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SAVINGS IN MICROINSURANCE: LESSONS FROM INDIA

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Combining the financial instruments such as savings and insurance makes sense when considering the complex financial lives of low-income households. Low-income households often experience challenges to manage cash flows, cope with risks, and raise money to meet large, unplanned expenses. These households can benefit from using a combination of financial tools to meet their financial needs, highlighting a need for composite financial products like savings-linked insurance.

Savings-linked insurance can also 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 did not receive anything 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.

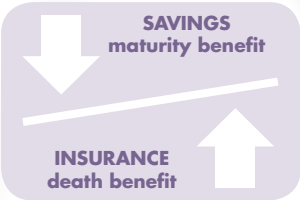
This briefing note[1] presents a framework that can be used to analyse the design of savings-linked insurance products. It uses the framework to assess a new wave of products targeted at the low-income market in India and presents lessons and trade-offs that insurers must consider when designing these products.

PRODUCT FEATURES

The products analysed in the study show that the insurers have taken different approaches to define the key features of the products (details outlined in Table 1). Insurers evaluate a number of subtle trade-offs to design products that have distinctive features and offer potential value to customers. Three of the features are explained below. See Microinsurance Paper 14 for a discussion on the other features.

THE BALANCE BETWEEN SAVING AND INSURANCE

Figure 1 Balance between saving and insurance



One of the main challenges of savings-linked products is to accumulate sufficient funds to cover benefits in the case of death or if the policy reaches maturity. The design of the product is influenced by the way in which the insurers view the importance of insurance to savings and how they allocate the customer's contributions across both these benefits. Some insurers 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. The insurers reviewed have adopted four different approaches to balance the death benefit and the maturity benefit in their savings-linked insurance products. The design is explained below using a hypothetical product with a ten-year term, annual contribution of INR 1,000 (US$22), annual premium of INR 30 (US$0.66) and administration fees of INR 50 (US$1.10).

[1] This brief is excerpted from the Microinsurance Paper no. 14, which includes the relevant citations and details on methodology and the cases reviewed. The paper is available at www.ilo.org/microinsurance. Rob Rusconi works at Lombard Life, South Africa, but wrote this paper in his previous capacity as independent consultant.

Table 1 Key features of savings-linked insurance products assessed

	Max New York Life Max Vijay	Bajaj Allianz Sarve Shakti Suraksha	SBI Life Grameen Shakti	ICICI Prudential Anmol Nivesh
Lives covered (approximate)	90,000	3.4 million	1 million	2,300
Allocation to savings and insurance	Premium deducted from contributions	Premium deducted from contributions	Implicit allocation	Premium deducted from contributions
Contribution payment options	Contributions entirely at option of customer after initial purchase	Monthly, quarterly, half-yearly or annual	Annual only	Annual only
Minimum contribution	INR 1,000 (US$22) initial contribution, INR 10 (US$.22) minimum thereafter	INR 45 (US$1) monthly contribution, INR 500 (US$11) if paid annually	No explicit minimum, but likely to be low	INR 1,200 (US$26), annual contribution only
Term limitations	Ten-year term only	No longer than seventieth birthday of policyholder	Five or ten-year term options	Between seven and fifteen years
Guarantee at maturity	No guarantee, but returns declared cannot be removed	Total contribution less premium and administration fees	Explicitly and clearly guaranteed	Total contribution paid
Sum assured (death benefit)	Five times the contributions paid	Guaranteed at amount set per group	Guaranteed from outset	Greatest of sum assured, fund value and sum of contributions
Investment returns	Guaranteed at declared amount	Based on returns on low-risk assets	Implicit in the guarantees	Based on returns on low-risk assets
Earliest withdrawal	Three years	Immediate	Three years	Three years
Partial withdrawal permitted	Yes	Yes	No	Yes

Max New York Life (MNYL): Premium deducted from contributions; no guarantee. From the contribution of INR 1,000, INR 30 is deducted as the premium. No maturity benefit is guaranteed, but the risk borne by customers that they might receive no benefit upon maturity of the policy is offset by explicitly defining the premium and guaranteeing investments returns (once declared). The product incentivizes savings by setting the death benefit at a multiple of total contributions paid. The death benefit would be INR 5,000 after year one, five times the annual contribution (INR 1,000), and an additional INR 5,000 with every subsequent INR 1,000 contribution.

