access to insurance initiative

Towards a strategy for microinsurance development in Zambia

A market and regulatory analysis

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Foreword

This study forms part of a series of country studies commissioned by the ILO/UNCDF looking to support country-level microinsurance strategies and to develop cross-cutting insights on designing and implementing such strategies. In the case of Zambia the study is conducted in partnership with FinMark Trust Zambia and the FinMark Trust South Africa.

It considers the scope for, opportunities and challenges to microinsurance expansion in Zambia in order to develop a comprehensive information base that provides the basis for dialogue amongst the key stakeholder categories, including potential clients, providers, intermediaries, government and donor/multilateral agencies, and on which strategies for the development of microinsurance in Zambia can be based.

The first step towards such a strategy process was a Stakeholder Workshop held on 11 June 2009 in Lusaka to present the preliminary findings of this study and to engage on the issues raised. It was attended by more than 60 participants from a range of stakeholder groups (see Appendix 5 for the full attendance list). Introductory presentations were made by the ILO and the Pensions and Insurance Authority (PIA), followed by a presentation of the study results by Cenfri. Participants were encouraged to debate the picture put on the table and to take it on board in a strategy process that they are the owners of. Foremost in the discussion were the challenges relating to the distribution of insurance, most notably the issues around bancassurance and aggregator distribution.

Agreement on strategy process. The workshop participants agreed on the need to take the process further to keep the momentum going, resolve key issues and implement programmes. Following the workshop, the consultants and representatives from the ILO and UNCDF met with the PIA to discuss the way forward. It was agreed that a representative platform should be created to define the strategy and action plan for both (i) a regulatory review of key issues and (ii) implementation of market development initiatives, including the need for capacity building, dialogue and critical analysis of industry performance and the scope for effective distribution to the informal market. The UNCDF, through the local UNDP office, the ILO and FinMark Trust indicated their willingness to act as “sponsors” of the process. The importance of the development of a workable strategy enjoying broad buy-in was emphasised.

Suggested way forward. The recommended way forward is to set up two committees and to appoint a local coordinator to act as secretariat:

- It was agreed that there is a need for broad participation of a range of stakeholders to ensure ownership of the strategy and specific programmes flowing from that. To do that, a **Technical Advisory Group (TAG)** is to be created from representatives of the various spheres. It will debate issues, suggest projects and critically assess feasibility.
- To ensure that the process remains independent and to represent the interests of the sponsors, a **Steering Committee** is then needed to filter and prioritise the suggestions of the TAG and to focus their work into specific, actionable projects. The steering committee will be smaller than the TAG and will comprise a member from each sponsor, as well as the Registrar from the PIA and one or two additional members currently being identified. The steering committee will therefore exercise functional control over the strategy process. To ensure consistency, the steering committee members will also participate in and provide support to the TAG process. Likewise, to

ensure that the market does not feel that the process is captured by the donors and regulator, the TAG will be requested to nominate one member to serve on the steering committee. That person should be selected based on capability/competence and commitment to microinsurance development.

- To be realistic about the time allocation priorities of the participants to the TAG and to, hence, ensure that the momentum of the strategy process is not lost, it was agreed that an **independent coordinator**/secretariat should be appointed to drive the process. This person will be a part-time, paid consultant, preferably with an in depth knowledge of the Zambian financial sector and the need for financial inclusion. One of the first tasks of the steering committee will be to identify and appoint a suitable candidate who can then coordinate the activities of the TAG and steering committee going forward.

A separate **Action Plan for the Promotion of Microinsurance in Zambia** has been developed by the sponsors and consultants. It sets out the rationale for, suggested composition and roles of each committee, as well as the terms of reference for the secretariat function. It also contains a matrix of potential strategic interventions to consider, out of which the two committees are to select between two and four actionable projects to implement in the first year of operation.

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List of abbreviations

AZIEA	Alliance of Zambia Informal Economy Associations
AMIZ	Association of Microfinance Institutions in Zambia
AML/CFT	Anti-money laundering/combating the financing of terrorism
BOZ	Bank of Zambia
BTDA	Bus and Taxi Drivers' Association
CSO	Central Statistical Office
CSWG	Contractual Savings Working Group
FGD	Focus group discussions
FSAP	Financial Sector Assessment Program
FSDP	Financial Sector Development Plan
IAIS	International Association of Insurance Supervisors
LCMS	Living Conditions Monitoring Survey
LFS	Labour Force Survey
MFI	Microfinance Institution
MSME	Micro, small and medium enterprises
PIA	Pensions and Insurance Authority
PICZ	Professional Insurance Corporation Zambia
WHO	World Health Organization
ZAMACE	Zambia Agricultural Commodities Exchange
ZANAMA	Zambia National Marketeers Association
ZCF	Zambia Cooperatives Federation
ZCSMBA	Zambia Chamber of Small and Medium Business Associations
ZDA	Zambia Development Agency
ZNFU	Zambia National Farmers' Union
ZSIC	Zambia State Insurance Corporation

Executive Summary

Zambia is a low-income country with a population just shy of 12m. Traditionally, the economy has relied on the copper mining sector, with the economic fortunes or misfortunes of Zambia closely related to world trends in the copper price. After experiencing economic growth averaging more than 4% between 1997 and 2007, Zambia is now feeling the brunt of the global economic crisis. Inflation is again on the rise and formal jobs, especially in the mining sector, are being shed. The country has also been unable to make significant headway in reducing poverty: 64% of individuals still live below $1.25 a day and almost 87% survive on less than $2.50 per day.

65% of Zambians live in rural areas. Consequently, agriculture plays an important role, with the majority of households deriving their livelihood from it. Apart from agriculture there is also a vibrant informal trading and MSME sector. Indeed, only 10% of the labour force is formally employed. This implies that the bulk of the Zambian market – for insurance as for other goods and services – is bound to be informal, posing particular distribution challenges. The informal market is however more organised than it would appear at first glance: a number of networks aggregate individuals within the sector. A conservative estimate would place the number of networked individuals in the informal sector at more than 210,000. This represents more than 40% of the current insurance market.

The reach of the financial sector is still very low: only about 15% of adults have a bank account and, after accounting for other formal and informal financial services, 66% of adults do not make use of any financial services. The banking sector has however significantly extended its retail reach in recent years, partly through extending its branch, ATM and POS network. Likewise, there has been strong growth in the payroll lending (microfinance) market. Indications are however that the market is now nearing saturation and that over-borrowing may lead to an untenable situation triggering stricter regulation of lending practices.

Insurance penetration is especially low. Just 6.6% of the adult population report that they have insurance. When vehicle insurance and the pension scheme for formal sector employees is removed, this reduces to 3.8%. For the most part, the insurance sector is only now waking up to the opportunities of the retail insurance market, having traditionally focused on the corporate and formal employee group market.

It is against this backdrop that this study sets out to scope the insurance market in Zambia and the regulatory framework governing its operation. The aim is to develop as comprehensive as possible an information base of the current market dynamics as well as an assessment of the opportunities for microinsurance development, the drivers thereof and the challenges to be overcome. This can then form the basis for an inclusive strategy process grounded in stakeholder dialogue.

Regulatory framework

Insurance regulation in Zambia falls under the jurisdiction of the Pensions and Insurance Authority, the PIA, established in 1997. It has the mandate to license and supervise insurers and initiate regulatory changes to accommodate new or relevant issues. Insurance is regulated by the Insurance Act, 27 of 1997, as amended by Act 26 of 2005.

Generally facilitative regulatory regime. The Government of Zambia pursues financial inclusion as part of the Financial Sector Development Plan (FSDP), its blueprint for the reform of the financial sector. Financial inclusion is also one of the core goals of the Bank of Zambia. The FSDP Secretariat, operating through a number of working groups, follows a facilitative approach to raise awareness of market opportunities. The PIA supports microinsurance development and plans to adopt a policy on microinsurance. This sends an important signal to the market.

Furthermore, the Insurance Act does not set high barriers to entry for prospective players: minimum upfront capital requirements are relatively low and are not perceived as prohibitive by new entrants. Though the institutional form is limited to companies with share capital, there are currently no prospective entrants for whom this is a deterrent. The 2005 amendments introduced strict demarcation between long-term and general insurers that may be a constraint to microinsurance development. The PIA has however set a precedent to cross the demarcation divide for microinsurance. On the insurance intermediation side, regulation imposes no caps on commissions and the file and use product approval system facilitates innovation.

Yet some uncertainties and challenges. There are nevertheless a few elements of the regulatory framework that may hamper microinsurance development. The 2005 amendments to the Insurance Act also introduced a number of ambiguities, such as the lack of clarity on the definition of short-term life insurance. While the PIA addresses these, along with issues such as demarcation, through its supervisory approach and has shown itself willing to accommodate development and innovation, it risks an ad hoc approach to regulation that does not facilitate regulatory certainty and may create an unlevel playing field. In addition, the Act makes no mention of medical or health insurance. In practice, health insurance is deemed to fall under long-term insurance. Yet the regulatory grey area has opened up the scope for some players to operate outside the supervisory scope of the PIA.

Two further aspects of the regulation pose microinsurance challenges. Firstly, each agent may enter into a relationship with only one insurer. Post-demarcation, this implies that an agent may only sell either long-term or general insurance. As no explicit provision is made in the Act for bancassurance, bancassurance relationships are governed under the agency stipulations, implying that a bank will have to choose between general and long-term insurance intermediation. This has been flagged as a constraint going forward. Furthermore, new entrants must have a local CEO with at least 10 years of insurance experience. This may be an entry barrier for foreign companies.

The insurance market in Zambia

Small but growing, and with new entrants. The total insurance market is still very small in absolute terms, with premiums equalling only around $44m for long-term and $152m for general insurance in 2007. The sector is however growing rapidly off this low base. Growth is especially pronounced for the long-term industry and the gap between general and long-term total premiums is narrowing. There are six long-term and six general insurers operating in Zambia. The most recent entrant, Blue Assurance, is the first insurance company to be formed by an MFI. There is also an application pending by the first dedicated health insurer intending to enter the Zambian market.

The insurance game is changing. Interest in the retail market is growing and there are some promising pilot and pipeline products. This goes hand in hand with the new dynamics introduced by new entry into the market and the strong growth experience. At the same time, there are some questions regarding the insurance industry's readiness to make microinsurance expansion a priority. 2007 industry financial statements[1] indicate profitability to be generally high, but reinvestment in the business seems to be limited and premiums generated are not adequate for the expenses incurred.

[1] Note that available data were inadequate to calculate many of the ratios for the long-term industry and that the analysis therefore largely pertains to general insurers.

The average loss or net claims ratio is also well below international standards, implying that limited value is paid back to the clients in the form of premiums. Furthermore, data point to excessive reinsurance. The PIA has indicated that, though no data are officially available yet, these ratios improved in 2008.

Limited informal activity. The Zambian insurance market is distinguished from many developing markets in that there is limited “informal” provision of insurance cover, i.e. by entities not registered as insurers. Though community-based risk pooling by so-called funeral associations or funds exists, the available evidence suggests that they have very limited reach. There is furthermore limited self-insurance in the funeral service industry. Indeed, the funeral parlour industry is still very underdeveloped in Zambia. In other jurisdictions credit providers that self-insure their credit life risk is often the largest form of informal insurance. Yet Zambian microlenders tend to either obtain underwriting or to price for the risk in their lending rates without charging an explicit insurance premium. The only area in which insurance is provided informally is the medical aid environment. This links directly to the regulatory loophole with regard to health insurance.

Limited usage, but promising microinsurance pilots and plans. It is difficult to ascertain what proportion of the already limited insurance usage in Zambia is targeted specifically at the low-income market, but it is likely to be negligible. A number of players are however now considering or actively planning products that will be targeted at the informal market. The products of relevance to microinsurance are: credit life (currently the insurance product with the broadest retail reach), funeral insurance and health insurance. General insurance has thus far not been a first-order priority, yet there are a few promising market developments, some of them testing the demarcation regime by combining for example funeral cover with cover for small business stocks.

*Distribution dynamics slowly changing***.** Broker-driven group sales dominate the insurance market in Zambia, but agency sales are on the rise. Bancassurance is a still underutilised distribution channel, but offers much scope for product innovation and a ready platform for the expansion of the insurance market. Alternative channels such as retail distribution are not yet in use, but there is at least one interesting cell phone distribution pilot underway. Insurers are also starting to recognise the scope for aggregator or affinity group distribution as the only feasible way to reach the informal sector and to sustainably collect premiums in a cash environment.

Demand for insurance in the low-income market

Profile of the low-income market. This study commissioned qualitative focus group research of the risk experience, coping strategies, understanding and perceptions of insurance. Together with the findings from the FinScope demand-side survey, this generates a number of insights on the demand for microinsurance in Zambia. The focus groups were characterised by low formal employment. Nevertheless, all participants earn a living in some way through informal trading or agriculture and manage their finances proactively. Their spending priorities follow the hierarchy of needs (such as food, clothing and education) and include keeping their businesses afloat. All groups also emphasised the cost of medicine and healthcare as an important priority.

The poor do save. Low income constrains but does not prevent saving. The predominant savings vehicle identified is through informal rotating savings groups called *chilimbas*, though under-the-mattress saving at home is also common. Savings are however not accumulated over the long run.

Death and illness biggest risks. Death and illness were consistently ranked as the two single biggest threats to the livelihoods of the participants. Funeral expenses were cited as unavoidable and very high relative to income. The same goes for healthcare expenses. Asset-related risks were also mentioned, but as a lower priority.

A variety of coping mechanisms. The resourcefulness of the poor is evident from the variety of mechanisms used to cope with the impact of risk events, from social networks to chilimba membership, to precautionary savings. Though community and family support can be taken for granted, it is most often not enough to cover the full cost. That may trigger more drastic coping mechanisms such as liquidating business stocks, selling off assets, borrowing, or even reducing food consumption or taking children out of school. Risk pooling groups are however not common.

Awareness and willingness to pay for insurance. Unsurprisingly, knowledge of insurance is generally low. Credit life insurance, the only insurance product which some of the participants had, is regarded as a condition to the loan rather than as an insurance product that provides cover against risk. There was a general understanding of insurance as "being protected" and once the concept was explained by the moderator, most participants expressed some willingness to pay for insurance and asked very relevant questions regarding the type of cover available and how it could be accessed. This highlights the need for consumer education and distribution through community structures that people are familiar with and trust.

The potential market for microinsurance

Given the socio-economic structure of the Zambian population, all expansion of the insurance market out of the corporate market and the higher echelons of society into the informally employed market can essentially be regarded as microinsurance. The market analysis indicates that there is scope for microinsurance expansion of up to three times its current reach just by covering the full currently banked market and the conservatively estimated 210,000 networked individuals in the informal market. This could be extended further if more pockets of networked individuals can be identified. There are seven submarkets posing first-order opportunities for microinsurance expansion in Zambia:

1. *Life and funeral market.* Funeral insurance is growing in importance despite the traditional apprehension to talk about death. Insurers and intermediaries are starting to emphasise funeral insurance as an entry product into the informal market and a number of products have been launched or are being planned.
2. *Credit market*. We estimate that there are at least 100,000 borrowers in Zambia not yet covered by credit life. Credit life also has the potential, if properly disclosed and offering value to the client, to introduce clients to the concept of insurance and to form the basis for the cross-selling of other, voluntary insurance products.
3. *Banked market*. As discussed, the currently banked market is the single biggest untapped market for insurers, offering 600,000 clients in excess of the currently insured market. The insurance sector can also learn from the distribution and product innovation in the banking sector.
4. *Agricultural market.* This is an important sub-market, given its scale. The analysis shows limited scope for viable crop or livestock insurance outside of isolated schemes driven by value chain aggregators with an incentive to reduce the risk exposure of members/farmers. There is however scope for the distribution of non-agricultural insurance products such as funeral or health insurance through agricultural aggregators as part of the networked market. At least 150,000 smallholder farmers are part of strong outgrower schemes.

5. *Informal and MSME market*. The informal and MSME market beyond agriculture is more fragmented, but there is still scope for cost reductions through for example informal market associations – an opportunity which we conservatively estimate at 60,000 individuals. Though micro-entrepreneurs may be in need of business/stock insurance, it is likely that life and health products may be the most viable first-order products for this market.
6. *Affinity groups*. The scope for affinity group distribution outside of the economic activities of individuals (such as churches, sports clubs, etc) needs to be explored further.
7. *Health market*. The demand-side evidence highlights the expressed demand for health financing. Traditionally, however, the health insurance market in Zambia has been limited to the high end of the income spectrum and has been undermined by high service costs in the currently unregulated fee for service health financing environment. This poses challenges to this particular pocket of opportunity. The situation is exacerbated by the uncertainty on health insurance regulation and the consequent unlevel playing field between regulated and unregulated players in the market.

Towards a strategy for microinsurance market development in Zambia

The analysis suggests a distinctive need for a strategy process to ensure ongoing dialogue between all possible stakeholder groups and to develop the microinsurance market. The list of possible strategic interventions (to be prioritised in discussion with stakeholders) includes:

- Create a platform for dialogue between different stakeholder groups, including insurers, banks, MFIs, value chain aggregators and the regulator. This platform should seek to overcome trust and competitive issues.
- Develop a microinsurance policy position and link it to the microinsurance strategy process. Base it on an understanding of the actual experience and models of insurers in the market.
- In the context of the microinsurance policy position and strategy, address the regulatory issues identified. Changes to the regulatory framework should be done in an explicit and transparent manner rather than through ad hoc concessions that are not generalised to the market. Embedding it in the broader policy position process will ensure that the various changes and amendments are aligned for optimal impact.
- Specifically, action steps towards comprehensive health sector regulation and to define the role for the insurance market within the broader health financing environment
- Pro-actively engage with the Bank of Zambia on potential changes in the low-income credit market to minimise negative consequences for the insurance industry and also to explore how insurance can support and enhance reforms in this space.
- Align strategies with the broader FSDP process and inclusion strategy.
- Commission a study to specifically consider the scope for and feasibility of the informal market through aggregator distribution and MSME networks.
- Catalyse innovation by conducting further research on key areas of opportunity and disseminating this to players through dialogue and targeted workshops.
- Consider the issues faced and possible solutions in the bancassurance market.
- Further explore demand-side aspects, including profiling how burials are conducted in urban and rural areas and understanding the reasons for low funeral association penetration.

