

Field Notes

CREDIT LIFE: IT'S SUPPOSED TO BE SIMPLE!

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The motivation behind our Field Notes is to share our experiences as microinsurance practitioners over the past decade with the wider community; we have not set out to be academically robust or research orientated. These are observations based on our personal experiences and often reflect lessons that have been learnt the hard way through failure. In this first edition we take a look at credit life, a product that most people dismiss as offering poor value for the poor, yet it's the starting point for many fledgling micro insurance programmes.

Most Roads Start From Here

Whilst I am not aware of any study that sets out to ascertain how many micro insurance programs start their journey by offering a credit life product, I would be willing to wager that the vast majority start with some form of credit life as the first product they offer. Whilst many people have raised concerns over the value of credit life to the end borrower, the fact remains that it is the most logical place from which to start if you want to enter the micro insurance market.

For a start, it is probably the simplest product technically and it is normally already widely available from a range of local insurers so you don't have to persuade your insurer to do something they are not already comfortable with and understand well. Most microfinance companies (MFI's) also find it a good place to start because the product naturally fits in the loan cycle and in its simplest form as a '*credit life only*' product, uses the same client data that MFI's collect on their loan

application form (e.g. name, date of birth etc.). This reduces the need for changes to the IT system and existing loan application process.

MFI's are also naturally drawn to credit life because it reduces the risk of default following the death of the borrower and so it is in the lenders interest to have the protection in place. However, in my experience reducing the risk is not as much of a driver for the MFI as the potential to earn revenue from credit life.

In 2002, most MFI's that we worked with charged borrowers a flat 1% of the loan value and used the resulting funds to pay off the outstanding loans when borrowers died; no insurer was involved.

As we started to implement credit life at these MFI's, we noticed that they continued to charge borrowers 1% even though the insurance company was charging 0.3% to 0.5% of the loan value. In essence, the MFI had outsourced the risk for a lower price but not passed the saving onto their borrowers, rather the delta was being booked as revenue. This practice is widespread today, which is a great shame, as we should all be focused on delivering good value for our clients.

COVERAGE OPTIONS Whilst credit life is in essence the simplest micro insurance product, I am always amazed that there are number of ways that the products can be configured each of which has its own pros and cons. Having done this

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at over 60 MFI's, I want to use this opportunity to share some thoughts on the different ways that this simple product can be implemented.

The first decision to make is around what the product will actually cover. Most people respond to this question with a blank expression and something like 'let's cover the loan'. Sounds simple, but credit life can be configured to cover the *outstanding loan only*, *outstanding loan plus accrued interest*, *outstanding loan plus accrued interest plus late fees* and all three of these options can be either according to the schedule

of repayments in the loan contract or alternatively according to the MFI's IT system at time of death. Finally, credit life can be arranged for the disbursed loan value on a *flat basis for the full period of the loan* or even for a *sum which exceeds the organisations maximum loan value for all loans irrespective of the loan value*. Let's try and unpack these!

Broadly speaking a credit life product that aims to pay off the outstanding loan has a profile that looks like product 'A' in figure one. The sum that the insurance company will pay upon death decreases over time according to the repayment of the loan. If you decide to go for this coverage then be very clear with the insurance company what you expect them to pay after the person has died. Is it the *outstanding loan principal* or is it the *principal plus interest* and do you expect them to pick up any late payment fees that may have accrued if the deceased was in arrears when they died?

