

## **Mainstreaming Micro-Insurance Schemes: Role of Insurance Companies in Nepal**

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### **ABSTRACT**

*Micro-insurance refers to the relatively short term insurances meant for health, accident, crop and livestock policies. The beneficiaries are the rural people who are mostly involved in agriculture which is subject to different external shocks. Along with agro insurance, the regulator is also encouraging insurance companies to insure micro enterprises such as water mills, tea shops, rickshaws and vending carts. The poor households currently need to incur huge amounts of health expenses which are over and above their current income(s) and savings and therefore, need to resort to multiple sources of financing, of which a major source is borrowing. At present, there are 25 registered insurance companies in Nepal. Of these, 8 are private commercial life insurers, 16 are private commercial non-life insurers and 1 is composite insurer. There is no scientific calculation of the crop's yield and of livestock, which will create ambiguity in the valuation of the property being insured.*

**Keywords:** Micro-insurance, risk management, poverty alleviation, microfinance.

### **INTRODUCTION**

In the movement of Microfinance –micro insurance also plays vital role for its success. There is a simple and proven tool to reduce the vulnerability to the financial consequences of ill health: insurance. Unlike the burden of financing huge health expenses from current income or through borrowing, insurance uses a solidarity mechanism and spreads the costs of illness over many households. It thus reduces the burden on the effected household. Furthermore, insurance converts unpredictable health expenses into predictable costs in form of health insurance premiums. This makes financial planning for households much easier and reduces the need to borrow money in an emergency situation at unfavorable rates. Health insurance can do more than only covering the medical costs: it can also provide coverage for the indirect costs, such as loss of income during hospitalization or the cost of transportation to the hospital. Health insurance can thus play an important role to reduce the vulnerability of the poor (Sharma, 2011). Micro Insurance is a new concept and still in a nascent stage in developing countries including Nepal. Generally, it is a means of protecting the low income households from risks and alleviating poverty. However, the concept of micro insurance means different things to different people. Insurance regulators see its nature as the insurance scheme designed for low income sector based on insurance principles and funded by premiums. Commercial insurers consider its potential as a way of reaching large underserved markets. Development institutions, such as, the United Nations, the World Bank and Asian Development

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Bank, highlight its potential to secure poverty alleviation. Financial journalists and analyst focus the size of markets at the bottom of the pyramid. General public argue that the transfer of risks is performed by low-income households to insurers. There is no universally accepted definition of micro insurance. Academicians and institutions have defined micro insurance in different ways.

**Box 1 : Definition of Micro Insurance**

International Association of Insurance Supervisors (IAIS)

"Micro Insurance is insurance that is accessed by low-income population, provided by a variety of different entities, but run in accordance with generally accepted insurance practices. Importantly, this means that the risk insured under a micro insurance policy is managed based on insurance principles and funded by premiums"

The World Bank

"Micro Insurance is an insurance product to improve a low-income person's quality of life by allowing the person to better manage potential problems while empowering that person to be more proactive as to the future".

Asian Development Bank

"Micro Insurance refers to the insurance products that are designed to be beneficial and affordable to low-income individuals or groups."

ILO, Micro Insurance Innovation Facility (ILO-MIF)

"Micro insurance is a mechanism to protect poor people against risk (accident, illness, death in the family, natural disasters, etc.) in exchange for insurance premium payments tailored to their needs, income and level of risk."

Munich Re-Foundation

"Micro insurance is the provision of insurance to low-income households that otherwise would not have access to insurance."

**Source: Microfinance Summit, 2013 Kathmandu**

Micro insurance is aimed towards low-income households that may not be covered by other insurance and social security schemes. Important features of micro insurance products include (Sharma, 2011):

- Designed to be appropriate to low-income household
- comparatively low premium
- Coverage is simple and straight forward
- Distribution channels are different
- Simple methods of claim settlement
- Simple documentation process

Micro insurance draws on the same generally accepted practices as conventional insurance, viz., actuarial pricing, reinsurance and claim handling; there are fundamental differences between micro insurance and conventional insurance.