- Consider the need for and viability of an effective and broad-ranging consumer financial education campaign specifically targeted at insurance.

1. Introduction[2]

Zambia is a low-income country. Only a small proportion of the labour force is employed in the formal sector and there is a vibrant informal economy consisting of smallscale farmers, traders and others.

Insurance as effective risk mitigation strategy. In times of crisis, it is more often than not the poor who are most at risk and least able to protect themselves. Calamities such as the sudden death of a family member, illness, injury or loss of income or property can increase the vulnerability of poor people and perpetuate poverty by causing costly interruptions to the difficult process of asset formation. Outside of direct government provision, such risks may be mitigated through savings, informal support networks and community risk pooling mechanisms. Such strategies are however often not adequate and may break down at the time when support is needed most. International experience has shown that insurance can play an important role in risk mitigation for the poor. Whereas the individual may not be in a position to accumulate sufficient savings to cover losses when they occur, she or he may be able to pay premiums relating to the risk, should the product be designed and distributed to be affordable and appropriate to the needs of the poor.

Objectives of this study. This document considers the scope for, opportunities and challenges to microinsurance expansion in Zambia in order to develop a comprehensive information base on which strategies for the development of microinsurance in Zambia can be based. The review covers demand-side, supply-side and regulatory dimensions of the market including the relevant socio-economic and financial sector context. In support of the strategy process this document seeks to provide the basis for dialogue amongst the key stakeholder categories, including potential clients, providers, intermediaries, government and donor/multilateral agencies. It forms part of a series of country studies commissioned by the ILO/UNCDF looking to support country-level microinsurance strategies and to develop cross-cutting insights on designing and implementing such strategies. In the case of Zambia the study is conducted in partnership with FinMark Trust Zambia and the FinMark Trust South Africa and seeks to inform FinMark Trust's own engagement in developing this sector.

The timing of the study is opportune: the Zambian insurance sector – traditionally comfortable in its largely corporate and group-based market – is showing signs of awakening to the potential of the low-income market. Players in the banking and microfinance sectors are already considering the scope for low-income insurance distribution and there are a growing number of experiments in this space. The insurance regulator, the Pensions and Insurance Authority, is alert to the potential benefit of low-income market expansion and the need to create a facilitative regulatory framework while at the same time ensuring prudential soundness and consumer protection. Furthermore, the Government of Zambia, through the Bank of Zambia, is learning from the first five years of experience with its financial reform programme, the Financial Sector Development Plan (FSDP). Zambia has just undergone a World Bank FSAP (Financial Sector Assessment Programme) evaluation and the World Bank is working with the Bank of Zambia to inform the strategy for the second phase of the FSDP – to be embarked upon from 2010.

[2] Throughout this document, unless direct USD references are quoted, an average year to date exchange rate of K 5404.18 per USD on 1 April 2009 (as obtained from www.oanda.com) is applied to convert Zambian Kwacha (K) amounts to USA Dollars ($). Note that, as the Kwacha exchange rate is quite volatile, the dollar amounts quoted are very sensitive to the exchange rate assumption. For the 6 months up to 31 March 2009, the average exchange rate was K4934.66/$. The average for 2008 was K3818/$.

On all fronts, there is a need for a coordinated strategy informed by market and regulatory analysis. This study aims to provide the platform for the development of such a strategy.

Structure. The rest of the document is structured as follows:

- **Section 2** defines microinsurance within the context of this study.
- **Section 3** sketches the Zambian context – socio-economic, as well as in terms of the role of three particular sectors that will be of significance to the insurance discussion in the sections to follow: the informal sector, agriculture and health. It then provides an overview of financial sector trends with particular emphasis on the evolution and current role of the microfinance/microlending sector.
- In **Section 4**, the insurance regulatory framework is analysed. Other regulation that may be of indirect relevance to the insurance sector is also considered.
- **Section 5** scopes the supply and distribution of insurance in Zambia, while **Section 6** provides evidence on the demand for insurance.
- Based on this analysis, **Section 7** then considers the potential for microinsurance.
- **Section 8** concludes on the salient market features, drivers and opportunities for microinsurance expansion that will form the basis of the strategy for microinsurance development.
- **Section 9** outlines strategic suggestions for microinsurance development in Zambia.

2. Defining microinsurance

*Insurance accessible to the low-income market***.** Microinsurance is defined by the IAIS (2007[3]) as "insurance that is accessed by [or accessible to[4]] the low-income population, provided by a variety of different entities, but run in accordance with generally accepted insurance practices (which should include the IAIS Insurance Core Principles). Importantly, this means that the risk insured under a microinsurance policy is managed based on insurance principles and funded by premiums". It therefore excludes social welfare as well as emergency assistance by governments, "as this is not funded by premiums relating to the risk, and benefits are not paid out of a pool of funds that is managed based on insurance and risk principles".

This definition of microinsurance builds on three concepts "insurance", "accessible to/accessed by" and "low-income population":

Insurance: Microinsurance forms part of the broader insurance market, distinguished by its particular low-income market segment focus. This market often needs distinctive methods of distribution and distinctly structured products. While definitions vary insurance generally

[3] International Association of Insurance Supervisors (IAIS), 2007. *Issues in regulation and supervision of microinsurance.* Available at: www.iaisweb.org
[4] Authors' own insertion.

denotes a contract whereby an insurer, in return for a premium, undertakes to provide specified benefits[5]. Insurance is distinguished from, for example, social welfare in that it is funded by premiums relating to the risk, and benefits are paid out of a pool of funds that is managed on insurance and risk principles[6] (IAIS, 2007). In an insurance product risk is transferred from the policyholders to the insurer and the insurer guarantees the insurance benefit if the premiums are paid. Benefits may include one or more sums of money that may be fixed or indemnify a specific expense or loss, services or other benefits, including an annuity. Benefits may also be provided in-kind (e.g. replacing a product or providing a service).

Accessible to: Microinsurance products need to be accessible to the low-income population. FinMark Trust defines financial inclusion as the position where consumers, particularly low-income consumers, can access, and use on a sustainable basis, financial services that are appropriate to their needs:

- *Access factors.* Factors that impact on access include affordability, physical proximity, regulation, or eligibility requirements imposed by the insurer.

- *Usage factors.* In addition to these access barriers there may also be usage factors that discourage people from taking up the product even if they have access. These include the availability of informal alternatives, fear of 'officialdom' and paperwork required by insurers, distrust in the formal sector, etc.

Both access and usage factors are important determinants of developing a financial market.

Appropriate products. It is important to note that financial inclusion is also defined in terms of *appropriate* products. It is, therefore, not merely about extending any product to the poor, but products that present value to them and they are able to use. In the case of microinsurance this means that consideration should not only be given to the sales side but also to the claims side, as that is where the value of the product is delivered.

The low-income population: The low-income nature of microinsurance has important implications for microinsurance products, as "low-income" also means "low premium" and may require special products, delivery channels and business models in order to provide such products in a cost-effective manner. Low premiums in turn imply low margins, which require high levels of efficiency in both market delivery and regulation[7]. The study however does not propose a specific income cut-off for the microinsurance target market and, in fact, suggests that too strict a limit on income levels may be inappropriate. The following should be taken into account:

- *Relative and absolute poverty.* Microinsurance is not necessarily restricted to those below the national or some international poverty line. Such poverty lines are typically defined to isolate the most vulnerable segments of society and trigger government intervention as final resort. There may be many other low-income households that are

[5] Note that, sometimes, these benefits need not be a pay-out, but can take the form of a defence made on your behalf by the insurer.
[6] Whereas social security is directly funded from government's annual budget.
[7] Despite this special focus, microinsurance remains an integrated part of the insurance market and should be managed accordingly.

not below the poverty line but still earn a low income, are vulnerable and are not served by the formal financial sector.

- *Limits of the insurance mechanism.* It must also be noted that the lowest income segments in a country may be beyond the reach of an insurance product that requires contributions in the form of premiums. These segments will remain the responsibility of government's social protection efforts[8].

- *Market expansion rather than exclusive poverty focus*. From a strategic market development point of view, facilitating market provision, i.e. expanding the current reach of the insurance market, is an important goal alongside the broader goal of social protection of the poorest and most vulnerable. Market facilitation requires an understanding of how markets evolve. While the extension into low-income markets can be accelerated or pushed into specific low-income client pockets, the momentum/trajectory of market development is likely to follow earnings potential. The market will prioritise the most profitable ("near") markets over less profitable ones. Getting insurers to move to the next market segment that is not currently served is taking them one step closer to an all-inclusive market. Given that most of the unserved market in developing countries will be of 'low-income' nature, expansion will serve the low-income market even if it gradually evolves from the middle-income to the poor to the poorest.

- *Subsidies.* A strict definition of income caps for microinsurance is usually only required when subsidies are provided and government wants to restrict subsidies to a very specific segment of society. If subsidies are not applied it may not be necessary to be too restrictive in the definition of the target market.

Implications for this study. In a country such as Zambia, where the insurance sector is traditionally focused only at the top end of the formally employed market and where income levels are generally low, one should therefore take caution in how one defines the microinsurance market. Instead of defining it as targeting only that part of the population that falls below a certain poverty line, this study considers the scope for the expansion of the insurance sector as a whole, with particular emphasis on the informal market (those not employed in the formal sector and therefore not falling in the traditional target market of financial services in Zambia).

In Section 7 we will briefly consider the role of microinsurance within the broader spectrum of social protection mechanisms (such as social cash transfers) aiming to reduce vulnerability and decrease poverty.

3. Context

3.1. Macro and socio-economic indicators

Political history sets the scene for the current economic and financial sector environment. Following independence in 1964, President Kenneth Kaunda introduced the Mulungushi

[8] Low income levels imply limited disposable income to allocate to insurance products and a high opportunity cost of doing so. The reality is that a proportion of the low-income population may simply be too poor to be reached by the commercial insurance market where they are expected to pay a premium.

Reforms in 1968. These reforms nationalised most industries, including insurance. A culture of state provision and limited innovation was created that many claim to partly persist until today. Multi-party democracy was only introduced in 1990, leading to the succession of Kaunda by Frederick Chiluba in 1991. Shortly after entering office, Chiluba liberalised the economy and introduced a privatisation drive. In the insurance sector as in the banking sector, this saw the entry of new players, ending the long-standing monopoly of the Zambia State Insurance Corporation.

Traditional economic dependence on mining and agriculture. The Zambian economy has traditionally been based on the copper and cobalt industry as the single biggest export sector and foreign exchange earner. The downturn in the international copper industry since the 1970s had severe economic consequences for Zambia. Over the past decade, the copper industry has however again started to grow. – until the past year, during which we have seen another downturn. Today, services account for 40% of GDP, with industry contributing 38%. As will be discussed in Section 3.4, agriculture is the sector where the overwhelming majority of Zambians earn their livelihood, especially in rural areas. It accounts for just less than 22% of GDP and comprises largely smallscale farming.

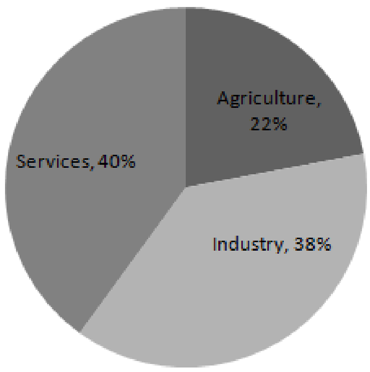

Figure 1. The structure of the Zambian economy

Source: World Bank, 2008b

Relatively strong recent growth experience and more stable inflation. In 2007, Zambia had a Gross Domestic Product (GDP) of $11.4bn. Adjusted for purchasing power parity (PPP), this increases to $16.2bn, ranking Zambia 120th out of 178 countries. Per capita GDP (PPP adjusted) was $1359, placing Zambia in the 140th position out of 167 countries for which such data is compiled (World Bank, 2008). Off this low base, the country has achieved strong GDP growth over the past decade:

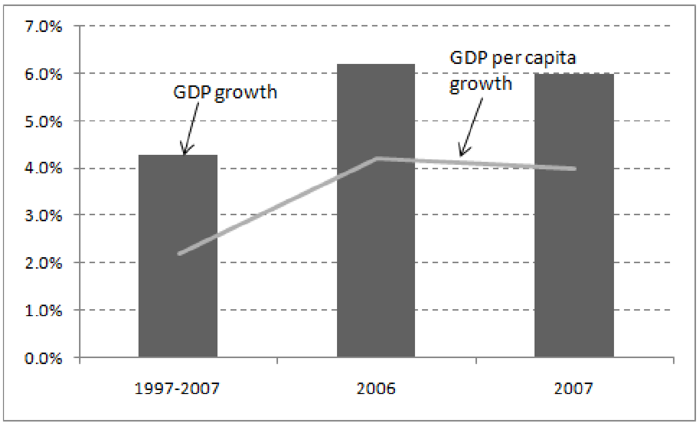

Figure 2. Zambia's recent economic growth experience

Source: World Bank, 2008b

After reaching single digit figures in 2008 for the first time in many years, inflation is again on the rise[9]:

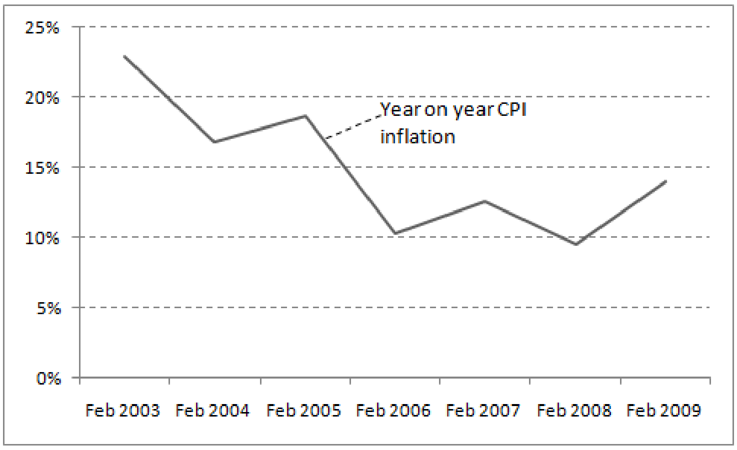

Figure 3. Inflation trends in Zambia

Source: CSO, 2009.

Small, poor and rural population with high mortality rate. Zambia had a population of 11.9m in 2007. 65% of the population reside in rural areas (World Bank, 2008b) and 68% of the population are under the age of 25 according to the Labour Force Survey (CSO, 2006). Despite the positive recent macroeconomic experience highlighted above, Zambia remains a very low-income country:

- 68% of people lived below the national poverty line of K111,747 (~$20.7) per month in 2004[10] with a large poverty gap[11]: on average, the poor in Zambia live on only 47% of the national poverty line income (CSO, 2005).

[9] The traditionally high inflation rates are named by some players as a market disincentive for especially life insurance, as insurance policies are not inflation index-linked due to a lack of index-linked investment opportunities for insurers.
[10] Defined by the CSO according to the Cost of Basic Needs Basket approach. The latest available data at the time of writing was from the Living Conditions Monitoring Survey of 2004. The CSO also defined a food poverty line (meeting only basic calorie needs, not additional needs) at K78,223 per month (CSO, 2005).

- 64% of individuals live below the traditional “dollar a day” poverty line, which has now been adjusted to $1.25/day[12].

- Almost 87% survive on less than $2.50 a day (the traditional $2/day line).

- With a Gini coefficient of 0.57, inequality is high (CSO, 2005). Urban inequality is starkest, with a fairly equal income distribution within rural areas.

The socio-economic indicators are equally disheartening:

- Life expectancy at birth of the average Zambian is only 42 years (World Bank, 2008b) and infant mortality is very high at 100 per 1000 live births (Population Reference Bureau, 2008).

- Zambia achieves only 0.453 on the UN’s Human Development Index, ranking it 163th – among the 20 lowest in the world (UNDP, 2008).

Cell phone connectivity on the rise. A significant recent trend has been the rise of cell phone penetration. Mobile phone use, as measured by the number of SIM cards in circulation, was 2.4 million at the end of 2007 (Langhan et al, 2009).

Small and illiquid capital market. The Zambian capital market is still small and illiquid. There are 21 listed companies on the Lusaka Stock Exchange (LuSE, 2009) with a market capitalisation at the end of 2008 of equivalent to US$ 4,106m, amounting to 45% of GDP (LuSE, 2009b). This compares to a market cap of about 200% of GDP in South Africa[13] and an African average (excluding South Africa and Zimbabwe) of 27% (World Bank, 2008c). Zambia’s market capitalisation is therefore above average in African terms, but lags well behind many other developing countries (in Malaysia, for example, market capitalisation is 161% of GDP – Kumo, 2008). The market is furthermore fairly illiquid: the trade volume for 2008 was 1.5bn shares with a turnover of K615bn across 8,384 trades. On average, this amounted to only 33 trades per day – well short of two trades per listed company per day.

High-yielding treasury bills crowd out retail lending. Traditionally, treasury bills (T-bills) have been the investment instrument of choice for many Zambian firms, including banks and insurers. It was argued in our consultations that the high and risk-free yields from T-bills have undermined the growth of the credit market in Zambia[14]. According to the earliest data available on the Bank of Zambia website, 273 day T-bill rates were about 31% in November 2003. Compared to the inflation data above, this rendered a real, risk-free return of more than 10% at the time. Since then, T-bill rates have decreased and now offer a real return of about 4% over 273 days:

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[11] The poverty gap is defined as the mean distance below the poverty line as a proportion of the poverty line. This measures the depth of poverty, or the increase in income that would be need to be given to each individual, on average, to bring everybody up to the poverty line income level.