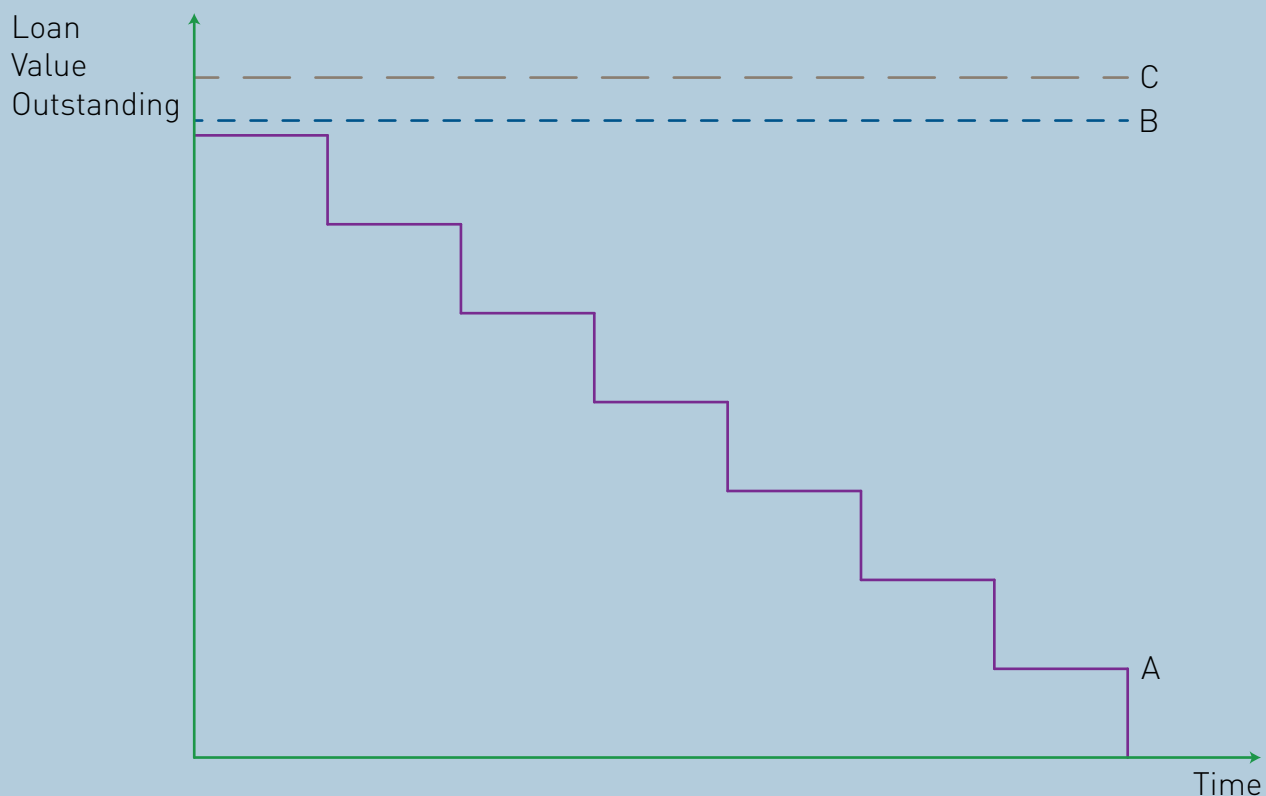


Figure One



Be aware that if you want to cover the interest and other fees then the insurer will probably ask to include those sums into the premium calculation and that can lead to added complexity for the MFI.

If you use option 'A', it's also worth ensuring that you clarify with the insurance company whether they are expecting to pay the loan *that is outstanding on the MFI's ledger* or whether the insurer will pay *according to the expected loan repayment schedule*. This is important because if a client gets sick for a while before they die then chances are the loan will be in arrears and as a result, the MFI will want to claim more than the insurance company expects to pay. It should always be made clear to the insurer that they are expected to pay the value of the loan outstanding on the MFI's books, including any arrears, so that the MFI is not left with an outstanding liability.

It's a result of these potential areas of misunderstanding between the MFI and the insurer that I have always favoured implementing credit life for a fixed sum insured for the full period of the loan which looks

like product 'B' in figure one. If a client takes a loan of \$300 for six months then the loan is insured for \$300 for the full six months irrespective of what the borrower has actually paid back, the MFI gets \$300. I should point out that this means that the MFI will be covered for the loan plus any accrued interest unless of course the client dies very early on in the loan cycle. This can happen and I remember when an excited borrower ran out of the branch celebrating the release of her loan, straight into the road and had an unfortunate road traffic accident.



The other drawback of insuring the full loan principal for the full loan period according to product 'B' is that the MFI has to decide what to do with surplus claim funds. A few years ago I was in Zambia visiting with one of our MFI partners and the branch manager was telling me that he had a very real problem. The MFI insured the loan for the disbursed principal and upon death deducted the outstanding loan and passed any surplus monies onto the bereaved family. The branch manager told me that he had these two clients from the same group that had died a few months apart; the first borrower had died early in the loan cycle and so the resulting claims surplus was only a few dollars. The second borrower from the same group died toward the end of the loan cycle and because more of the loan had been repaid, there were more surplus claim funds to pass over to the bereaved family. The result was a riot in the town as the family of the first woman took this as the MFI placing a lesser value on her life as compared to the second woman who had died!