<b>Box 2: Micro Insurance vs. Conventional Insurance</b>	
Micro insurance	Conventional Insurance
<ul style="list-style-type: none"> <li>• Simple policy document with few, if any, exclusions.</li> <li>• Primarily group policies only</li> <li>• Small sums insured</li> <li>• Premium accommodate irregular cash flows, paid in cash or otherwise</li> <li>• Primarily groups pricing and selling</li> <li>• Period of coverage can be as short as 4 months.</li> <li>• Screening requirements would be limited to a declaration of good health.</li> <li>• Distribution channels manage the entire customer relationship, premium collection, etc.</li> <li>• Market is largely unfamiliar with insurance.</li> <li>• Claims process should be simple.</li> </ul>	<ul style="list-style-type: none"> <li>• Complex policy document with standard exclusions.</li> <li>• Selling to individuals.</li> <li>• Small and large sums insured</li> <li>• Regular premium payments as banking transaction.</li> <li>• Priced based on age/specific risk</li> <li>• Usually minimum of 12 months.</li> <li>• Screening requirements may include a medical examination.</li> <li>• Agents and brokers are primarily responsible for sales.</li> <li>• Market is largely familiar with insurance.</li> <li>• Claims process may be quite difficult for policyholders</li> </ul>

Source: Microfinance Summit, 2013 Kathmandu.

Micro insurance is not only beneficial to low-income households; it is equally useful to insurance companies and intermediaries too (Sharma, 2011). It can generate profits by expanding activities of insurers in large rural markets and helps to get the company's brand name, develop a good relationship with the regulator and government in new markets and further, is an act of corporate social responsibility. The benefits of micro insurance for low-income households (policy holders), intermediaries, insurers and society at large are presented in Box 3 below.

<b>Box 3: Benefits of Micro insurance.</b>	
<p><b>A. Benefits for low-income households (Policyholders):</b></p> <ul style="list-style-type: none"> <li>▪ Products adapted to client needs</li> <li>▪ Products adapted to client capacity to pay</li> <li>▪ Reduced focused on loss of life and livelihood.</li> <li>▪ Insurance can improve ability to cope with loss.</li> </ul> <p><b>B. Benefits for Intermediaries (Agents and Brokers)</b></p> <ul style="list-style-type: none"> <li>▪ New line of business</li> <li>▪ Large policyholders base</li> <li>▪ Improve morale among employees</li> <li>▪ Corporate social responsibility</li> <li>▪ Enhance corporate image</li> <li>▪ Increase commission earnings</li> <li>▪ Training and capacity building</li> </ul>	<p><b>C. Benefits for Insurers (Insurance Companies)</b></p> <ul style="list-style-type: none"> <li>▪ New line of business</li> <li>▪ Large policyholder base</li> <li>▪ Improve morale among employees</li> <li>▪ Corporate social responsibility</li> <li>▪ Enhance corporate image</li> <li>▪ Increase profitability</li> </ul> <p><b>D. Social Benefits</b></p> <ul style="list-style-type: none"> <li>▪ Improved morale among rural communities</li> <li>▪ Employment generation and women empowerment</li> <li>▪ Increased ability to face problems</li> <li>▪ Poverty alleviation tool</li> </ul>

Source: Microfinance Summit, 2013 Kathmandu.

<b>Box 4: Key Challenges of Micro Insurance</b>	
<p><b>From Policyholders (Clients) Perspective:</b></p> <ul style="list-style-type: none"> <li>▪ Negative attitude towards insurance industry</li> <li>▪ Lack of insurance knowledge as a risk management strategy</li> <li>▪ Low and irregular income</li> <li>▪ Information lacking</li> <li>▪ High default/lapsetion rates (lack of cash)</li> <li>▪ Lack of client friendly products.</li> </ul> <p><b>From Delivery Channels Perspective:</b></p> <ul style="list-style-type: none"> <li>▪ Lack of institutional infrastructure (delivery channels and training institutions)</li> <li>▪ Lack of insurance competence</li> <li>▪ Slow claims handling /complicated documentation process</li> <li>▪ Conflict</li> </ul>	<p><b>From Insurers Perspective</b></p> <ul style="list-style-type: none"> <li>▪ Lack of knowledge of the micro insurance market</li> <li>▪ Very risky business (Catastrophe, high mortality rate)</li> <li>▪ High transaction cost per client (remote areas, record-keeping, collection costs, communication costs, etc.)</li> <li>▪ Large volume but low margins due to low premium</li> <li>▪ Unknown potential market (No statistics, experience)</li> <li>▪ Low risk retention capacity</li> <li>▪ Very strict claims provision (may be 30 days)</li> </ul> <p><b>From Regulators Perspective</b></p> <ul style="list-style-type: none"> <li>▪ Lack of Awareness</li> <li>▪ Micro insurance regulation</li> <li>▪ Capacity building</li> <li>▪ Issue of subsidies in micro insurance.</li> <li>▪ Access to reinsurance capacity</li> </ul>