[12] Following the 2005 International Comparison Programme (ICP), the results of which were released in December 2008. It used newly collected price data from 146 countries to estimate new purchasing power parity exchange rates. It also reassessed the poverty lines applied in various countries and subsequently revised the $1/day line of absolute poverty to $1.25/day, at 2005 prices and 2005 PPP rates (World Bank, 2007).

[13] According to the JSE Securities Exchange 2008 Annual Report, the JSE had a total market capitalisation of R4.514bn by the end of 2008. This amounts to 198% of GDP (2008 GDP at current prices taken from the Statistics GDP statistics, P0441).

[14] High t-bill yields can crowd out retail lending but should also incentivise deposit mobilisation. This would have been an incentive to grow the retail deposit base.

Selected dates	Nominal treasury bill rates (273 days)
20-Nov-03	31.42%
04-Mar-04	10.63%
03-Mar-05	19.59%
02-Mar-06	12.20%
01-Mar-07	11.01%
06-Mar-08	12.50%
03-Mar-09	18.20%

Table 1. Treasury bill interest rate trends

Source: Bank of Zambia, 2009

Spillover effects from global financial and economic crisis. Like many other developing countries, Zambia has not been immune to the current global economic crisis. Though the direct impact on the financial sector has been cushioned by reliance on domestic funding and a lack of exposure to toxic assets, with all banks being adequately capitalised, there has been a rippling effect in the real sector. Most notable has been the plummeting copper price, from a peak of nearly $9,000 in July 2008 to below $3,000 in December 2008. As copper accounted for almost 80% of Zambia's exports in 2007, this has had severe effects on the balance of payments and employment and has led to a sharp depreciation of the Zambian Kwacha. It has also had secondary effects on foreign direct investment in the mining and other sectors as well as capital inflows (foreign portfolio investment) more broadly. Reduced government earnings from mining royalties are likely to lead to constrained infrastructure and other budgets (Miningweekly.com, 2008; AfricaCan, 2008; Fundanga, 2009).

3.2. The role of the informal sector in the Zambian economy

Small formal sector dominated by government employment. Zambia has very low formal sector employment. According to the 2005 Labour Force Survey (CSO, 2006), there are 6.2m people aged 15 and above in Zambia, the definition CSO uses to define the working age population. Of this population, 4.9m are in the labour force[15]. The unemployment rate is 16%, implying that 84% of the labour force earns an income through some kind of formal, informal or self-employment. Of those that are employed, only 495,784 work in the formal sector. This amounts to 10% of the total labour force and 12% of the employed labour force. Although it is not documented in the Labour Force Survey report, anecdotal evidence from our consultations suggest that between 100,000 and 300,000 of the formal employees are employed in the government and parastatal sector. We therefore estimate an average figure of 200,000 in the diagram below, which summarises the composition of the Zambian labour force:

[15] The labour force is defined as all people (employed or unemployed) who are available for work. It therefore excludes full-time students, retired persons and housewives.

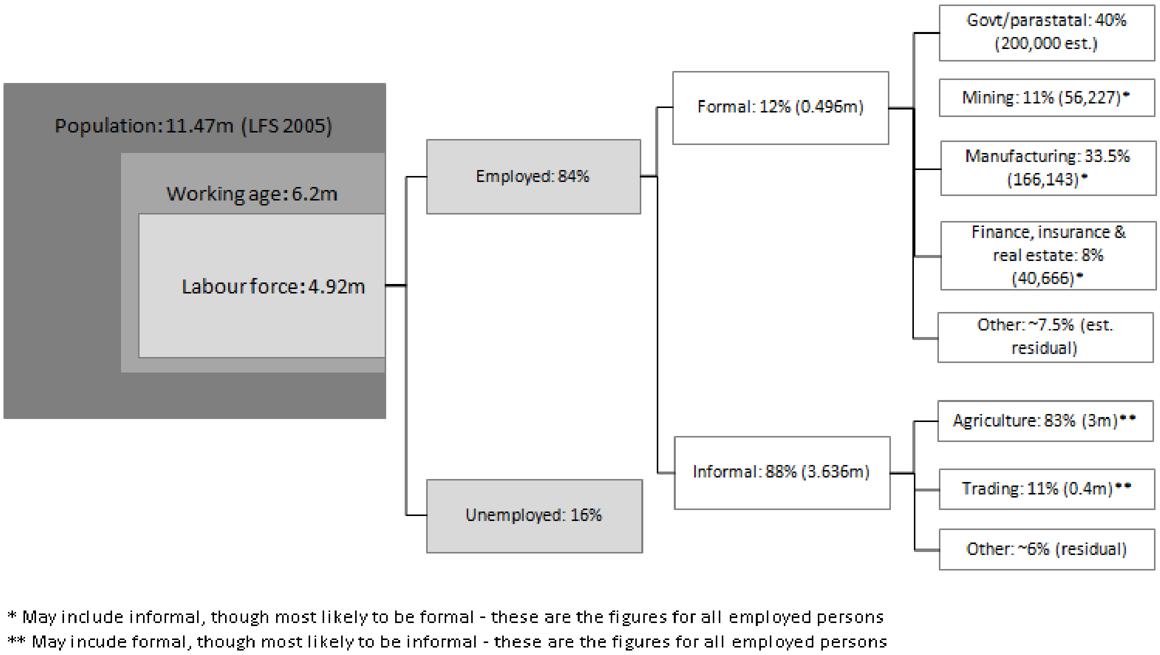

Figure 4. Zambian employment information[16]

Source: CSO, 2006, Labour Force Survey 2005

Bulk of microinsurance target market defined as informal. The vast majority of all economically active individuals in Zambia earn their living in the informal sector. When discussing the scope for microinsurance or any type of mass market expansion in Zambia, one therefore in essence refers to *informal sector penetration*.

Box 1. Note on the definition of "informal employment" in the Labour Force Survey data used

The Labour Force Survey defines informal sector employment as employment where the "employed persons were not entitled to paid leave and pension, and that less than five people were employed at their work place."[17] All three requirements had to be fulfilled for a person to be classified as working in the informal sector. Informal agriculture was also included. Therefore those working for companies employing more than 5 people would be regarded as formal even if they are unregistered. From our consultations, it would seem that there may be a substantial number of such businesses – implying that the number of people employed in formally registered businesses is even lower.

Informality undermines extension of formal financial services. Informality has a number of implications for financial inclusion. Banks cannot easily lend to the informal sector due to regulatory and headquarter restrictions (e.g. know your customer requirements for anti-money laundering purposes). For the most part, the banking sector has only recently started to aggressively target the mass market beyond formal sector employment. That means that banks are also not a channel for providing insurance to the bulk of this market. More directly, informality also poses challenges (if not an absolute barrier) to insurance

[16] Note that the data on the informal sector is largely confirmed by the LCMS (2004), where the share of informal agriculture in total informal employment is estimated at 82%.
[17] This is the same convention applied in the Living Conditions Monitoring Survey. According to Mwenechanya (2007), the common understanding of informal businesses in Zambia is however simply businesses that are not registered. Such businesses tend to be small and are run from homes, street pavements "or other informal arrangements". It also includes self-employed individuals.

distribution: premium collection among self-employed individuals or informal employees is likely to be difficult and special product features may be called for (e.g. to accommodate irregular incomes).

Small businesses as important group within the informal market. In practice in Zambia, the term informal market is often used interchangeably with the term "MSME" (micro, small and medium enterprises) or "small business market". Though not all small businesses are of necessity informal, the majority of them do operate in the informal sector (the upcoming Zambia Business Survey[18] results are likely to indicate that up to 95% of small businesses are informal). When discussing the networks in the informal market we therefore likewise refer to small business networks – of which the bulk of the membership is likely to be informal.

Box 2. The MSME sector in Zambia

Small business proprietors and employees, be they informal or formal, are an important potential target market (as individuals or as businesses) for microinsurance.

Composition of the small business market. According to a study commissioned by the ILO in October 2002 (Judai & Associates, 2002), 46% of small business proprietors are female, 36% are male and 18% have multiple owners. Each small business on average employs 2.1 individuals[19]. The recently conducted Zambia Business Survey (ZBS), will provide a more complete and updated picture. Preliminary indications are that single-person MSMEs predominate, with 67% of business respondents having no employees, 30% having between 1 and 10 employees, 2% between 11 and 30 and 1% between 31 and 50. Furthermore, the preliminary findings are that 70% of MSMEs operate in agricultural production and a further 21% in trade. This largely confirms the CSO data on the composition of the informal sector quoted in Figure 4. A third of MSMEs are female-headed and nearly 50% have only primary education.

The importance of small businesses now being recognised. Government and other role players have only recently started to recognise the role of MSMEs in the economy. Though the Small Enterprise Development Board (SEDB) was set up by government several years ago, tasked to promote SME development, results were limited. The SEDB has since been replaced by the SME division within the Zambia Development Agency (ZDA).

Various support initiatives. A number of small business development initiatives have now been launched in the donor arena. For example, the ILO and the African Development Bank are involved in private sector and business development initiatives and there are steps to set up small business "incubator units" in association with the Ministry of Commerce, Trade and Industry. The ZDA, in partnership with the Zambian Chamber of Small and Medium Business Associations (ZCSMBA) and the Zambia National Farmers Union (ZNFU) is in the process of operationalising a business development voucher scheme for MSMEs (ZCSMBA, 2009 – personal communication). This scheme is jointly financed by the Zambian

[18] The Zambia Business Survey (ZBS) is a joint partnership between government's Private Sector Development Reform Programme (PSDRP), the Zambia Business Forum, FinMark Trust and the World Bank. It interviewed a nationally representative sample of 4,800 MSME business owners, defined as all businesses employing fewer than 50 employees in line with government policy definitions.. This was combined with a large business survey of 161 businesses with 51 or more employees. Note that the findings quoted here are draft findings only. The final report will be available towards the end of 2009.

[19] It must be noted that the original research on which these estimates were based was conducted in 1996, therefore the findings may be outdated.

Government, the Netherlands, Finland and the ILO.

MSME policy under development. Government's recognition of the role of small businesses is contained in the draft MSME development policy developed by the Ministry of Commerce, Trade and Industry. It is aimed at enhancing coordination between the various public and private institutions and initiatives aimed at MSME development, including government's Private Sector Development Reform Programme (PSDRP) and the initiatives under the Citizens Economic Empowerment Act of 2006, including the Citizens Economic Empowerment Fund. Furthermore, it highlights the constraints faced by MSMEs and sets out a range of measures to be undertaken by government to create an enabling environment for enterprise development (Ministry of Commerce, Trade and Industry, 2008). An MSME Working Group was set up as part of this initiative. Various processes feed into the working group, including the ILO Lusaka Office's wealth and job creation programme[20]. Insurers are also slowly starting to see the opportunities posed by small businesses and their associations as a pool of demand as well as a potential distribution channel for microinsurance. This will be discussed in more detail later on in the analysis.

Various networks provide access to informal sectors. The informal sector in Zambia is often regarded as the 'disorganised' sector. This is, however, not really the case. Initial indications from the Zambia Business Survey are that 10% of all small businesses (most of whom we assume to be informal) belong to some sort of an association[21]. Though only covering a small percentage of all MSMEs, this represents 372,000 MSMEs (most of them sole proprietors). A number of such associations are potential touch points or aggregator channels from an insurance distribution point of view. Our consultations revealed the following existing networks (note that this is not an exhaustive list):

- **ZCSMBA (Zambian Chamber of Small and Medium Business Associations)** is a network of associations with a combined business membership stated as 13,000 across 88 associations represented in 69 of the 72 districts in Zambia. 10-15 of their member associations are considered to have the capacity to implement an insurance scheme. ZCSMBA has already been approached by an insurer to consider a partnership to offer group-based insurance to their members.
- There are various associations representing market traders and other informal professions. This includes: **ZANAMA** (Zambia National Marketeers' Association); **ZANAMCA** (Zambia National Marketeers' Credit Association); the Bus and Taxi Drivers' Association (**BTDA**), to name just a few. Such organisations will range in their degree of organisation and membership base. The umbrella body for many informal economy associations is **AZIEA - Alliance for Zambia Informal Economy Associations**.
- **ZNFU (Zambia National Farmers' Union)** reports that it has up to 350,000 members, most of whom are smallholders[22]. The smallholder farmers link into ZNFU via various district and commodity associations.

[20] Note, however, that the PSDRP officially came to an end in December 2008, though the PMU is still operation while it re-defines a Phase 2.
[21] Interestingly enough, 71% belong to a church. Should there be large networks of churches, this presents a potential touch-point for microinsurance distribution purposes. This needs to be investigated further.
[22] Note that there may be limited overlap with ZCSMBA membership.

- The **Zambia Cooperatives Federation (ZCF)** reports that it has two million members, mostly in the agricultural sector. This sector is however very fragmented and virtually collapsed over the past decade due to its history as vehicle for subsidised government inputs to farmers and the difficulties that arose around that. Financial cooperatives make up a small proportion of these. According to ZCF, there are currently 253 **SACCOs** (Savings and Credit Cooperatives) with a combined membership of about 40,000. This sector is however also not well organised at present.

Estimated total networked market – in excess of 200,000. What is the total market potential for insurance across these various networks? Though no hard data are available on the true size of the informal market or the number of viable associations from an insurance distribution point of view, one can venture the following "back of the envelope" calculations:

- *Total inside the agricultural sector.* Sections 3.4 and 7.2 will elaborate in more detail on the existing networks and associations in the agricultural sector. Based on this information, one can safely assume that a minimum of **150,000** small farmers present a ready target market for insurance.

- *Total outside of the agricultural sector*. If, from Figure 4, we assume the informal market outside of agriculture to comprise 600,000 individuals, and we assume 10% of them to be networked, this would suggest about **60,000** people for whom an existing aggregator channel exists..

This renders a conservative estimate of the networked informal market as potential insurance target market of at least 210,000 people[23]. Though low compared to the overall informal market, this figure accounts for more than 40% of the current insurance market.

3.3. Financial sector trends

3.3.1. Banking sector

Why consider the banking sector in an insurance study? Though this study does not directly pertain to the banking sector, a quick overview is nevertheless useful given the current and potential role for bancassurance in insurance distribution. Our consultations revealed that a number of banks in Zambia are proactive in expanding their retail client base and have even started to consider the bundling of insurance with bank accounts to enhance the service offering to clients. Furthermore, as the bank sector reach is much greater than that of insurance, the banked population presents an important pool for insurance penetration growth, could the full potential of bancassurance be unlocked.

Limited banking infrastructure. There are 16 registered banks in Zambia with a combined footprint at the end of 2008 of 233 branches, 295 ATMs and 726 POS devices (Bank of Zambia, 2009). This network compares as follows with that of some of the other countries in the region:

[23] Note that this is much lower than the estimated 372,000 small businesses that belong to an association according to the preliminary ZBS findings. We are however comfortable with this estimate as not all associations will be viable aggregators with strong communication channels to their members and potential means of premium collection. The 210,000 estimate is therefore deliberately conservative to indicate the likely lower bound of networked individuals, or the "low-hanging fruit" for insurance distribution purposes.

Country	Per 100,000 of the population (2005): Branches	ATMs
Zambia	1.5	0.7
Kenya	1.4	1
Tanzania	0.6	0.2
South Africa	6	17.5
Zimbabwe	3.3	3.4

Table 2. Branch and ATM penetration in Zambia and selected other Eastern and Southern African countries.

Source: adapted from OPM & PMTC (2008)

Zambia compares well with Kenya and especially Tanzania in terms of financial sector infrastructure, but lags significantly behind Zimbabwe. South Africa is a regional outlier, included for comparison purposes. The bank branch, ATM and POS network is biased towards urban areas, especially along the Livingstone, Lusaka, Copperbelt area (Langhan et al, 2009). Historically, the ratio of urban to rural bank branches was 50:50. This was in line with government policy which stipulated that the ratio should be equal. When this requirement was dropped in 2004, the share of rural branches dropped to 43% (De Luna Martinez, 2006). The distribution is likely to have been skewed further since then.

Low but growing financial penetration. The Zambian access strand[24], a tool that maps the usage of formal and informal financial services as a percentage of the adult population, reveals low overall penetration of banking services for 2005 data:

[24] The access strand is a tool used to capture the reach of the financial sector in a particular country. The concept was created as part of a collaborative effort by the World Bank, the International Monetary Fund (IMF), the UK Department for International Development (DFID) and the FinMark Trust. The access strand consists of three indicators that rely on usage as proxy for financial access. Although it does not distinguish between access and usage, it allows for the creation of an international benchmark which can be used to facilitate country comparisons.
The access strand divides the adult population of a country into:

- Those who are served by the *formal banked* sector (i.e. the proportion of adults who currently have one or more bank account)
- Those served by the *formal other* sector (i.e. don't have a bank account but have one or more other formal financial product such as an insurance policy, a microfinance loan etc)
- Those who use only *informal* services, such as rotating savings clubs, informal money lending, informal risk-pooling, etc.
- Those who do not use any kind of financial service, formal or informal (the *financial excluded*).