An alternative approach is for the MFI to purchase a life insurance contract for all of its borrowers



for a fixed value, which is more than the maximum expected loan value. Product 'C' in figure one is an example of this approach where a MFI can opt to purchase cover for \$1,000 per borrower knowing that its maximum loan is capped at \$750 per borrower. This is quite rare but is used by a number of MFI's in the Philippines because term life insurance rates are much lower than pure credit life rates in the Philippines. After years of trying to work out why this is, I am increasingly convinced that it is driven by the rural banks who actually want insurers to quote a higher premium rate for credit life so they can increase the value of their commission – ironically, insurers that quote low rates secure less credit life business as a result!

Finally, some MFI's have sought to declare just their outstanding loan

portfolio value to an insurer each month and for a single rate to be applied to the outstanding loan portfolios. Whilst this is the simplest way to secure cover and

results in the lowest workload for the MFI, it has some significant pitfalls for the insurer.

Firstly, the insurer will not get any information on the nature of the clients it is underwriting; so it will not be able to build up a picture of the age and sex of the borrowers, which would help the actuaries better tune the premium rates charged for the group at subsequent renewals. The insurer is also open to significant abuse if it limits itself to underwriting claims on the back-end; I have seen a number of MFI's

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realise that the insurer has no way of knowing what the true sum insured should be. The MFI simply declares a lower value of the true value of loans disbursed, pays a resulting lower monthly premium and then advises the insurer which clients have died but of course the insurer has no way of knowing if those that died were actually included in the premium calculation.

BEING CLEAR ABOUT TIME In my experience, many MFI's are really confused about time. I can't tell you how many times I have sat with the staff of an MFI and they have told me they have a 12 month loan with 50 repayments or a four month loan with sixteen repayments. Interchangeably using weeks and months is a common pitfall and you need to be clear with your insurer that you want a 16 week cover rather than a four month cover. You also need to be careful to ask whether a loan has a grace period at the start; finding out how long the borrower is actually on risk is much harder than you might imagine!

Another area of common pitfall is around rescheduled loans; the MFI needs to decide what to do when a loan has to be rescheduled because it is in arrears. Having paid the premium upfront for the loan the insurer may have used the loan disbursement and loan maturity dates to equate to the insurance start and end dates.

Many MFI's that I have worked with have been caught out when a delinquent borrower (who may have had a long-term critical illness) dies after the loan was scheduled to mature and hence the insurer turns down the claim. It's worth negotiating with your insurer to ensure you are covered if the loan needs to be rescheduled or advise the insurer if the maturity date has been changed.



CREDIT LIFE PLUS Before too long, most organisations start to seek to differentiate themselves in the market by adding features to the standard credit life cover. Typically, these added product features include;

Disability: This is probably the easiest rider to organise. Most insurers can be persuaded to cover total permanent disability (TPD) for no additional charge. Whilst this may seem attractive, you should ask yourself what the MFI borrower would need to secure to prove she is disabled. In some countries the necessary doctors report is almost impossible to secure or very expensive which can lead to a reputational risk where the community can see an individual is disabled but the claim is significantly delayed.

Acute Illness: Cover for acute sickness (e.g. Cancer or AIDS) or temporary total disability (TTD) can also be arranged so an insurer pays the loan installments for up to 30 days in certain circumstances. Be careful to define what is needed to make a claim if you decide to opt for this.



Property: Typically, this cover is in relation to the outstanding loan and covers the lender in case the microfinance business is damaged or destroyed by fire or natural disaster (flood, earthquake, windstorm, typhoon etc). When this rider first appeared, it was a requirement that

a minimum number of borrowers be affected by an event. The insurers were trying to limit their exposure to market fires or major catastrophes rather than to a single borrower who decided that they could not repay the loan and hence set fire to the business. Over time, insurers relaxed this requirement as they realised that the outstanding loan was nearly always much less than the value of the business and stock.

Funeral: Increasingly credit life plus policies provide some cover upon death beyond just the value of the loan. The most comprehensive policies will provide a fixed sum upon death of the borrower, the spouse, and a number of children. A number of non-life insurers that are allowed to offer credit life have sought to remain competitive by covering funerals if they arise from accidents; in essence they can't provide funeral cover arising from natural death as they don't have a life insurance license so they provide cover for deaths arising from accidents. In my experience, there is huge potential for misunderstanding here and I recall one widow telling me that her husband

had died from a heart attack; as he had not planned to die, it must be an accident in her view. Of course, she is right but the insurance company did not pay as he died from a natural cause rather than an accident. Beware what you are buying - it's cheap for a reason.