Source: Microfinance Summit, 2013 Kathmandu.

## DATA AND METHODS

This article is based on descriptive research design. The article is based on secondary data source using various publications of government and non-governmental organization and microfinance summit 2013. Especially the insurance company related data are taken from economic survey of 2012/13 published by ministry of finance, government of Nepal. Ownership pattern of insurance companies, sources and utilization of fund, mobilization of premium and status of investment

## RESULTS AND DISCUSSION

The history of insurance industry in Nepal is not long. It has its roots in the 20<sup>th</sup> century. The first insurance company, Nepal Insurance and Transport Company Ltd (now named Nepal Insurance Co. Ltd) was established in 1947. Prior to that most of the branches of the Indian insurers were doing business in Nepal which was not regulated.

The number of insurance companies by mid-March 2012 totaled 25 including 8 companies dealing with life insurance, 16 with non-life insurance and one with both life and nonlife insurance. From ownership structure perspective, 3 insurance companies are operating with full foreign capital investment, while 3 of them are operating as joint capital venture of foreign Insurance companies. Similarly, 18 companies are under private ownership and the government of Nepal owns one Insurance company. The total resource/ utilization of these insurance companies increased by 9.8 per cent to Rs. 67.2 billion by mid-

March 2012 from 61.3 billion in mid-July 2011. By mid-July, 2011, insurance companies have collected a total premium of Rs. 17.5 billion from both the life and non-life insurances while this premium figure was Rs. 15.3 billion in the same period of last year (MOF, 2013).

**Table: 1 Ownership Pattern of Insurance Companies.**

Ownership	Nature of Company			Total
	Life	Non-life	Composite	
Government	-	-	1	1
Private	5	13	-	18
Foreign	1	2	-	3
Joint Venture	2	1	-	3
Total	8	16	1	25

Source: MOF, 2013.

The total financial source and their utilization of life and non-life insurance companies operating in the country by mid-July of 2011 have reached Rs 61,213.4 million, which is 22.5 per cent growth as compared to the previous fiscal year. By mid-January of 2012, such amount has reached to Rs. 67,183.4 million (MOF, 2013).

**Table 2: Sources and Utilization of Life and Non-Life Insurance Companies\* ((In million Rs.)**

Resource	FY 2008/09		FY 2009/10		FY 2010/11		FY 2011/12**	
	Life	Nonlife	Life	Nonlife	Life	Nonlife	Life	Nonlife
a) Paid up capital	1,647.3	1,270.4	1,890	1,560.0	2,451.4	1,642.0	2,451.4	1,642.0
b) Reserve Fund	26,425.4	2,383.7	33,250	4,060.0	44,040.0	6,830.0	48,020.0	7,850.0
c) Other Liabilities	1,565.0	3,722.5	2,980	3,720.0	2,750.0	3,500.0	3,200.0	4,020.0
<b>Utilization</b>	<b>29,637.7</b>	<b>7,376.6</b>	<b>38,120</b>	<b>9,340.0</b>	<b>49,241.4</b>	<b>11,972.0</b>	<b>53,671.4</b>	<b>13,512.0</b>
a) Cash in Bank and at Hand	1,079.9	657.5	920	700.0	750.0	900.0	820.0	980.0
b) Investment	26,062.9	4,966.9	33,500	6,700.0	44,491.4	8,202.0	48,491.4	8,942.0
c) Fixed Asset	566.2	522.3	1,540	870.0	2,100.0	1,070.0	2,290.0	1,270.0
d) Other Assets	1,928.7	1,229.9	2,160	1,070.0	1,900.0	1,800.0	2,070.0	2,320.0
<b>Net Resource/Net Utilization</b>	<b>29,637.7</b>	<b>7,376.6</b>	<b>38,120</b>	<b>9,340.0</b>	<b>49,241.4</b>	<b>11,972.0</b>	<b>53,671.4</b>	<b>13,512.0</b>