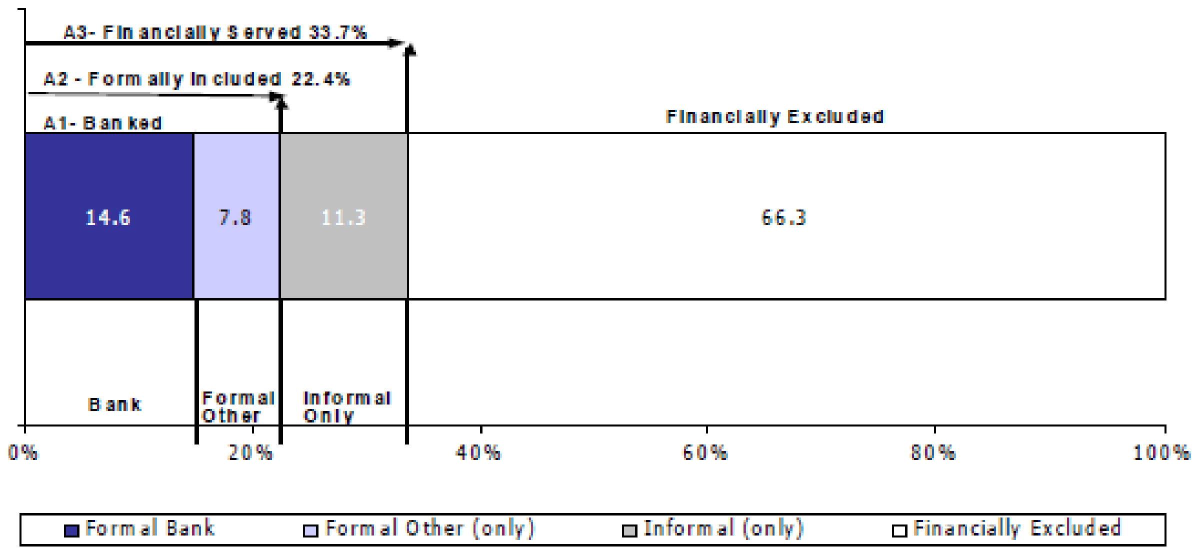

Figure 5. The Zambian Access Strand

Source: FinScope findings report (2005 data)[25]

Fewer than one in six (14.6%) adults indicate that they are currently banked. An additional 7.8% only use other formal financial services (such microloans, insurance, pensions, etc) and 11.3% only use informal financial services such as a chilimba (savings group) or kaloba (money lender). (Note that those that use formal services may also use some kind of informal services. This part of the access strand measures those who use exclusively informal financial services). Two thirds of Zambians use no financial services whatsoever.

Drive to expand the banking market. Since the FinScope survey was conducted in 2005, the importance of financial inclusion (as contained in the Financial Sector Development Plan – to be discussed in Section 4.1) has been emphasised by the Bank of Zambia. Over the same period, due to a confluence of various market forces, a few banks have embarked on major retail expansion drives. To name just two examples:

- **Barclays** employed a force of direct sales agents numbering 4,000 at one stage, combined with an aggressive new branch roll-out strategy (including a number of prefabricated steel structure branches), to triple its retail client base over the past 2 years. It also introduced a savings/transaction account, named the Tonse account, aimed specifically at the low-income market. It has low opening and minimum balance requirements, with transaction fees tailored to the needs of the low-income market[26].

- **Zanaco**, the erstwhile state-owned Zambia National Commercial Bank, has also been innovative in its approach to penetrate the mass market. It has a branch in Lusaka's Soweto Market as part of its strategy to open branches in densely-populated, formerly

[25] FinScope is a nationally representative demand-side survey conducted in Zambia and a number of other African countries with support from the FinMark Trust. See www.finscope.co.za for more details. In Zambia, the first consumer survey was conducted in 2005. A small business survey and a follow-up consumer survey are currently underway.

[26] An opening and minimum account balance of K40,000 (~$7.4) applies. A monthly service charge of K20,000 ($3.7) is levied. This entitles the user to two free withdrawals and one free deposit per month. For further ATM withdrawals, the charge depends on the amount withdrawn: K1,000 for any amount up to K100,000, K3,000 for amounts between K100,000 and K250,000, K5,000 for between K250,000 and K500,000, and K7,000 for anything beyond K500,000. A withdrawal at another bank's ATM or from abroad costs K10,000 ($1.85). The account may be used as a salary account for people earning no more than K750,000 per month. Electronic fund transfers are charged 1% of the transferred amount. The maximum balance for this account is K10m ($1850).

unserved areas. In addition it makes use of direct sales agents to explain financial products and services and sign up customers in workplaces, open markets, shopping malls, schools and any other high traffic areas. At the end of 2008, Zanaco also launched its aggressively marketed Xapit Instant Banking account. This visa electron card-based account attracts low transaction fees and no monthly charges and forms the basis for a range of mobile phone-based transactions including the loading of airtime, money transfers and bill payments.

The low "banked" penetration as indicated by the 2005 FinScope survey results may therefore mask the innovative dynamics in the sector currently. The second FinScope survey, currently underway, will provide an updated picture of the level of bank account usage. Note, however, that as a result of the global financial crisis's impact on the Zambian economy, as well as pressure from their parent companies where international subsidiaries are concerned, the banking sector is now looking for ways to minimise losses. This is likely to have implications for innovation budgets.

3.3.2. The rise in the low-income credit market

Microinsurance internationally is dominated by credit life insurance (often with riders offering additional cover, e.g. for funeral expenses) distributed on a compulsory basis via the microfinance sector. There have been some particular developments in the Zambian low-income credit market that will impact on its role as channel for insurance and is worth considering here.

Large microloan portfolio dominated by payroll lending and commercial microlenders[27]*.* Currently, the Association of Microfinance Institutions in Zambia (AMIZ) estimates there to be 250,000 microlender/payroll loan clients in Zambia. This is in line with estimates by recent research (OPM, 2008) of between 200,000 and 250,000 clients in the sector. In addition to the microlenders, banks and social MFIs contribute estimated client portfolios of up to 150,000 and about 50,000 respectively:

- Two of the largest retail banks between them have about 90,000 loan clients (data disclosed during consultations). Based on this number, one could make a liberal assumption (assuming no overlap of loan clients between banks) that the total bank loan market is unlikely to exceed 150,000 borrowers. A substantial proportion is likely to be personal loan (payroll or debit order-based) clients.

- OPM (2008) estimates the total social microfinance market to have about 50,000 clients. Studies commissioned by AMIZ (Musana, 2003; AMIZ, 2004) suggest that this may be slightly higher.

Based on the above estimates and likely overlap between bank, MFI and microlender borrowers the microloan market can be estimated to range between 300,000 (depending on

[27] A note on terminology: the microfinance market in Zambia comprises three categories: (1) what we refer to as **microlenders** or sometimes known as consumer lenders: commercial financial service providers who provide individual loans, mostly based on payroll deductions; (ii) **social microfinance institutions** (MFIs): these are traditionally donor-funded NGOs, many of whom have now transformed to commercial companies, who provide group loans mainly for productive purposes, relying on the group methodology to enforce repayment discipline; both of these categories are registered microfinance institutions with the Bank of Zambia; (iii) **banks**, though they are not microfinance institutions, also provide what can essentially be considered as microloans through their portfolio of personal loans. These loans are a combination of payroll-based loans and debit order-based loans.

the view taken on the size of the microlending market) and a maximum of about 450,000. Between 250,000 and 400,000 of these are individual loan/payroll clients who represent between 50% and 80% of the estimated formal employment market (of 0.5m people). It is our hypothesis that a total figure of around 350,000 would be most realistic.

Large-scale change in structure of microloans market. The dominance of payroll lending suggested by the above figures is a development that emerged within the last five or more years as result of dramatic changes in the credit market. Over this period, the microfinance industry in Zambia transformed from a model based on the donor-driven group-lending methodology focused on productive loans, to one largely based on commercial microlending (individual loans) and payroll lending in particular. This was the result of a number of key events in the Zambian credit market that are noted below.

Fraud. limited capacity and delinquency leads to near-collapse of social MFIs. Prior to liberalisation in 1992, microfinance supply in Zambia was largely comprised of agricultural credit provided by parastatal credit institutions. These institutions however collapsed in the mid-1990s, paving the way for the donor-driven small business/retail trading finance model (AMIZ, 2004). The social microfinance model underwent a difficult period in the early 2000s when it came to light that it had overextended its management capacity in the rapid scale-up attempted and had experienced a fraud meltdown. AMIZ (2004) ascribes the below-par performance to poor programme design, lack of technically skilled staff and management, as well as the negative impact of the poor credit culture arising from failed government and NGO credit projects. In fact, delinquency proved to be so high that AMIZ commissioned a separate study (Musona, 2004) to investigate its causes and possible solutions.

The poor performance has adversely affected donor support, with two formerly major donors, USAID and the EU, significantly curbing their support (AMIZ, 2004). At the time of writing, the AMIZ report found promising signs of a reverse in the trend among a few conventional MFIs, most notably PRIDE Zambia, CETZAM Opportunity Microfinance and Micro Bankers' Trust. It was however emphasised that this sector is likely to remain dependent on donor support (AMIZ, 2004). In a more recent study, OPM (2008) finds that social MFIs are still often loss making, even though they remain costly to use for clients by international standards. This can at least partly be ascribed to high cost ratios of up to 80%.

The rise of microlending. At the same time, new entrants established payroll lending in Zambia. This market provides personal loans for those on the formal sector payroll[28] and has seen significant growth over the past few years. The microlending market charges higher monthly interest rates than banks typically would on their payroll or debit order loans and may be less strict in its screening requirements than banks generally are[29]. According to OPM (2008b), banks in 2007 paid on average 1.3% per annum in deposit interest and charged on average 17.7% interest on loans, creating an average spread of 16.4%[30]. For MFIs, the spread is much bigger[31]: during the first quarter of 2008 an average annual interest rate of 24% was

[28] While it is possible that they also serve the informal sector (where an informal company can e.g. generate payslips for its employees or proprietor) to a greater extent than the bank sector, the main client base of the microlending industry remains the formally employed market.
[29] Note, however, that some players, especially the larger ones, do screen loan applicants according to affordability and other criteria and applies a certain debt service ratio when approving loans.
[30] Unlike the risk-free rate of return on T-bills referred to earlier, this is not a risk-free return. Therefore banks traditionally had more incentive to invest in T-bills.
[31] A fact that OPM (2008b) notes with concern, given high returns on equity of between 60-70% in the industry and the fact that salary loans are relatively low-risk.

paid on MFI funding, while charging on average 95% per annum on loans, implying a spread of 71%.

Failure of social MFI models results in commercialisation of social MFI sector. In an attempt to overcome the fraud collapse, to deal with competition from the microlending industry and to survive without donor funds, most of the social MFI models are also transforming into commercial entities. For example: PULSE Financial Services, initially set up with DFID funding as the Peri-Urban Lusaka Small Enterprise (PULSE) Project under CARE International and applying the group loan methodology, is now a fully commercial enterprise focusing on individual loans. Though some group-based MFI lending is still taking place, the microfinance sector as a whole is now dominated by payroll lending.

Late entry of banks into low-income credit market. The low market share of banks in this market is reflective of the lack of incentive to enter low-income credit markets as well as stricter regulatory conditions (in some cases imposed by foreign head offices rather than domestic regulation – see the discussion on AML/CFT in Section 4.3) on bank credit. In the banking sector, high t-bill yields as highlighted in Section 3.1 traditionally disincentivised the development of the credit market. With the stabilisation of inflation and the levelling off in t-bill and interest rates witnessed over the past five to six years, the bank lending sector has however developed at a steady pace (AMIZ, 2009 – personal communication).

Regulatory reform and life beyond payroll lending. There is growing recognition that the payroll market is nearing saturation, given the fact that total formal employment is less than 500,000. The OPM (2008) results caution that the market may be less healthy than it would appear at first glance: it is found to be relatively uncompetitive and uncontested, with high and variable[32] average prices and sub-optimal capital use[33]. Regulation is also catching up with the rapid market development and there are signals that government and employers are no longer willing to tolerate overextension of borrowers. Several consultations indicated that there is mounting pressure on government to impose a central credit screening mechanism to enforce some debt service ratio (whereby a person may not obtain credit that would amount to more than a certain proportion of their monthly salary). Currently, while some of the bigger microlenders do apply credit screening, it is common practice for people to doctor payslips in order not to reflect other deductions (AMIZ, 2009 – personal communication). With the recent introduction of the Credit Reference Bureau (which is still building up its database)[34], it should however be easier to control.

A return to productive loans? Should the growth in the payroll market start levelling off as suggested by the evidence, this would once again imply the need for the reinvention of the industry to provide business loans to the large untapped MSME market. According to AMIZ, some of the microloan players are already starting to consider new models such as the Grameen lending methodology.

[32] The limited survey responses elicited from individual commercial microlenders by OPM (2008) range between 3½~13½% per month for one month lending and 4¾~9% per month for 12 month lending.

[33] It is found that they are highly over-capitalised: " their actual eligible capital is nearly 2½ times the required minimum which in turn is set at a conservative 15% of risk-weighted assets" (OPM, 2008). The larger capital base could however hedge against the potential worsening of the book as OPM predicts

[34] The need for a Credit Reference Bureau to address the poor credit culture was identified in the 2002 IMF/World Bank Financial Sector Assessment Programme of Zambia and subsequently adopted in the Financial Sector Development Plan of 2004. The credit reference bureau – Credit Reference Bureau Africa Lt – was launched in January 2007. The Bank of Zambia has however expressed concern with the level of cooperation of banks and financial institutions in supplying data to the bureau and stated in August 2008 that the credit data mined so far is inadequate for the production of meaningful reports (BoZ, 2008).

3.4. Overview of the agricultural sector

An understanding of the agricultural sector in Zambia is important for the analysis in the rest of the document for a number of reasons. As is apparent from the discussion below, it is the sector where most Zambians are active, many of them earning a surplus out of which insurance premiums could be paid. Furthermore, it contains various farmers' and processing networks that provide touch points to leverage the potential scale provided by the sector. These networks are often linked to the agricultural value chain. Where a part of the value chain that serves as aggregator of another (e.g. a processor with various small farmer suppliers) has an interest in minimising the risks faced by the farmers, this bodes well for insurance development. We will return to this in Section 7.2 where we consider the scope for agricultural microinsurance in Zambia. The present section aims to sketch an overview of the agricultural sector that will form the backdrop for that analysis.

Most Zambians earn their livelihood through agriculture. In 2007, agriculture contributed almost 22% to Zambia's GDP (World Bank, 2008b)[35]. This figure masks the crucial role it plays in the lives of most Zambians. The latest available Labour Force Survey (2005) indicates that just more than 3m individuals, or 73% of the employed labour force, are active in the agriculture, forestry and fishing sector, primarily in subsistence farming. Of these, 99% are in the informal sector (2,989,435) versus only 36,399 (1%) who are employed formally.

The Central Statistics Office's (CSO) bi-annual Living Conditions Monitoring Survey (LCMS) tracks the number of households that are engaged in agriculture. As the table below indicates, 90% of all rural households indicate being involved in agriculture (livestock or crop):

	Total number of households	Proportion engaged in agriculture
Rural	1 287 490	90%
Urban	823 150	26%
Total Zambia	**2 110 640**	**65%**

Table 3. Proportion of total households engaged in agriculture.

Source: CSO, 2005, LCMS 2004

The importance of agriculture is confirmed by the FinScope findings, even if the figures are somewhat lower than those captured by the CSO. Of those who indicated having a main source of income, 37% state their main income source to be agriculture (versus 23% earning their main income in trading). This would suggest that, though 90% of rural and 26% of urban households are engaged in agriculture, it is likely not to be a main source of income for many. The income question in FinScope is however likely not to reflect subsistence farmers, as they do not earn a cash income from their crops.

The vast majority of Zambian farmers are smallholders. Out of the approximately 1.2m crop growing households reporting their areas under crop in the CSO 2004-05 Post Harvest Survey[36], 96% have cropped land of less than 5h and can be classified as smallholders (see

[35] The share of agriculture has risen steadily over the past 20 years from 12% in 1987. This corresponded to a marked decline in the role of manufacturing from 28.8% in 1987 to its current level of 11% (World Bank, 2008b).

[36] Note that this total households figure differs from that of the LCMS 2004 survey quoted above. These are only crop-growing households. Furthermore, not all households reported their area under crop, implying different scaling up than in the LCMS survey.

Box 3 below for definition). The remaining 4% can be considered emerging farmers. The survey did not monitor commercial farmers:

Area under crop	Number of households	% of total
0-1.99ha	825 744	69%
2-4.99ha	317 935	27%
5-19.99ha	49 323	4%

Table 4. Distribution of crop-growing farmers by size of plot under crop.

Source: CSO, 2005, 2004/2005 Post Harvest Survey

These orders of magnitude correspond to the data of the Zambian National Farmers Union (ZNFU). Of the 350,000[37] farmers and businesses represented by their members, more than 95% are smallscale farmers[38] (personal communication, 2009). Likewise, FinScope reports that out of those earning an income in agriculture (main or supplementary), almost 80% classify themselves as smallscale farmers; a further 18% have smallholdings and only 2.7% are commercial farmers[39].

Box 3. Definition and profiles of smallholder and emerging farmers

The discussion above refers to "smallholders" and "emerging farmers" as opposed to commercial farmers. Emerging farmers are also sometimes referred to as medium scale farmers. USAID/PROFIT (2009), summarising various CSO surveys on agriculture, defines the following definitions:

- **Small scale farmers**: farmers with less than 5ha under cultivation. There are an estimated 1.1m smallholder farmers in Zambia (a number which has not grown over the last three years). Of these, only 18,000 (2.5%) do not grow crops. Smallholders mostly farm on communal land (ZNFU, 2009). They utilise low input, low output production technology and depend on family labour and hand tools, with some limited use of oxen (USAID/PROFIT, 2008). They produce partly for subsistence, but also earn cash from crops such as cotton.