Whilst moving from credit life to credit life plus, packages result in increased value for the borrower and a competitive market positioning for the MFI, they result in a more significant administration burden. With credit life the MFI just has to advise the name, date of birth, sex, value of loan, start and end date; with credit life plus the MFI will have to declare the location of the micro-enterprise for property cover and the names and ages of spouse and children for funeral cover. These details are typically not collected on the loan application form of most MFI's and not captured in the loan software; so the question comes, how will this information be captured, stored and reported on?



Insurers also need to be wary about these products when it comes to claims. I recently had a chance to review the loss data for three large MFI's with more than two million borrowers each. The death rate for the male spouses was three times higher than for the women borrowers. Whilst the men were typically engaged in more dangerous occupations, this did not actuarially explain why the mortality rates were orders of magnitude higher than for women. Bear in mind this was a huge sample of clients with millions of people covered. The more I pushed the officers of the MFI's the more I became convinced that male spouses were being 'fictitiously killed off' by loan officers when a borrower fell behind with loan repayments so that their portfolio at risk numbers would not be negatively impacted. If the borrower cannot pay, pretend the spouse has died and claim from the insurer.

As a micro insurance intermediary, one of our key performance metrics is claims turnaround time and we track this across countries and products to determine if we have issues with our service.

Recently we started trying to track this from 'date of death to date the bereaved family received payment' rather than just measuring the time we took ourselves to process a claim. What we learnt was disappointing because we were setting ourselves a target of days or weeks to process the claim and get the insurer to pay but our analysis showed that in many cases the MFI was taking months to advise us of the claim and make sure the clients received their payments. These products only benefit clients if claims are turned around quickly which means all parties in the chain need to focus on efficiency and clearly more work is needed on this in the future.

CLAIMS The whole point of insurance is to pay claims when something happens, but it always amazes me how little attention people pay to 'how' claims will be paid until they have an issue after the event. The best approach is to try to simplify the products terms and conditions paying special attention to the exclusions and thinking through likely scenarios. It's also worth negotiating with the insurer for the type of documents that will be accepted as a proof of claim before you launch the product. Most insurers will ask for a death certificate or police report but these documents can be expensive to obtain and take a lot of time and effort to secure.

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Try getting a death certificate in a semi rural area where it is typical to bury a body within hours of death and you will get the picture. We have typically asked insurers to accept a letter from local leaders, branch managers or even from local religious leaders. The idea is to build in some flexibility upfront.



In most cases claims are paid directly to the MFI by the insurer because they are the 'client' under the group policy and they have an interest in the funds to pay off the outstanding claim but also because the MFI borrower has no way to cash a claim cheque. Over the years, we have tried to do our own investigations to determine whether top up benefits such as funeral cover actually reach the bereaved family. The results have not always been particularly positive with many clients reporting that they did not receive funds that were intended for

them; clearly this is an area of concern that random checks can highlight.

For many entering the micro insurance market, credit life is often the most obvious product to pursue. Although comparatively simple, there are many pitfalls that can potentially over-complicate the product development and administration process. We hope that by sharing some of our experiences we will enable others to become better positioned to serve the needs of the poor throughout the developing world.



MicroEnsure is an insurance intermediary dedicated to serving the poor throughout the developing world. We serve millions of poor people with an affordable and appropriate range of products including life, funeral, property, health and weather index based insurance.

In 2002, Opportunity International, one of the world's largest microfinance organisations, began to look at the possibility of providing micro insurance for its existing loan clients in the developing world. Among the first tasks for this special project included a careful assessment of the market potential and research among 10,000 Opportunity clients to determine their needs.

It was apparent that there was a large demand for microinsurance products. Although life, funeral, and property were the first products to be introduced, it was realised that health and crop insurance were often the most in demand by the poor.

By 2005, the insurance operations were growing so rapidly that MicroEnsure was established as a wholly-owned subsidiary of Opportunity International in order to concentrate exclusively on developing and expanding microinsurance to meet global demand.

With a \$24.2 million grant from the Bill and Melinda Gates Foundation in 2007, the pace of expansion accelerated and more ambitious growth targets became a reality.

The aim is to achieve sustainability for insurance companies, product distributors, and clients. Key to minimising the cost of micro-insurance is the sophisticated MIS system employed in the back office processing system that tracks details of clients covered, collects premiums and administers claims.

By acting as an intermediary, MicroEnsure are well-positioned to extend insurance coverage very efficiently with simple, understandable, and scalable products. Extensive market research and insurance expertise ensures that products are designed that address the real financial risk management needs of the poor.