Source: Insurance Committee \*with inclusion of estimates of Rastriya Beema Samiti \*\*Only till Mid-March 2012

The table shows the contribution of insurance company in Nepal. In this domain if the regulatory would formulated a certain percentage compulsory fund in micro insurance sector, it will indirectly and directly contribute on the rural, women, poor and deprived group of Nepal.

**Table 3: Mobilization of Insurance premium and status of Investment**

Fiscal Year	Total Insurance Fees Income (in million Rs.)			Growth rate	Investment (in million Rs.)			Contribution of insurance fees income to GDP
2005/06	3,788.9	2,854.9	6,643.8	16.92	15,201.1	3,211.0	18,412.1	1.01
2006/07	4,623.3	3,288.9	7,912.2	19.09	18,397.6	3,447.5	21,845.1	1.08
2007/08	5,489.9	3,851.9	9,341.8	18.07	20,349.9	4,183.1	24,533.0	1.14
2008/09	6,635.7	4,420.4	11,056.1	18.35	26,516.2	5,007.9	31,524.1	1.11
2009/10	8,766.0	6,496.7	15,262.7	38.05	29,939.9	5,927.6	35,867.5	1.30
2010/11	10,422.2	7,063.9	17,486.1	14.56	42,751.1	7,472.7	50,223.8	1.31
2011/12	11,600.0	8,100.0	19,700.0	12.66	47,600.0	870.0	56,300.0	1.41

Source: MOF, 2013.

Insurance is divided into two core categories: life and general insurance. The table 3 shows that the regular improvement of the contribution of insurance service fee income to GDP, which can be considered as a grain of salt. In this context, the business of regulated Nepalese includes products like endowment policies, whole life policies, term policies and pension plans. General insurance covers all other types of insurance including motor policies, fire policies, marine policies, etc. Nepal's insurance penetration (premium as a % of GDP) in 2011-12 is low at 1.5 per cent only. It is estimated that less than 6 per cent of the population has some forms of life insurance, provided either by group or individual policies. The Nepalese economy is primarily rural based. Most of the rural population is illiterate, poor and small holders. More than 25 per cent of the population lives below the poverty line. The average per capita income of Nepalese people is around U.S. \$700 only. In this context, micro insurance need to be mainstreamed to support the microfinance program effectively and efficiently.

### CONCLUSION AND SUGGESTION

Most of the general insurance companies have not adopted micro-insurance as a policy matter as such. They are limited to the middle and high income people and for the business sector. However, few non-life insurance companies have started to introduce micro-insurance policies. It is high time to regulate insurance companies so as to adopt the policy of micro insurance. The companies should make mandatory of investment of certain percentage of portfolio in the field of microfinance.

Linking micro finance with micro insurance which facilitate the various related risk. Awareness creation program should be introduced in the group and center of microfinance program. Insurance Board should take initiatives in widening outreach of micro insurance like IRDA is taking initiatives in widening outreach of micro insurance in India. Appointment of agent to conduct micro insurance business among the institutional insurance agent, agent appointed can work only with an insurer in case of similar line of business. Appointment of motivator to assist the micro insurance business among the person qualified to be an insurance agent, motivator appointed can work only with an insurer. Commission to be paid to the agent or motivator is mentioned clearly. Written agreement with agent must be concluded prior to appointment of such agent and the functions of the agent must be based on agreement. Functions and responsibilities of the agents should be mentioned. Obligation of insurer to provide basic training to the

employees, agent and motivators in respect of micro insurance business administration, management, distribution and claim settlement Insurer must manage to pay the claim within 30 days after verification. Twenty percent of the claim must be paid through insurance agent within 7 days if the claim is found to be genuine. Insurer can reimburse the amount paid for settlement of claim from micro insurance pool. Leveraging existing network for micro-insurance is another dimension. Human resource is required to be trained to cover the huge untapped market. There is a need for developing adequate feedback mechanisms

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