- **Medium scale/emerging farmers**: farmers with between 5 and 20 ha under cultivation (the ZNFU estimates the typical range at 5-50ha). The number of medium scale farmers appears to have grown by approximately 10% of the last three years to an estimated 44,000 in 2008. Of these, only 300 (less than 1%) do not grow crops. An emerging farmer will typically own the land he or she farms on, either as titled land or via a resettlement scheme[40]. He or she will use modern inputs and often some farm machinery, for example a light truck and an old tractor. His farming operations are constrained by a lack of access to inputs and loans (of all those involved in agriculture, only 15% receive input financing[41] according to FinScope, 2005) and the lack of a reliable output market. This means that he has on average only 10-20ha of his farm under production (ZNFU, 2009 – personal communication). The main crops produced by this sector are maize, sunflower, soybeans tobacco and cotton (USAID/PROFIT, 2008).

Despite the fact that many smallscale farmers produce largely for subsistence purposes, there is also

[37] Note that other players estimate this number to be significantly lower.
[38] Note, however, that ZNFU does not consider informal "microfarmers" – who only grow some crops for own consumption, in their back garden so to speak – as part of their figures. For this reason, the total number of farmers as estimated by them may differ from the CSO figures.
[39] FinScope did not define the three terms or the difference between "smallscale farming" and "a smallholding". Note that there were not enough respondents for smallholdings and commercial farmers for the results to be statistically significant.
[40] An area demarcated and developed in terms of infrastructure by government. Such schemes were popular in the 1970s and the idea is gaining popularity again
[41] 23% of whom through government financing programmes, 26% through outgrower schemes and 33% through cooperative financing schemes (the only response with enough respondents to make the results statistically significant). The vast majority of these 'co-op' loans are government fertiliser subsidy loans managed by the co-ops.

a vibrant cash economy in the smallholder and emerging farmer sector.

- **Commercial farmers** are owners of large farms that operate fully commercially and are formally registered businesses. According to ZNFU there are about 600-800 commercial farmers in Zambia (740 according to the 2000 Census conducted by CSO). They account for virtually all of Zambia's agricultural exports and the bulk of the production of cash crops such as coffee and tobacco.

Not all types of agriculture relevant from insurance distribution point of view. The intermediation of insurance to smallholder farmers requires a production surplus (from which premiums can be paid) and ready aggregators (organised groupings that can be used as distribution network). This narrows down the agricultural sector to certain subsectors, as explored below.

In the 2008/9 season, maize accounted for 66% of all agricultural production and more than half of the area planted to crops in Zambia, a figure that rose from 46% in the 2006/7 harvest:

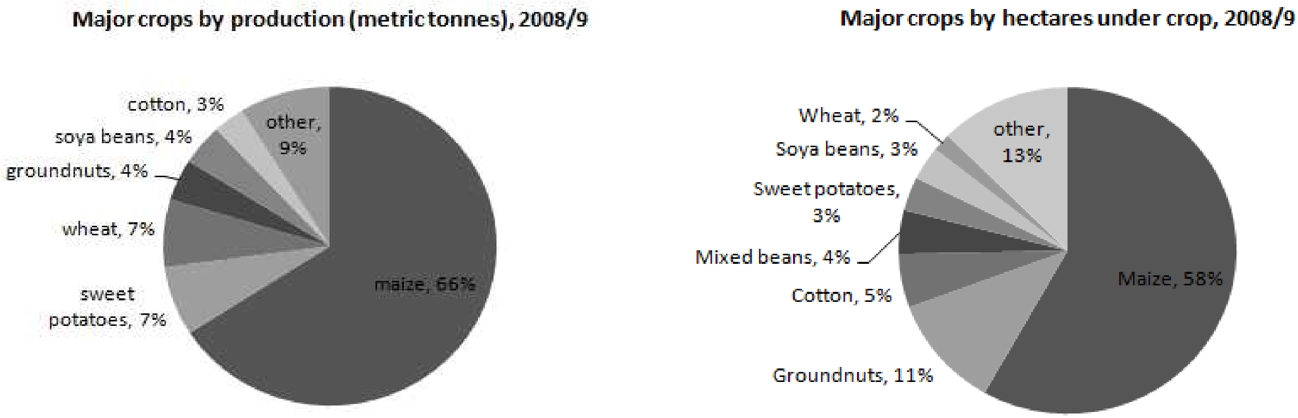

Figure 6. Major crops in Zambia, 2008/9 season

Source: USAID/PROFIT (2009), based on CSO 2008/9 Post-Harvest Survey

Some crops more readily lend themselves to smallholder cash crop production than others. The following table summarises the major crops by type of producer:

Crop	Type of farmer that dominates
Maize	Mixed
Cassava	Smallholder
Sorghum/Millet	Smallholder
Rice	Smallholder
Groundnuts	Smallholder
Soya beans	Mixed, but mostly commercial
Seed cotton	Smallholder
Tobacco	Mixed
Mixed beans	Smallholder
Wheat	Commercial
Sugar	Commercial
Coffee	Commercial

Table 5. Crops in Zambia by type of farmer that dominates its production.

Source: USAID/PROFIT (2008)

The crops where the most smallholder farmers are concentrated are:

Maize. 88% of Zambia's total maize crop is produced by small and emerging farmers (CSO Post-harvest Survey, 2009). Maize has been described as a "political" crop, with a history of state intervention in inputs and output markets for smallscale farmers through the cooperative sector. The average national yield is low by international standards and not sufficient to reach breakeven point, commercially (USAID/PROFIT, 2008). According to various CSO surveys summarised in USAID/PROFIT (2009), only 25 to 30% of all smallholder farms nationwide annually sell their maize – the rest see themselves as subsistence producers. This is confirmed by the following statistics (USAID/PROFIT, 2009):

- Each year since 2000/01, roughly 10% of the smallholder farms account for 45 to 50% of all of the maize produced by the smallholder sector. The bottom 60% of all smallholders only account for about 20% of production.
- The top 10% of smallholder farms account for at least 80% of all of the maize to be **sold** by the smallholder sector.
- Only 55% to 80% of the total maize area planted by smallholder farmers was actually harvested (depending on the year and the rainfall).
- Smallholder yields are on average very low: only 1.14 metric tonne per hectare in the 2008/9 harvest, versus 4.54t/ha for commercial farmers.

The manner in which maize is produced therefore does not provide surpluses to the small farmers, keeping them mostly to subsistence farming. Though the largest single crop in Zambia, maize is therefore a potentially challenging sector from an insurance distribution point of view – unless specifically targeting the roughly 10% of commercially minded maize farmers who do create a cash surplus. Agricultural reform would be a prerequisite for insurance to play a role in supporting the development of the sector.

Cassava is the staple crop in two of Zambia's nine provinces, but there is no formal market for cassava. Production is largely for subsistence purposes and sales are through informal marketing channels only (USAID/PROFIT, 2008).

Cotton. In the 2008/09 harvesting season, there were about 100,000[42] smallscale farmers in the cotton industry, accounting for 95% of Zambia's cotton production (USAID/PROFIT, 2008). All of these form part of outgrower schemes and there are no "independent" cotton growers. More information on the cotton outgrower schemes are provided in Box 4.

Box 4. Cotton outgrower schemes in Zambia – how does it work and what are the challenges?

There are nine major cotton ginning companies in Zambia. The two largest ginners, Dunavant and Cargill (formerly Clark Cotton) have longstanding outgrower schemes, and several others are now following similar models. The remaining ginners tend to operate on a looser arrangement with farmers and do not invest as much in production.

[42] In previous seasons this number was as high as 180,000.

Under the outgrower model, cotton processors recruit and contract mainly smallholder farmers to outgrower schemes, thereby guaranteeing a market for their harvests. Input packs consisting of seeds and chemicals, to the value of K150,000 to K200,000 (~$28-$37) for a basic pack, are then provided to farmers on credit. The outgrowers are also provided with extension services, as well as empty bags and crop transport. Generally, no fertiliser is used as it is thought that the risk and returns do not warrant the investment. This is just one of many constraints to productivity, including late planting, poor plant populations, insufficient weeding, lack of access to productivity enhancing technologies such as herbicides, etc. Some farmers also plant non-certified seed, which can significantly impair yields.

The cotton ginners primarily deal with farmers through distributors or agents. Such distributors/agents can be contracted third parties (distributors), contact farmers or employed agents. The third parties screen farmers for their credit worthiness, on-lend input credit, monitor production and recover loans at the end of the season.

Most ginners issue an indicative pre-planting price. Upon the completion of the harvest, distributors receive commission on debt recovery. The income generated by each smallholder is generally very low and is regarded by the poorer performing farmers as a way of converting family labour to cash rather than as a commercial enterprise. It is estimated that an average farmer sells about $200 of cotton each harvest (MTZL, 2008 – email communication).

Source: USAID/PROFIT (2008).

Tobacco. There are about 35,000 smallscale growers in addition to the 400 commercial farmers in this sector (more than 300 of which are expatriate Zimbabwean farmers that moved to Zambia under the political turmoil experienced there). While earning per hectare are high for this crop, smallholder yields and areas planted are generally quite low. However, these small tobacco growers are well networked through the tobacco growers' association and also access credit via the association (ZNFU, 2009 – personal communication).

Cattle. In addition to these crops, about 70% of all cattle in Zambia are in the smallholder sector. As a rule, cattle is not only sold commercially, but is regarded as a valuable asset for rural households by providing food, employment and status and by contributing draught and manure for crop production (USAID/PROFIT, 2008). There is almost no networking in this industry. The largest player in the beef industry, Zambeef, merely provides a marketplace and does not operate a network or support structure as in the case of the outgrower schemes. It can however potentially provide a central access point to farmers.

Dairy. Though smallholder farmers represent 99% of all dairy farms, this has thus far not been a viable sector from a commercial insurance point of view. Cattle are mostly kept for beef production, with milk as a side product. Yields in the smallholder sector are therefore very low and most production is used for family consumption or is marketed informally. This situation is however starting to change: there are now a number of smallholder producer associations that supply milk to Parmalat, the largest producer, on a limited but growing scale (USAID/PROFIT, 2008). The figure of volume of smallholder milk moving into the formal market (i.e. through one of the main processors) is growing rapidly. From January to March 2009, over 1.3 million litres of milk was collected from smallholders by three commercial processors (USAID/PROFIT, 2009) When smallholders are tied to a processor, there is an opportunity for insurance[43].

Poultry. There are an estimated 10,000 poultry raisers in Zambia, most of them on a small 'backyard' scale. There are four larger processors, two of which have outgrower schemes (Bear, 2005, quoted in USAID/PROFIT, 2008).

The opportunity of aggregation. In the discussion above, we referred to the degree to which smallholders and emerging farmers are networked or sell into formal markets. These can be regarded as "channels of aggregation" of smallscale farmers and will be of relevance in the discussion on the scope for microinsurance in the agricultural sector in Section 7.2. Small farmers can only feasibly be reached if this can be done through existing networks and structures that provide economies of scale and that have the incentive to support farmers to manage risks. The reach of the most feasible agricultural aggregation schemes can be summarised as follows:

Type	**Number of feasibly aggregated smallholders**
Maize	n/a
Cassava	n/a
Cotton	100,000[44]
Tobacco	35,000
Cattle	n/a
Dairy	No estimates available, but likely to number a few thousand
Poultry	<10,000
Total	**~ 145,000**

Table 6. Summary table: agricultural outgrower schemes or supplier relationships

Source: based on estimates by USAID/PROFIT (2009)

The extent of membership of cooperatives, farmers' associations and outgrower schemes will be discussed again in Section 7.2 in the context of the scope for insurance to the agricultural sector. As will be seen, we estimate the total feasible agricultural market to amount to 150,000 small farmers based on the calculations above. As there are also various other farmer's associations and cooperative structures, this is a deliberately conservative estimate to indicate the minimum opportunity[45].

3.5. Overview of the health sector

As with agriculture, it is important to also build an understanding of the structure of the health sector in Zambia. As will be apparent later on, the health insurance market is of particular relevance from a demand-side point of view, but is also one of the most difficult micromarkets to unlock.

[43] Note that such an arrangement, whereby a small supplier has a contractual supply arrangement with a processor is different to ad hoc sales to a large buyer without any fixed relationship as is the case in e.g. the cattle industry.
[44] This figure is likely to change from season to season and has reached a high of 180,000 before.
[45] For example: the outgrower schemes in the sunflower and soya bean industry are not explicitly highlighted in this report. In order to make a conservative estimate of the number of ready touch points, we only focused on documented cases of well-resourced outgrower schemes. Likewise, outside of the agricultural sector the SACCO channel is noted as a potential aggregator channel. Due to current capacity constraints, we however, did not include them in the current estimates. The various potential aggregator groups in the agricultural sector will be considered in more detail in Section 7.2.

Public healthcare within reach of three quarters of Zambians. Public healthcare is widely available in Zambia. Three quarters of all Zambians are within 5km of their nearest health facility:

Distance to health facility	Rural	Urban	Total
0-5km	56.7%	96.9%	75.5%
6-15km	30.7%	1.4%	17.0%
16km+	12.6%	1.8%	7.6%

Table 7. Distance to health facility: percentage of households in Zambia

Source: CSO, 2005, LCMS 2004

No means test is applied. Primary public healthcare is free of charge to children under 5 and in rural areas[46]. In urban areas adults are charged minimal consultation fees[47]. Though public healthcare is generally affordable, the cost of medication is however not covered.

Government dominant provider of health services. In 2002 (as quoted in the National Health Strategic Plan for 2006-2010), there were a total of 97 hospitals and 1,210 health centres in Zambia. As can be seen from Table 8, the state is the largest player in the market. It accounts for 55% of all hospitals, rising to 95% of all health posts in rural areas. Only 15% of all health institutions are mission or private-run.

Type of medical facility	Government		Mission	Private	Total
	Number	Share			
Hospitals	53	55%	27	17	**97**
Health Centres	1052	87%	62	97	**1210**
Health Posts	19	95%	0	1	**20**
Total[48]	1124	85%	88	115	**1327**

Table 8. Number and type of health institutions in Zambia

Source: Ministry of Health, 2005, quoting 2002 data

The 2004 Living Conditions Monitoring Survey (CSO, 2006) asked survey respondents whether they have "consulted over an illness" in the two weeks prior to the survey. Of those, the majority indicated that they used either a government hospital or clinic:

[46] Healthcare user fees for all except children under five years of age were introduced in Zambia in the 1993 under budgetary pressures given Zambia's structural adjustment programme (Birbeck et al, 2002; Masiye et al, 2008). However, user fees for rural areas were abolished in 2006 with funding from DFID to compensate district health facilities through user fee replacement grants (Moszynski, 2006; Masiye et al, 2008).

[47] There is no uniform set of fees. Local providers are allowed to set user fees in line with locally defined affordability criteria, with all fee structures to be approved by the Ministry of Health (Masiye et al, 2008).

[48] The definition of health centres and health posts versus hospitals differs depending on the size of the catchment population they are to serve and, hence, the scale of the institution. Full definitions are contained in Ministry of Health, 2005.

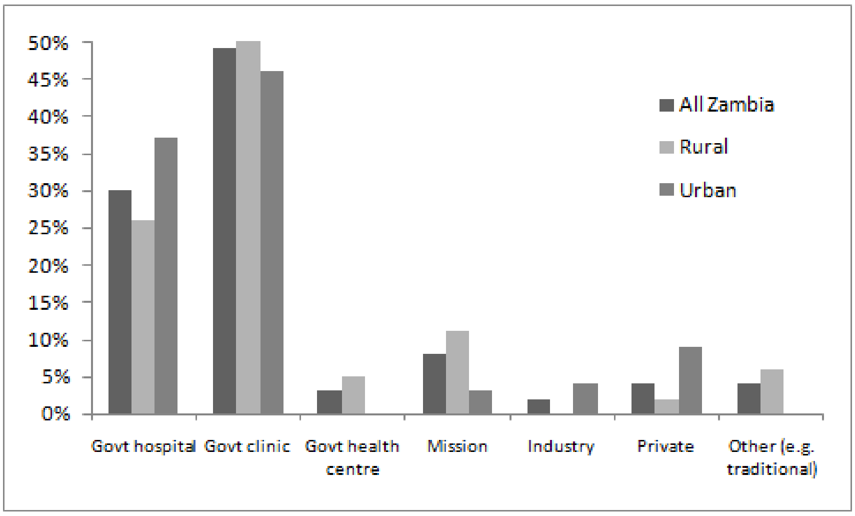

Figure 7. Percentage of ill persons visiting various types of healthcare institutions.

Source: CSO, 2005, LCMS 2004.

Of the total number of individuals that have visited a health facility shortly before the survey, 82% reported to have visited a government hospital, clinic or health centre. In comparison, only 14% reported to visit missionary, industry-provided (e.g. factory clinic) or private health facilities. Amongst rural households the use of public facilities decreases slightly to 81%. This is due to higher usage of missionary health facilities (11%) in rural areas. Only 2% of rural respondents visited a private facility.

Staff limitations undermine delivery. Despite the relatively wide reach of the public health network, skills shortages undermine government's ability to deliver healthcare. In its National Health Strategic Plan for 2006-2010, the Zambian Ministry of Health (2005) states that, despite improvements in certain indicators, the health sector in Zambia is still not on track to meet the Millennium Development Goals by 2015 and that staffing is insufficient to meet the healthcare needs of the population. Health care delivery continues to be constrained by a lack of adequate resources, most notably human resources: in 2004[49], there were 1264 physicians, a density of only one for every 10,000 of the population. There were 22,010 nurses and midwives (20:10,000) (World Health Organisation, 2009). These figures compare favourably to that of a small sample of peer countries:

	Nurses & midwives per 10 000 pop.	Physicians per 10 000 pop.
Tanzania	4	<1.0
Malawi	6	<1.0
Uganda	7	<1.0
DRC	5	1
Kenya	12	1
Zambia	20	1
South Africa	41	8

Table 9. Health infrastructure and personnel indicators: Zambia versus selected other African countries

Source: World Health Organisation, 2009b

[49] Latest available data according to 2006 World Health Organisation Country Health System Factsheet for Zambia, data from the World Health Statistics 2006.