Bajaj Allianz: Premium deducted from contributions; guarantee based on contribution less premium and administration fees. The guarantee is based on the sum of all contributions, INR 1,000 in each year, less the premium and administration fees, a total of INR 80 in each year, giving a maturity benefit after ten years of no less than INR 9,200. It provides a guaranteed maturity benefit, but does not guarantee the premium amount and insurer has the ability to change the premium through the policy. This type of guarantee is safe to provide because it exposes the insurer to the least risk, and is easy to calculate. Though it is not good for the customer as it offers no investment return and does not guarantee the premium amount upfront, it allows the insurer to consider increasing value elsewhere in the product, which Bajaj has chosen to do through the surrender terms (see below).

ICICI Prudential: Premium deducted from contributions; guarantee based on total contributions. Though the insurer funds the premium by deducting it from the contribution, the guarantee is based on total contributions, in other words INR 10,000 after ten years of INR 1,000 contributions. ICICI Prudential provides a maturity benefit that, notwithstanding the deductions for insurance, is guaranteed to be at least

equal to or more than the value of total contributions. The insurer assumes risk to meet this guarantee from the net investment return on the portfolio. It manages this risk by imposing a reasonably high minimum premium 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 provides a clearly defined benefit, but does not disclose the costs of providing this benefit. SBI Life offers a maturity benefit on its ten-year policy guaranteed at the total amount of contributions less sales tax of 1.03 per cent annually, or a little under INR 10,000 based on 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.

Each approach has advantages and disadvantages from the point of view of the insurer and customer. In addition, each allows the insurer to provide other benefits to the customer based on the trade-offs and priorities of its customers.

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SURRENDER TERMS

One of the most important design features in products that combine savings and insurance is the terms to withdraw savings from the policy, partially or completely. Surrender terms under three of the products are similar with no penalties only if policy is surrendered after three years. Bajaj Allianz provides more generous terms for policy surrender, particularly by permitting surrenders at any time (though surrender in the early months is likely to produce a low payout), and at lower fees.

As persistency with savings products is an important determinant of financial viability of the product for the insurer (see Box 1), flexible terms for surrender can increase the likelihood of financial losses if significant numbers of policyholders surrender. Such a feature, however, may provide a competitive advantage to the insurers, and enable sales and build loyalty.

Box 1 Need for persistency

Persistency of long-term insurance products has a significant impact on their financial viability for insurers. This is much more important for savings policies than for pure insurance products because in policies with savings components the profits are generally skewed toward the later years of the policy. A failure to keep policies active for a sizeable part of their duration can harm the insurer in three ways:

1. A surrender takes away the future stream of revenue that the policy provides;
2. A surrender reduces investment capital of the insurer, reducing both the fees and the margins that the insurer may have been able to generate for policies on books;
3. In the insurer may incur a financial loss because it fails to fully recover costs of issuing and maintaining the policy.

Figure 2 Variation in surrender terms

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. Flexibility (choice) 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. Furthermore, flexibility can lead to behaviour that undermines the protection if customers fail to make contributions or surrender their policies early on.

The insurers reviewed offer varying levels of choice:

- 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.

MNYL offers the most choice to its customers in terms of the contribution structure. The insurer found it difficult though to motivate customers to make contributions on

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a regular basis. After making their initial contribution, approximately five out of six customers did not make any additional contributions despite the very small instalment amounts. This, in turn, has undermined the financial viability of the portfolio, reducing either the insurer's profitability or the investment return available to customers, or both.

Some compromise on flexibility in favour of simplicity seems to have helped Bajaj Allianz and SBI Life in reaching scale. Simplicity is likely to enhance 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 enhancements. The reverse is not true, as it is almost impossible to simplify an existing product.

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

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