that have adopted different approaches to extending savings and insurance products to low-income households provides some preliminary insights for others interested in designing similar products.

Establish the key objective and focus everything on this. Microinsurance customers live complex financial lives, but it is not possible for products to meet all needs. Customers need products that meet one specific goal. They must understand what they are purchasing, particularly if the product seeks to combine elements of insurance and saving. The distribution channel, the product design and the internal infrastructure of the insurer must support this. Failure to focus on one goal compromises the clarity of the message to customers, reducing the sales potential and undermining customer loyalty to the detriment of the sustainability of the business.

Prioritize distribution. Portfolio scale is crucial for insurance products that provide savings, so giving the business the best opportunity to sell large numbers of contracts is a priority. This probably means making some tough decisions early on, for example to exclude access for the general public, but these can be reviewed once a sustainable structure has been achieved. Successful insurers in this study have been single-minded in their approach to distribution.

Stimulate trust and loyalty. From a number of different perspectives it seems that trust plays a significant part in the success of the insurer, whether the primary channel of product distribution is intermediated or not. Insurers, it follows, should monitor the satisfaction of customers with the product and services being received from the insurer and
intermediaries. This should extend through the whole chain of contact with customers. Good customer service, timely payment of claims, minimal exclusions and smooth administration service all serve to enhance the reputation of the insurer in the community that it serves. Happy customers are more likely to stay, and keeping existing customers is cheaper than replacing them with new ones. Insurers must recognize that it is not primarily about sales, but about persistency, as customers who leave early are worse than those not gained at all.

**Simplicity has merit.** In savings products, as in microinsurance more generally, some compromise on flexibility in favour of simplicity seems to have helped in at least two of the examples considered in this paper. It appears that, while consumers generally desire choice, they acknowledge and appreciate the benefits of longer-term contractual arrangements that impose constraints, in contribution payment for example, in return for rewards. This has a considerable positive impact on the sustainability of the product and must be considered by the insurer in the context of the product’s key objectives. Simplicity enhances customer understanding which, in turn, is likely to improve loyalty and hence the financial sustainability of the portfolio. It may alienate customers with more sophisticated needs, but these can be met at a later stage through product enhancement. The reverse is not true, as it is almost impossible to simplify an existing product.
4 > CONCLUDING THOUGHTS AND WAY FORWARD

Microinsurance practitioners are paying more attention to the manner in which customers might be encouraged to combine savings with insurance. A number of insurers in India have launched products that do just this (this paper considers four of them), providing some preliminary lessons for other insurers in a similar position, namely:

- determine business and design priorities and stick to them;
- prioritize distribution;
- stimulate trust and loyalty and
- design for simplicity, focusing on customer understanding.

Trade-offs are an unavoidable part of the product design process. Ultimately, insurers need to make their own decisions on these issues, acknowledging the importance of their context. Customer satisfaction does not come easily.

A number of questions have emerged in the course of this research that could not be answered with the information available from insurers. Further research is needed in a number of areas, including:

- the effectiveness of different distribution channels and commission models in delivering sales, and the quality of these sales, in terms of persistency rates, for each of these models;
- the take-up and persistency of customers across product variations, for example, the term of policies purchased and the level of cover – and contribution – where options are available;
- incidence and causes of policy lapses, characteristics of lapsing customers, and influence of product features (such as surrender terms) on lapse rates;
- the proportion of group members taking up cover made available to them through the group and the persistency experience of the members and
- customer satisfaction levels and the link to product design.

All of this research requires considerable commitment from insurers and some of it might be difficult to cover in the public domain, but these insights would be of tremendous benefit to others considering a venture into this segment.
REFERENCES


MICROINSURANCE INNOVATION FACILITY

Housed at the International Labour Organization’s Social Finance Programme, the Microinsurance Innovation Facility seeks to increase the availability of quality insurance for the developing world’s low income families to help them guard against risk and overcome poverty. The Facility was launched in 2008 with the support of a grant from the Bill & Melinda Gates Foundation.

See more at: www.ilo.org/microinsurance