For the African region as a whole, the physician density however is 2:10,000 and the nurses and midwives density is 11.7:10,000. Zambia is therefore below average on number of physicians, but above average on nursing personnel.

Out-of-pocket expenditure exceeds government expenditure on health. Despite free access to a relatively wide network of public healthcare facilities, individuals still spend a large amount of money on healthcare. In 2006, the Government of Zambia dedicated 10.8% of its expenditure to health. Per capita government expenditure on health amounted to $29 (PPP adjusted). However, private or external (e.g. donor or mission) expenditure on health services is even higher at $33 per capita (PPP adjusted) (World Health Organisation, 2009b). In some cases this is to access private healthcare. In other cases private expenditure was to cover medicine cost not provided free of charge.

Medication remains a key area of expenditure. As noted above medicines are not provided free of charge by public facilities and contribute to the high level of private expenditure. In focus groups conducted for this study, medication was highlighted as a large expenditure item in the minds of low-income households. This is confirmed by the fact that 15% of all respondents in the FinScope survey who have a loan indicated that they have obtained it to purchase medicine (Finscope, 2005). According to the LCMS 2004, individuals spend the following average amounts per visit (consultation and/or medicines) to a health practitioner (public and private):

Type of consultation	**Mean amount spent (ZMK)**
All Zambia	*9167*
Rural	4147
Urban	18956
Doctor	35587
Clinical officer	4382
Norse or midwife	2421
Community health worker	1015
Traditional healer	18618
Spiritual healer	7253
Other	1547

Table 10. Average amount spent on medication and/or consultation

Source: CSO, 2005, LCMS 2004

Private expenditure on health can be out of pocket, prepaid (through insurance or medical aid schemes), or may be sponsored by an employer or other party. In Zambia, more than 70% of private health expenditure is out of pocket and less than 1% is prepaid. This compares as follows to selected peer countries:

	Private prepaid plans as % of private expenditure on health	**Out-of-pocket expenditure as % of private expenditure on health**
DRC	n/a	100
Kenya	6.9	80
Malawi	16	30.5
South Africa	77.7	17.5

	Private prepaid plans as % of private expenditure on health	Out-of-pocket expenditure as % of private expenditure on health
Uganda	0.2	51.8
Tanzania	4.5	83.4
Zambia	**0.6**	**71.1**

Table 11. Out of pocket versus prepaid contributions to private healthcare in Zambia and selected peer countries

Source: World Health Organisation, 2009b

Private facilities utilised by the poor despite high cost. With the exception of some mission hospitals, private institutions are more expensive to access. Many focus group participants did however indicate that they make use of private services from time to time, especially for emergencies[50]. Some indicated paying K20,000 ($3.70) for a doctor's consultation, whereas others indicated amounts as high as K50,000 ($9.25) per visit to a general practitioner. According to industry consultations, a private consultation will cost in the order of $8.

Microinsurance could reduce gap in healthcare provision. The fact that individuals have significant out of pocket health expenses indicates a potential need for health financing mechanisms over and above that provided by government. This suggests an opportunity for micro health insurance for those who are able to pay, perhaps targeted at the most critical needs and particularly supporting access to medicine. In Section 7.3 we explore the scope for health microinsurance. The large part of the population that is unlikely to afford other financing mechanisms will however remain dependent on government's efforts to address the problems in public sector delivery.

4. Regulatory framework

PIA as regulator and supervisor. Insurance regulation in Zambia falls under the jurisdiction of the Pensions and Insurance Authority, the PIA. The PIA was established in February 1997 as regulatory and supervisory authority for both the pensions and insurance industry. It draws its authority from the Pension Scheme Regulation Act No. 28 of 1996 and the Insurance Act No. 27 of 1997.

The PIA's mission is: "to regulate the conduct of the Pensions and Insurance industry through prudential supervision in order to protect the interest of pension scheme members and insurance policyholders and to foster the industry's growth". In this regard, it issues guidelines, policies and regulations and is the entity responsible for drafting suggested amendments to the Insurance Act itself. It also licenses and supervises insurers. All registered insurers have to report information (including audited financial statements) to the PIA. The PIA also has the mandate to take a policy stance on new or relevant issues, for example the role of microinsurance, and to initiate regulatory changes to accommodate it.

The PIA is managed by a Registrar and two Deputy-Registrars for respectively insurance and pensions and governed by a Board.

[50] The most common reason quoted, as will be discussed in Section 6, is the quality of services and the fact that long queues at public institutions may mean that emergency cases are not treated soon enough.

Structure of the regulatory analysis. This section provides an overview of the regulatory framework that governs the delivery of insurance and considers the impact that such regulation may have on the development of microinsurance in Zambia. Consideration is given to insurance regulation as well as other regulation that may impact on the insurance sector. In discussing the regulatory framework we follow the regulatory scheme as outlined in Appendix 2. It groups the aspects of policy, legislation/regulation and supervision to be considered into the following fields:

1. Financial inclusion policy

2. Insurance regulation, which consists of:
    - Product regulation
    - Prudential regulation
    - Institutional and corporate governance regulation
    - Intermediation regulation
3. Other regulation – regulation outside the insurance fold of relevance to insurance providers

Main conclusions. The analysis to come underlines the following implications for microinsurance market development:

- *Generally facilitative regulatory regime*. Zambia has a financial inclusion policy in place and the PIA supports microinsurance development. This sends an important signal to the market. Furthermore, the Insurance Act does not (through minimum upfront capital requirements) set a high barrier to entry for prospective players. There are no commission caps and the file and use product approval system facilitates innovation. AML/CFT and credit regulation pose no real challenges to insurance provision or expansion. Though there are institutional limitations on the type of organisation that may register as an insurer, there are no "candidate organisations" such as cooperatives that are affected by this at present. Furthermore, the PIA is willing to cross the demarcation divide (a significant constraint to microinsurance development in some other jurisdictions) for microinsurance products.
- *Yet some uncertainties and challenges*. There are nevertheless a few elements of the regulatory framework that may hamper microinsurance development. With the 2005 amendments to the Insurance Act also came a number of ambiguities, such as the lack of clarity on the definition of short-term life insurance. While the PIA addresses these inconsistencies through its supervisory approach and has shown itself willing to accommodate development and innovation, it risks an ad hoc approach to regulation that does not facilitate regulatory certainty. It furthermore risks creating an unlevel playing field as there is no consistent framework within which the supervisor's positions can be based. Compliance costs may also be increased if each company needs to approach the PIA individually in the absence of clear industry-wide guidelines and it risks placing the application of the law at the mercy of individuals. It is therefore important that the uncertainties in the Act itself be resolved.

- *The act makes no mention of medical or health insurance*. This has created a regulatory grey area in which unlicensed players operate, thereby creating an unlevel playing field. Though preliminary discussions are underway to consider the introduction of social health insurance and the holistic regulation of the health insurance sector in Zambia, no clear roadmap exists yet and interdepartmental communication on the matter has proved challenging.

- As the analysis will show, two further elements are proving challenging to microinsurance development: each agent is limited to only one insurer (long-term or general) and new entrants must have a local CEO with at least 10 years of insurance experience. Both of these may pose significant barriers to microinsurance development.

4.1. Financial inclusion policy

Well-developed financial inclusion policy. The Government of Zambia has an explicit financial inclusion policy in the form of the Financial Sector Development Plan (FSDP). The development of the financial sector is also one of the core goals of the Bank of Zambia. The FSDP is managed out of the Bank of Zambia, whose Non-bank Financial Institutions Department houses the FSDP Secretariat. It was adopted in 2004 subsequent to the deficiencies in financial sector development identified in the 2003 World Bank/IMF FSAP of Zambia. It expired in June 2009, but the Bank of Zambia is planning to implement a second five-year plan. It is receiving support from the World Bank to adapt the strategy to the latest FSAP (conducted in November 2008) (Maimbo, 2009).

Facilitative approach raising awareness of market opportunity. The FSDP largely uses moral suasion to push for financial inclusion across the financial sector as a whole. It also has some sector specific initiatives through its various industry Working Groups. A target of a 50% access strand (i.e. 50% of 'financially served' adults using any form of financial services – including informal) has been set for 2009. Industry has not been subjected to specific quotas or targets to achieve this goal. The FSDP has however, with the help of the FinScope survey, managed to raise significant awareness within the financial sector of the need for financial inclusion and it can be argued that this has to a large extent contributed to the growing recognition of the formal financial sector of the opportunities of the retail (and also low-income) market.

No specific focus on microinsurance. Insurance resorts under the Contractual Savings Working Group of the FSDP. While this group is working towards the development of the insurance sector, it has thus far not explicitly focused on microinsurance as a means of developing the sector and extending financial inclusion. It has identified the following strategic focus areas for the next few years:

1. Lobbying for the introduction of **tax incentives** for pension schemes

2. Encouragement for Zambians to pursue **actuarial studies**

3. To work towards the inclusion of **health insurance** in the Insurance Act and the promotion of health insurance provision and a level playing field

4. To launch insurance **awareness campaigns** among the general public

5. To conduct a **survey** of the insurance markets and regulation in other countries in the region to determine **best practice**

6. To develop a **Code of Conduct** for the pensions and insurance industry

These focus areas do not yet pay explicit attention to expanding the reach of the insurance market and no particular emphasis is placed on microinsurance. Going forward, the broad membership of the working group, which includes the Central Bank, the PIA, the insurance industry (current chair), the pensions industry and the broker industry, places it in a good position to initiative activities to develop the microinsurance market in Zambia. Furthermore, many of the other activities of the FSDP, e.g. the development of the payment system, will indirectly benefit the development of the microinsurance sector.

Insurance regulator supports microinsurance development. Although there is currently no explicit government policy on microinsurance in Zambia, the Pensions and Insurance Authority is enthusiastic about the scope for microinsurance and has indicated its willingness to adopt such a policy and make appropriate adjustments to legislation to support the development of this market. It has also already made such adjustments by, upon application, allowing two general insurance companies to write short-term life policies under their general insurance license. In addition, the regulator is dedicated to building consumer awareness and runs a weekly show on national television where a panel of experts discusses aspect of insurance and answers questions from the public.

4.2. Insurance regulation

Insurance regulations in the process of amendment. Insurance in Zambia is regulated by the Insurance Act, 27 of 1997, as amended by Act 26 of 2005 (henceforth referred to simply as the Insurance Act). It is supplemented by the Insurance Regulations issued by the Minister. The regulations are currently being revised by the PIA. The new regulations are still in the process of finalisation and were not available for this analysis.

Below we outline the components of the Insurance Act most relevant to the development of microinsurance.

Definitions and product regulation

Letter of act not in line with interpretation of insurance definitions in practice. The act defines “insurance business” as “the business of issuing policies of insurance, and includes re-insurance business” (S.2). The 1997 Act initially only referred to life and general insurance. The 2005 Amendment then included long-term insurance as overarching category. Insurance is divided into <u>long-term insurance</u>, defined as “insurance business of such classes as the Minister may, on recommendation of the Board by statutory instrument, prescribe”, and <u>general insurance</u>. General insurance is defined as any business other than <u>life</u> insurance business. A <u>life</u> policy is defined as “a policy under which the insurer assumes a contingent obligation dependent on human life, and includes any contract of insurance customarily regarded as a life insurance contract” (S.2). It however states a number of important exclusions to the definition of life insurance, namely:

- Funeral policies; and

- Any policy for a period of less than 2 years

According to the letter of the legislation, it would imply that any life policy of less than two years as well as all funeral policies would by default be classified under general insurance even though they are related to life events and not assets. In practice, long-term insurance business is interpreted to cover all life policies irrespective of term and, therefore, includes shorter-term life policies and funeral policies even though they are excluded from the definition of life insurance. It is contradictory that funeral and short-term life insurance is excluded from the definition of *life* insurance but then included under the *long-term* category in interpretation. This confusion was introduced when the amendments were inserted into the Act in 2005 without a complete review of the previous provisions. Although the definitions seem to be adequately managed by PIA on a case-by-case basis, the discrepancy between *de jure* and *de facto* insurance definitions may result in confusion and open up space for regulatory arbitrage.

Health insurance deemed to fall under long-term insurance. Long-term insurance is also deemed to include health insurance, though there is no explicit reference to health insurance in the Act (see the discussion on health insurance in Section 5.3). There is also no regulatory directive on the matter.

File and use system. The Act requires a file and use system for all insurance products (S.73). Insurers must submit all policy forms to the Registrar at least 30 days before intended use. These can then be used if not prohibited before that date. In the case of life policies the premium rate must be certified by an actuary and both the rate, its basis for calculation and the actuary certificate must be filed with the registrar 30 days before the category of policies are issued (S.98).

General insurance policies cease upon non-payment of premiums. A general insurance contract will cease to operate if a premium is not paid within thirty days after the due date of the premium or within such period as the contract may stipulate. No similar provision is made for long-term insurance. A premium is deemed to be paid to the insurer as soon as it has been paid to the broker, who must then pay it over to the insurer within a specified time (S.76). This has become a particularly relevant issue for the insurance industry, as the poor credit culture undermined the solvency of the industry. In response, the PIA issued a Premium Credit Policy as discussed in the box below:

Box 5. The PIA's premium credit policy

Rationale for the credit policy. The poor credit culture in Zambia is often highlighted as a challenge to premium collection in Zambia. The PIA Annual Report for 2007 emphasises it as one of the three core challenges to the insurance industry in that insurance premium settlement default adversely affects insurer solvency (PIA, 2008). In response, the PIA issued Circular 1 of 2005. It contains guidelines on insurance credit issued to all insurance companies and brokers in Zambia pursuant to Section 99 of the Insurance Act of 1997. This is relevant from both a product regulation and intermediation regulation point of view.

Premiums on credit prohibited unless explicitly agreed between insurer and insured. Under the guidelines, insurers are advised that all premiums should be paid as they are due[51]. Where the insurer and the insured have agreed otherwise, it should be stated in the policy document. In this

[51] Under the Insurance Act, "due date of premium" is defined as "the date of commencement of the period of insurance cover referable to that premium under the contract of insurance".

case, "any credit period extended to an insured entity shall not exceed 11 months and must be finalised within 21 days of policy inception plus first premium instalment."

Stricter requirements imposed on handling of premiums by brokers. Brokers must pay over the premium to the insurer within 60 days of the policy inception date. This, interestingly, doubles the allotted period of 30 days under the amended Insurance Act (S.21). "If a broker at its own volition decides to extend credit to its clients such agreement will in no way derivate from the broker's obligations under the Insurance Act." Brokers are required to maintain a separate bank account approved by the PIA known as the "client account" and must deposit all premiums received into this account. They are not allowed to transfer any funds from the client account to their own office account except for agreed commissions and charges. These provisions mirror those inserted into the Act as S.21(4) by the 2005 Amendment.

Cancellation of general insurance contracts on non-payment. All general insurance contracts should contain a cancellation condition. It must stipulate that the policy will be cancelled if the premium is not paid by the due date (as is provided for in S.76 of the Act). When an insurer decides to cancel a policy on this basis, it is entitled to premiums for its time on risk. It is also instructed to send a circular to other insurers via the Insurance Association to inform them of the cancelled policy, the broker or directly insured client involved. No insurer is then allowed to accept such a policy unless the outstanding premium amount has been settled. If a claim is made before the cancellation period, the insurer is obliged to pay the claim only if the full premium is paid immediately.

No provision is made for the cancellation of long-term/life policies upon failure to pay premiums.

The PIA has indicated that, while premium arrears were still a significant threat in 2007, significant inroads have been made since 2008 in reducing this problem.

Foreign currency denominated policies allowed subject to transparency of premiums and sums assured. Every policy must state the sum assured, premium and any other sums involved. It must do so in Zambian Kwacha or any foreign currency acceptable to licensed banks and financial institutions (S.77). Given the fact that Zambia has no foreign exchange controls, this implies that dollar (or any other recognised foreign currency) denominated policies are allowed.

Offshore insurance allowed only when not locally available. The Act prohibits offshore insurance unless the "particular type of insurance is not available locally" (S.120). Therefore Zambians are not allowed to purchase policies abroad that would cover them in Zambia. However, the section does not apply to re-insurance.

Premium rates. The Registrar can request premium rates to be submitted to him and can order the insurer to cease using rates "that are determined to be inappropriate" (S.74). An actuary must approve the premium rates on each life insurance product as suitable to that class of policy and must lodge a certificate to the Registrar at least 30 days before the rate is given effect (S.98). Apart from these requirements there does not seem to be any general provision to control premium rates. However, industry negotiated with the PIA for a set of prescribed *minimum* risk premium rates for general (asset) insurance to prevent negative competition in the industry. These are contained in the PIA's Premium Rating Guidelines effective from December 2006.

Prudential regulation

Limited to insurance business only. A registered insurer may conduct no business other than the business of an insurer, unless the Registrar has approved such business in writing as reasonably ancillary to insurance, or the other business represents less than 5% (or such other proportion that the Minister may prescribe) of the turnover of the insurer (S.19).

Registration limited to specific classes of business. Upon licensing, insurers are authorised by the PIA to conduct the classes of business for which it has applied, provided that the PIA is satisfied that the applicant will conduct its business in a prudent manner, in accordance with the Act and will be likely to at all times meet its obligation to policyholders (S.11(2)). Should an insurer at a later stage wish to offer an additional class of business, it may apply for the amendment of its license (S.12).

Minimum capital requirements not restrictive. Section 41 of the Act gives the Minister, on the recommendation of the PIA Board, the authority to prescribe minimum paid-up share capital to be maintained by a licensed insurer. Though different amounts can be prescribed for different classes of insurance business (Section 41(2)), a uniform requirement of K1bn ($185,000) is currently required of both long-term and general insurers (PIA, 2009 – personal communication) that is quite low relative to many other jurisdictions, as the following comparative data indicates:

Country	**Minimum capital requirements**[52]
India	$25m
Philippines	* $24m - new insurers * $3m - new MBAs ($305k existing MBAs) * $122k - all MI MBAs;to be phased up to **$305k** over time [*this is the microinsurance tier*]
Colombia	$3-4.2m (depending on business line)
South Africa	$1.3m life $0.7 de facto non-life
Uganda	$580k (double for composite)
Ethiopia	$300k general $400k life $700k composite
Zambia	$185k

Table 12. Comparative minimum capital requirements for insurers in selected developing countries.

Source: Bester, et al (2008); Smith & Chamberlain (2009

Unpaid premiums and offshore assets excluded from definition of admitted assets. Insurers are subject to solvency requirements to ensure that they will be able to meet their liabilities to policy holders. General insurers are subject to specific reserving requirements (S.33). For all insurers, admitted assets must exceed admitted liabilities (S.33-36) and a solvency statement to this effect must be submitted to the Registrar within 120 days after each financial year-end (S.37). A number of assets are excluded from “admitted” assets, including: an unpaid premium which is more than 60 days overdue, unsecured loans, or, importantly, an asset held outside of Zambia other than an amount due from a foreign insurer (S.38(2)(h)). Therefore, while insurers may invest their funds in any type of investment as may be approved by the Registrar (S.44), including investments abroad, admitted assets may only be invested locally.

[52] Approximate dollar amounts; reflecting the exchange rate between the local currency and the USD at the time of writing of the source documents.

All insurers to submit audited accounts, but only long-term insurers to appoint an actuary. All insurers and brokers must appoint an auditor (S.63). Under S.45, all insurers must submit audited annual financial statements to the Registrar within 90 days of the financial year-end. The obligation to appoint an actuary is on life insurers only (S.46). Under S.48, the actuary must make an assessment of the statutory life fund at least every 3 years (or at any shorter interval that he or she deems necessary). If it is found to have a surplus, at least 90% of this surplus must be distributed to policy holders (S.49).

Fidelity fund established to protect policyholders. Under Part XI of the Act, inserted by the Insurance Amendment Act of 2005, the Minister must establish an Insurance Fidelity Fund. Its purpose is to indemnify or otherwise protect policyholders and other persons with an interest in policies from the inability of an insurer to meet its liabilities (S.109). The PIA Board shall have powers over the management of such fund and any disbursements made. The fund totalled K1.13bn (about $209,000) by 31 December 2007. It accumulates all license fees (the main source of income), other income and related investment income receipts under the Insurance Act (PIA, 2008). The PIA's annual report for 2007 states that "due to funding constraints, the Fund has been utilised cumulatively over the years to also fund the Authority's administrative operations in contravention of the requirement [Section 112] of the Insurance Act 1997". The PIA has been refunding this negative balance as of May 2008 and hopes to clear the balance in three years.

Institutional and corporate governance regulation

Normally, financial sector regulation can be regarded as either *functional* (placing requirements on the function of e.g. insurance provision – as contained in the Insurance Act), or *institutional* (relating to the institutional form of the organisation providing the service, for example a Companies Act or a Cooperatives Act). In this Section, we focus on the functional regulation of insurance in Zambia. Nevertheless, the Insurance Act and the guidelines issued to insurers by the PIA contain some elements relating to the institutional nature of insurers and how they should conduct corporate governance. These are summarised below.

Insurers restricted to share companies. Only companies with share capital registered under the Companies Act are allowed to undertake insurance business. This excludes entities such as member-based organisations from registering as insurers.

Foreign insurers allowed, but local CEO and office required. There is no limitation on foreign insurers doing business in Zambia, provided that they obtain a local license and appoint a local CEO. The Insurance Act requires that the CEO should be resident in Zambia (S.26(4)(a)), but the PIA in practice requires the CEO to be a Zambian citizen, in line with the objectives of the Citizens Economic Empowerment Act. All insurers must also maintain a principal office in Zambia (S.25).

Demarcation between life and general insurers introduced in 2006. Until 2005, one insurer could provide both life and general insurance. With the December 2005 amendment, insurance was however demarcated, restricting one insurer to either of the two categories (S.4). All composite insurers except for the Zambia State Insurance Corporation (ZSIC) were given one year to either split into two insurers or close down one part of their business. ZSIC was granted three years (S.5).

Scope for microinsurance across demarcation divide based on the policy term. As described above, funeral and other short-term (e.g. one year renewable) life policies, though excluded from the definition of "life insurance" by the letter of the law, are still deemed to resort under the long-term insurance licence and may not be provided by general insurers. Two insurers were however granted an exemption by the PIA which allows them to write life-related short-term policies under their general licenses: credit life and funeral insurance for an MFI in the case of the one, and a composite policy (including funeral and personal accident cover) targeted at marketeers and other groups in the case of the other. This sets an interesting precedent and though not yet utilised by other insurers, presents an opportunity for composite microinsurance underwriting, should microinsurance be defined as inherently short-term. In consultation, the PIA indicated that it would indeed be open to the relaxation of demarcation if it can be shown that all microinsurance products would be short-term and simplified in nature.

Corporate governance requirements not prescriptive. The PIA has drawn up a number of Corporate Governance Guidelines for insurers that were disseminated to insurers by email instruction in 2006. It places obligations on respectively the board of directors and senior management of an insurer, but does not rule on how a board is to be constituted. The board has the power to dismiss and appoint senior management. Board members must have sufficient knowledge, skills and experience to oversee the insurer effectively. Each board must establish sub-committees with specific responsibilities (e.g. risk management, audit) through which it operates. Amongst others, the board must:

- Monitor the risks related to the business and satisfy itself that the insurer is organised in a prudent way. To do so it must establish audit and actuarial functions, strong internal controls and the necessary checks and balances.
- Assign decision making responsibilities between the board, CEO and management to ensure a balance of authority.
- Establish business conduct standards and ensure ethical behaviour for directors, senior management and all personnel.
- Establish a remuneration policy to be reviewed periodically.
- Ensure that the insurer complies with all relevant laws, regulations and codes of conduct.
- Set out policies to ensure fair treatment of customers and information sharing with stakeholders.

Senior managers, on the other hand, are required to:

- Oversee the insurer on a day-to-day basis in accordance with the policies set out by the board of directors.
- Recommend objectives, strategy, business plans and major policies for the management of the insurer to the board.

- Provide the board with relevant and timely information that is comprehensive enough to enable the board to fulfil its function and to hold management accountable for its actions.

These requirements aim to ensure transparency and sound management in the insurance sector.

Intermediation regulation

The Insurance Act applies the conventional definition of a broker as acting on behalf of the consumer and an agent as acting on behalf of an insurer:

- "'*broker'* means a person (legal or natural) who, on behalf of an insured person or a person who intends to take up an insurance policy, arranges insurance policies;

- *'insurance brokerage'* means the business of acting as a broker;

- *'insurance agent'* means a person (legal or natural) who, not being a salaried employee of an insurer-
  a. initiates insurance business; or

  b. does any act in relation to the receiving of proposals for insurance, the issue of temporary insurance cover-notes, or the collection of premiums;

  on behalf of an insurer"

Only brokers and agents may register as intermediaries. The Insurance Act requires that only brokers and agencies may act as insurance intermediaries. Only companies and partnerships can act as brokers (S.5). This space was initially restricted to companies, but was broadened to partnerships under the 2005 Amendment Act. This however seems to be contradicted by Section 13, which holds that: "The Registrar shall issue a broker's licence to an individual who has a minimum of ten years experience as a licensed agent." Individuals or companies may register as insurance agents (S.16).

A broker is not allowed to carry on any business other than insurance brokerage unless such other business is approved by the Registrar in writing as sufficiently ancillary to insurance brokerage, or the turnover obtained from non-brokerage activities is less than some percentage that the Minister may prescribe (S.20). This would, for example, imply that a bank is not allowed to conduct insurance brokerage, unless it sets up a separate company for such purposes. No bank in Zambia has however done so yet.

Direct distribution not prohibited. Though not explicitly included in the Act, insurers are also allowed to engage in direct sales. This is however not widely practiced at the moment (with the most notable exception being African Life with its force of direct sales agents[53]). The agency category is in practice regarded quite broadly and does not preclude for example

[53] Note that the use of the word "agents" here may be confusing. Should the direct sales agent force comply with the agency requirements, this category need not be regarded as "direct distribution", but can resort under agent distribution. We however make the distinction, as African Life is commonly referred to in consultations as the only insurer to engage in direct (agent) sales in a significant way.

retailer distribution or distribution by affinity groups. For the most part, such groups are however treated as group policy holders[54].

Bancassurance done on an agency basis. Bancassurance is not explicitly mentioned in the Act, but the interpretation in the market is that a bank may act as an agent for an insurer. Any company, including a bank, can register as an insurance agent (S.16). Yet only three banks are currently registered as agencies, even though quite a number of banks obtain credit life underwriting for policies. While it could be that some banks enter into a relationship with an insurer via a third-party broker, the PIA has indicated in consultation that more banks need to register as an insurance agency. This requirement has not been effectively enforced thus far, but the PIA plans to more strictly insist on it going forward.

Experience and qualification requirements apply. Both brokers and agents are subject to certain minimum qualification and experience requirements:

- As mentioned above, an individual **broker** must have at least 10 years' agent experience. The majority of the directors of a company or partnership applying for a brokerage license must have either 10 years' of experience at management level in insurance brokerage "or other comparable work", or must hold qualifications approved by the Registrar and adequate experience in brokerage. The principal officer of an insurer or broker shall have at least 5 years of experience working for the broker or insurer in question (Regulation 5 of the Insurance Regulations). Under S.26(4)(d), the **CEO** of a brokerage must be deemed fit and proper to perform the task by the Registrar (though no specific set of fit and proper requirements exists other than the usual stipulations of no criminal record and no bankruptcy history).

- In the case of an **agent**, the Registrar must deem an individual or company to be of good repute and to have suitable qualifications and experience to perform the duties of an agent (S.16). Regulation 8 of the Insurance Regulations requires at least three months' training in the insurance business of the class or classes which the person is likely to transact.

- **Employees** of a broker or agent that are involved in insurance sales are required to obtain a certificate from the Zambia Insurance Business College Trust (ZIBCT), an education institution accredited by the PIA. A two week training course is the minimum requirement (PIA, 2009 – personal communication). According to industry consultations, employees should also have experience of two years or more.

Agents limited to one insurer only. A significant provision for the purpose of this study is that an insurance agent may act for only one insurer (S.9(2)). The implication is that an agent can only act for either a long-term or general insurer and cannot sell both life and general insurance. This is an anomaly left from the pre-demarcation legislation. As will be discussed later on, this may prove challenging for banks acting as insurance agents.

No commission caps. Though Section 98(4) suggests that maximum rates of commission can be prescribed for various classes of policies, no commission caps are imposed in practice. However, the PIA indicated in consultation that the market applies a de facto *minimum*

[54] This, similarly, is a somewhat grey area: such group policy holders in practice often act as institutional agent of the insurer, earning a commission. Yet they are not regulated as agents.

commission requirement of 20% for general insurance (with the exception of motor vehicle insurance, for which the accepted range is 12-15%) to ensure that sales are viable.

No market conduct regulation. Apart from the registration and qualification requirements for brokers and agents, no explicit controls are exercised on how the intermediation process is conducted. For example, there are no stipulations on the information to be disclosed to the client and in what way. There are also no requirements for financial advice.

No explicit channels for consumer recourse contained in legislation. There is currently no insurance ombudsman in Zambia. The need for greater consumer protection measures, including appropriate recourse channels, arises strongly from demand-side research (see, for example, Manje, 2005 and 2007). The PIA is considering the issue with the view of proposing the creation of an ombudsman. In the mean time, the PIA is the only avenue for complaints. They can however only respond to complaints related to matters explicitly included in the Act.

4.3. Other regulation of relevance to the insurance sector

In addition to the insurance regulation noted above there are also other aspects of the legislative framework that impacts on the development of microinsurance. These are discussed below.

Anti-money laundering/combating the financing of terrorism (AML/CFT)

Interplay between AML/CFT regulation and financial inclusion. International research (Bester et al, 2007) has shown that anti-money laundering requirements may affect people's ability to open accounts or purchase financial services, as well as the relative incentives for using formal and informal channels. For financial institutions, anti-money laundering requirements may increase the transaction cost of bringing a new customer on board and undermine the relative incentive to service low-value products and, by implication, low-income customers. There are three main ways in which anti-money laundering regulations are relevant to financial inclusion:

- Through the imposition of so-called KYC (know your customer) or CDD (customer due diligence) requirements.
- Through the requirement of customer profiling and monitoring of suspicious transactions.
- Through record-keeping and reporting requirements

No explicit enforcement of know your client (KYC) requirements for insurance at present. The **Prohibition and Prevention of Money Laundering Act was enacted in 2001**. It criminalises money laundering, sets out the principles to be applied and specifies the obligations of the financial sector (sections 13 and 14) to keep records, conduct customer due diligence, train staff on anti-money laundering procedures and report suspicious transactions. It does however not contain detailed requirements on what CDD should entail. This is left to the **Anti-Money Laundering Directives of 2004**. This route was chosen because it is easier to change directives than legislation. For example, the directives can be adjusted to incorporate any revisions to the FATF[55] recommendations that may arise. The Directives are however only applicable to "regulated institutions" under the Banking and Financial Services Act. This is defined as banks or non-bank financial institutions licensed or supervised under the Banking and Financial Services Act. *Insurers are therefore explicitly excluded from the Directives' ambit*.

PIA responsible for supervision of AML within the insurance sphere. Sections 5 and 6 of the Act set up an Anti-Money Laundering Investigations Unit to collect information and prosecute money laundering cases. The supervisory authority is, however, sector-specific. In the insurance sphere, the Registrar of Insurance (the Pensions and Insurance Authority) is the AML supervisory body. The PIA, together with the Bank of Zambia and the Registrar of Companies, is part of the Zambia National AML/CFT Taskforce, the body spearheading and coordinating the anti-money laundering effort in Zambia and representing the country in the regional AML body, ESAAMLG (Eastern and Southern African Anti-Money Laundering Group) (PIA, 2009 – email communication).

Treatment of insurance. Currently, there are no AML/CFT directives in place in the insurance sector. The PIA has drafted AML directives which it circulated to the Pensions and Insurance industry for comment. It plans to issue and implement these directives in the near future[56]. In the mean time, the PIA has published its preliminary position on AML on its website. KYC requirements currently seem to be applied on an ad hoc basis rather than across the board on all transactions, as is evident from the following extract (PIA, unknown date):

> "Insurance companies have been instructed to carefully consider the business that is placed with them to avoid facilitating money laundering. In this regard all insurers are required to appoint an officer specifically dedicated to monitoring suspicious transactions. These transactions are reported to the Anti-money Laundering Unit which may undertake investigations on the matter. In order to avoid suspicion any entity dealing with an insurance company must be transparent and be willing to avail information concerning its identity and nature of its business. Individuals are sometimes required to avail copies of utility bills to demonstrate that they are of fixed abode and are therefore traceable."

Foreign headquarter-imposed AML/CFT regulation impact on domestic market. The consultations with market players did not indicate any direct adverse effects of anti-money laundering requirements on the ability of individuals to access insurance or the incentive of insurers to service low-value accounts. KYC requirements are of more direct relevance to banks and MFIs, who are required to identify and profile customers and monitor accounts for suspicious transactions[57]. Though some financial institutions consulted in Hougaard et al (2008) did indicate that KYC, compliance and record-keeping requirements impact on per-user costs, they regard it as a necessary overhead that does not necessarily impact on their approach to any particular customer segment.

Indeed, it is often international headquarter KYC policies rather than local regulatory requirements that can be regarded as prohibitive[58]. Here the impact may be significant. One

[55] This refers to the Financial Action Task Force, the OECD-based body charged with compiling international recommendations and standards on anti-money laundering.
[56] Note that the PIA did not make a copy of the draft Directives available to us at this stage.
[57] See Cenfri (2008) for an overview of the various requirements on banks and financial institutions under the AML directives.
[58] While the Bank of Zambia is willing to accommodate a simplified standard or innovative means to comply with the standards, they are not willing to compromise on minimum anti-money laundering standards. Financial institutions are therefore encouraged to be proactive in finding solutions that will minimise the impact on access. All in all the impression gained is that

bank noted that as much as 20% of its loan applications had to be turned down due to the inability of clients to comply with the AML policies of their head quarters oversees, which is more onerous than the requirements of domestic regulation. Given that microinsurance tends to rely on the development of credit markets for distribution, this will impact significantly on the extension of microinsurance.

Banking and Financial Services (Microfinance) Regulations, 2006

The Bank of Zambia passed the Banking and Financial Services (Microfinance) regulations in 2003. They were, however, only gazetted on 30 January 2006, from which date MFIs were given 24 months to comply. Therefore the regulations have effectively been in force from 1 February 2008 (AMIZ, 2008 – personal communication). In the rest of the discussion we will refer to these regulations as the *MFI regulations*.

Rationale for dedicated MFI regulations: recognition of role of MFIs and need to supervise in order to protect consumers. The MFI regulations provide a legal framework for the operation and development of the microfinance industry in Zambia. They were issued in recognition of the growing importance of the microlending market and the need to regulate it explicitly. At the time, there were an estimated 98 MFIs in Zambia, 45 of which were affiliated with the Association of Microfinance Institutions in Zambia (AMIZ) and only 3 of which were registered non-bank financial institutions under the Banking and Financial Services Act of 1994 (Bank of Zambia, 2003). The MFI regulations allow the Bank of Zambia to enforce the Banking and Financial Services Act with respect to microfinance institutions, in a way that is tailored to their specific characteristics (Chiumya, 2006).

Definition of MFIs. Microfinance institutions are defined as follows:

- *Microcredit*: "a credit facility that does not exceed five per centum of the primary capital of a licensed microfinance institution, as prescribed by the Bank of Zambia"

- *Microfinance institution*: "a person who, as part of their business, advances microcredit facilities"

- *Microfinance service*: "the provision of services primarily to small or micro enterprises or low income customers and includes the following:
  c. the provision of credit facilities usually characterised by frequent repayments; and

  d. the acceptance of remittances and any other services that the Bank of Zambia may designate"

Deposit-taking MFIs introduced. Under Part III of the regulations, any person other than a registered MFI is prohibited from providing microfinance. The Bank of Zambia, as regulator, needs to determine the suitability of the application within a maximum of 180 days after the application has been lodged. Part IV (S.14) provides for two categories of MFIs:

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the regulator has an "open-door" stance. As in other spheres of the Bank of Zambia's operations, AML implementation is mindful of the need for a balancing act with regard to financial inclusion.

- Deposit-taking MFIs, subject to a minimum capital requirement of K250m (about $46,200 in current terms), which is substantially lower than the K2bn applicable to registered non-bank financial institutions; and

- Non deposit-taking MFIs, who are required to hold a minimum of only K25m in capital (about $4,630).

Non deposit-taking MFIs are limited to the provision of credit only (S.16). They may take a variety of legal forms, including companies, registered NGOs and cooperatives. Deposit taking MFIs are subject to additional regulatory requirements, such as that they must be registered as companies and that voting control is limited to a maximum of 25% per shareholder (unless explicit exemption is obtained from the Bank of Zambia) (Chiumya, 2006). Their range of services is however expanded to (S.15):

- Credit

- Linkage banking

- In-country transfers

- Savings, and

- “such other services as the Bank of Zambia may prescribe”.

The definition of deposits remains unchanged from that contained in the Banking and Financial Services Act, but the regulations make it clear that cash received as collateral, whether in the form of “compulsory savings” or some type of “loan insurance fee” (which does not entail a risk pool, but is kept as collateral against default) constitutes a deposit and may therefore only be provided by deposit-taking MFIs (Chiumya, 2006).

The potential role for MFIs in insurance. The Bank of Zambia explanatory notes to the 2003 regulations (Bank of Zambia, 2003) refers to insurance as one of the “other” services that the poor do not have access to and that can potentially be provided by MFIs under Section 15. Though preliminary discussions with the Bank of Zambia did not indicate any intention to provide for MFIs to become registered insurers, it is therefore a possibility under the regulations. The precedent for this has just been set by Blue Financial Services, which established a separate life insurance company (Blue Assurance Zambia). At the same time, this provision allows MFIs to act as agents for insurers as long as they meet the institutional requirements for agents in the Insurance Act (namely that you have to be a person or a company meeting the minimum skills requirements). No MFIs are however listed as registered insurance agencies by the PIA.

Governance requirements seek to ensure transparency and consumer protection. Part V contains the governance requirements for MFIs: each MFI should have a governing body of at least five members, the majority of which are permanent Zambian residents. A framework of checks and balances should be in place, including the separation of the chief executive and chief financial officer roles. MFIs are also subject to certain transparency/consumer protection requirements. Upon making credit available it must disclose the cost of borrowing to the client in writing. Customer rights and responsibilities must also be displayed in writing in a conspicuous place. (Part VI).

Financial reporting required. Under Part VII, all MFIs are subjected to supervision by the Bank of Zambia (or another entity to which the Bank of Zambia chooses to delegate this task). They must submit returns to the Bank of Zambia and publish their financial statements on a quarterly basis.

Impact on the market. All in all, the MFI regulations serve to regularise the industry and make it more transparent, clearing away the loopholes and uncertainty that existed earlier and which in effect created the space for unscrupulous practices to the detriment of consumers (Chiumya, 2006). It has however also created a divide between the registered and non-registered MFIs that may imply an unlevel playing field if the unregistered MFIs are allowed to continue to operate. Today there are 16 registered MFIs, up dramatically from the three registered as non-bank financial institutions prior to the regulations (BOZ, 2009c). Of these, 5 have applied for deposit-taking licenses (AMIZ, 2008 – personal communication). There is however still some unregistered activity in the market.

No credit rationing or regulation of credit life (provided through MFIs or otherwise). The credit market in Zambia is thus far unregulated outside of the regulation of credit providers. That is, there are no statutory limitations on the amount or proportion of income somebody may borrow. However, the FSDP does mention the poor credit culture in Zambia as one of the core challenges to be addressed in developing the financial sector. It provided for the creation of a Credit Reference Bureau (discussed in Section 3.3.2) to address this.

No explicit disclosure requirements. There are also no specific disclosure requirements for credit life insurance and there is no stipulation that consumers must be allowed a choice as to the insurance cover or provider[59]. Under the Competition and Fair Trading Act of 1994, business is however prohibited from conducting any misleading or deceptive conduct, or any conduct which is likely to mislead or deceive. Strictly interpreted, this would imply that insurers and MFIs are obliged to properly disclose the terms of credit life cover. There is however no regulation on exactly how they should do this and in practice credit providers and clients alike often regard credit life insurance as a precondition to the loan rather than an insurance product offering a potentially valuable pay-out[60].

Health regulation

Health insurance deemed to be a long-term insurance product. Health insurance/medical schemes regulation – or rather the absence thereof – deserves special mention given the potential role of health microinsurance in Zambia. As discussed, health or medical insurance is deemed by the supervisor as a long-term insurance product line despite not being mentioned in the Insurance Act. Registered long-term insurers may therefore be authorised

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[59] In South Africa, for example, the requirement for disclosure and choice was recently cemented in the National Credit Act (which came into effect in the middle of 2007). It was found that those two elements are a precondition to ensuring that credit life premiums are transparent and reasonable. Previously, credit life premiums were often a multiple of what the same cover would cost in the open market.

[60] This was confirmed in the focus group discussions. Three of the eight groups were selected from MFI group loan members, all with compulsory credit life. The participants were generally aware of the credit life and even of what the premium is (1.5% of the value of the loan, capitalised upfront as a single premium deducted off the loan), but did not consider it as a personal insurance product, something that necessarily protects them against risk.

to provide health insurance. This is the case for Professional Life and Madison Life (through its subsidiary Madison Health Solutions).

Regulatory arbitrage leaves medical schemes outside of the insurance regulatory net. Medical schemes (also referred to as medical aid) are distinguished from medical insurers in that it refers to entities that are not regulated for insurance purposes and effectively operate in a regulatory vacuum created by the fact that the Insurance Act makes no explicit mention of medical aid or medical schemes. They are therefore not registered insurers and may not legally offer any type of insurance cover. The PIA views them as illegal providers of insurance.

Ministry of Health does not actively regulate health financing. The Ministry of Health also does not actively supervise medical schemes. The Medical Council of Zambia (MCZ) is the health sector supervisor. It is a statutory body established by law under the Ministry of Health to regulate ethical and professional standards of practice of health care professionals and to regulate the provision of quality healthcare services. All health practitioners and healthcare institutions such as hospitals and consulting rooms are to be registered with the MCZ. Its supervisory scope however does not extend to medical schemes or other forms of health financing.

Though so-called Medical Aid Societies were historically found as legal form in Zambia, they were dissolved and prohibited in the Medical Aid Societies and Nursing Homes Act, no. 55 of 1975. Section 6(1)(a) states that (Ministry of Health, 1975):

> "no company, society or other association shall be formed in the Republic for the purpose of providing directly or indirectly to its members medical, surgical or other curative treatment or preventive health service or of reimbursing such members the whole or part of any expenses incurred by such members in obtaining such treatment or such service, or providing to such members any other benefit during or in relation to their sickness, injury or other indisposition."[61]

Regulatory gaps create unlevel playing field. Some industry role players argue that the regulatory framework described above creates an unlevel playing field between medical schemes and medical/health insurers as the former are not subject to reserve and other requirements that can impact on the organisation's cost structures. In a high claims ratio business such as medical insurance, this can make an important difference. There are indications that some of the medical schemes are in discussion with the Ministry of Health to consider the development of a regulatory framework. No such framework however exists yet, implying that medical schemes are not registered or regulated at present. As far as we are aware, there are no active discussions or coordination on the field of health insurance between the Ministry of Health and the Pensions and Insurance Authority (PIA). The PIA has however indicated that it is aware of the issue and plans to incorporate health insurance in the insurance regulations (personal communication, 2009). It has also initiated a process of interaction with the Ministry of Finance to work towards a solution for the effective regulation and supervision of health insurance.

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[61] The Medical Aid Societies and Nursing Homes (Exemption, Establishment and Operation) Regulations of 1994 overrides this prohibition, but are only applicable to nursing homes (Ministry of Health, 1994). It therefore allows the formation of nursing homes, but not of medical aid societies providing the services outlined above.

5. The insurance market in Zambia

5.1. Players, size and performance

Formal market

Limited number of players, but new entry on the rise. There are 6 registered long-term insurers currently operational in Zambia and 6 general insurers. They are shown in the table below:

Long-term insurers	General insurers
Professional Life Assurance Ltd	Professional Insurance Corporation (Zambia) Ltd
Madison Life Insurance Company Ltd	Madison General Insurance Company Ltd
Zambia State Insurance Corporation Life Ltd	Zambia State Insurance Corporation Ltd
Cavmont Life & Asset Management Company Ltd	Cavmont Capital Insurance Corporation Ltd Zambia Ltd
African Life Assurance Company Zambia Ltd	NICO Insurance Zambia Ltd
Blue Assurance Services Zambia (registered in 2009[62])	Goldman Insurance Ltd
Zigi Insurance (being wound down)	

Table 13. Registered insurers in Zambia

Source: PIA, 2008 and personal communications.

The first four insurers in each category stem from the same parent companies, having been composite insurers before splitting during the course of 2006 under the new regulatory dispensation (PIA, 2008). Another previous composite insurer, Zigi Insurance, is being wound down. At the time of writing, there were two license applications pending: one for a long-term insurance license focusing on health insurance, and one for a general license.

Relatively small market in terms of players and turnover. The total insurance market in Zambia is still very small with total premiums of only K180bn ($43.7m) for life insurance and K626bn ($152.1m) for general insurance in 2007[63]. In total, this equalled roughly 1.7% of GDP in 2007. This compares favourably to Nigeria, where premiums to GDP is only 0.5% and Angola (1.6%), but is lower than Botswana (3.5%), Namibia (8.9%) and Kenya (2.4%). The corresponding figure for South Africa is 15.4% in 2007[64]). The small size of the insurance market may reflect the relatively recent liberalisation of the market, but also the limited push thus far by current players to extend market penetration. As will be evident from the Products and Usage discussion in Section 5.2, only the highest echelons of the Zambian society are currently covered by insurance.

No dominant player in general insurance. The gross premium market shares of the general insurance market are as follows:

[62] Licensed status is subject to the appointment of a local CEO.
[63] Note that, for 2007 data as quoted here, we use the average exchange rate for 2007 of K4114.45/$, as obtained from www.oanda.com.
[64]Calculated by dividing total premium figures from SwissRe (2008) by nominal GDP figures for 2007 obtained from the World Bank World Development Indicators database. These are the only sub-saharan African countries tracked in the Swiss Re. Sigma Report. Data for 2007.

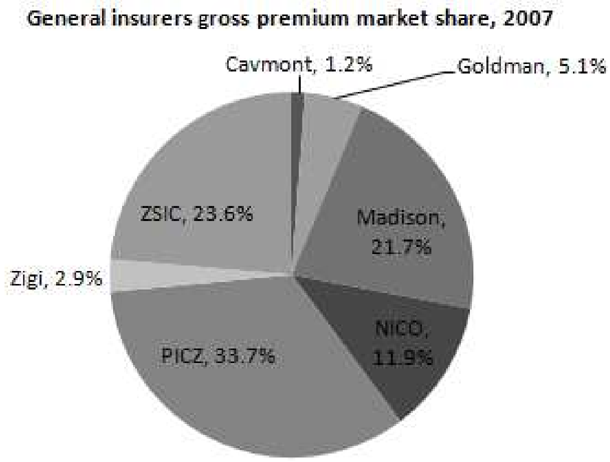

Figure 8. General insurance gross and net premium market shares, 2007

Source: PIA, 2008

The largest player, PICZ (Professional Insurance Corporation) had dollar-equivalent gross premiums of $36.6m in 2007, followed by ZSIC at $25.7m and Madison at $23.5m. That of Cavmont was only $1.3m. ZSIC surpasses PICZ as largest player in net premium terms[65]. The three largest general insurers between them account for 79% of gross premiums. The smallest three account for 9.2% of market share.

Small life insurance industry. Total premiums in the long-term industry, at less than $44m, was less than one third that of general insurance in 2007. This reflects the traditional corporate focus of the insurance industry as well as the inflation erosion of life benefits experienced and the consequent reluctance of the market to buy life insurance products. Figure 9 indicates the market shares for the long-term insurance industry:

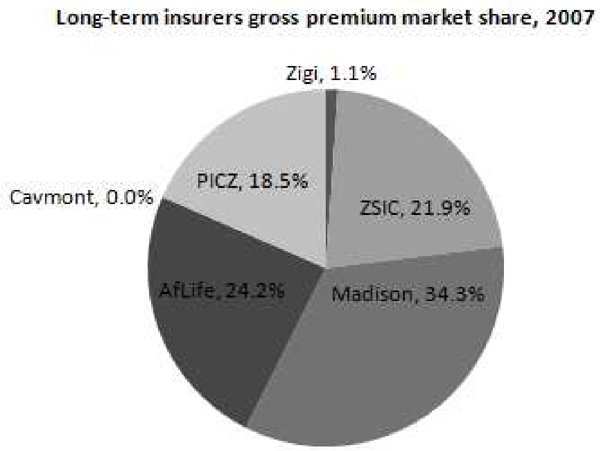

Figure 9. Long-term insurance industry figures, 2005-2007

Source: PIA, 2008

[65] The difference between gross and net premiums is the proportion of premiums ceded to reinsurance. This is highest for PICZ. Its net premiums for 2007 total only about $16m, implying that it has paid over the equivalent of $20.5m in reinsurance premiums, or 56% or all gross premiums. ZSIC, on the other hand ceded only 11% to reinsurance. Reinsurance will be discussed in the Industry Analysis sub-section.

The largest player, by quite a margin, is Madison Life. The three largest players (Madison, ZSIC Life and African Life) have a combined market share of 80.5% of gross premiums. PICZ however surpasses African Life as third-largest *net* premium player, indicative of the fact that African Life pays over a proportionally larger share of gross premiums to reinsurance (as will be discussed below). Cavmont Capital Life had zero premiums in 2007.

Strong premium growth in general and life insurance. Off this small base, the sector as a whole is growing rapidly. The 1.7% premium to GDP ratio achieved in 2007 deviated from the traditionally flat ratio of around 1.2% (OPM, 2008)[66]. The average insurance sector gross premium growth for 2007 was 35%, a figure that significantly outstripped GDP growth (PIA, 2008). Total premium growth in the **general** insurance sector was 15% between 2005 and 2006 and 30% from 2006-7. Growth in the long-term industry was even higher, reaching 50% in 2007. Of the **long-term** players, African Life has seen the greatest premium growth, surpassing ZSIC as second-largest player for the first time in 2007. Its share in gross premiums rose from 8.5% in 2005 to 11.9% in 2006, before increasing to 24.2% in 2007:

	General gross premium growth	
	2005-6	**2006-7**
Cavmont	-37%	109%
Goldman	-15%	106%
Madison	0%	34%
NICO	63%	26%
PICZ	13%	25%
Zigi	31%	-14%
ZSIC	24%	34%
Total market	**15%**	**30%**

	Long-term gross premium growth	
	2005-6	**2006-7**
Zigi	54%	69%
ZSIC	17%	39%
Madison	37%	16%
African Life	100%	204%
Cavmont	-66%	-100%
PICZ	76%	45%
Total	**43%**	**50%**

Table 14. Gross premium growth in respectively the general and long-term industries: 2005-2007

Source: PIA, 2008

Given its stronger growth, the share of life insurance in total gross premiums is on the rise (from 22% in 2005 to 29% in 2007).

[66] This premium to GDP figure that is fairly average in African terms. It is comparable to that of Nigeria, but only half that of Kenya (OPM, 2008)

New entry and developments in especially the long-term market. The long-term insurance market is seeing significant activity at the moment. Up to recently, African Life was the most recent and only foreign life-only entrant. It was also the only traditionally dedicated life insurer, with all the other long-term insurers having previously been part of composite insurers. Another foreign player, Blue Assurance, has however just entered. It is the first microlender to set up an insurance company in Zambia. There is another long-term insurance application pending which, if it goes ahead, will be the first insurer primarily focused on health insurance, including micro health insurance.

Concerns regarding industry performance and solvency. A basic analysis of performance indicators based on 2007 industry data (as reported in the insurers' annual financial statements) reveals a few concerning trends relative to international best practice. Appendix 4 contains the full tables analysing 13 key ratios for Zambian insurers against internationally accepted ratios. Here, we highlight the implications for the solvency and performance of the industry.

In the **general insurance** market, the average return on equity was 34% for 2007. Insurers are therefore profitable. However, a number of solvency indicators are alarming. Out of seven companies[67]:

- Five companies have an undesirable level of uncollected premiums. The remaining two companies are close to but not yet at the acceptable target. The industry average is 169%, compared to an internationally accepted maximum ratio of 50%. This means that actual profitability is likely to be significantly lower than indicated – should premiums not be collected. The PIA however indicated in consultation that this ratio improved in 2008 following the introduction of its policy on premium credit.

- Four companies have a serious liquidity problem in the event that a high level of claims should materialise. The ratio of their current assets to their current liabilities does not meet the internationally acceptable minimum level of 125%

- Four companies have inadequate capital for the premium they retain (the net risk ratio – net premium written over equity – is unacceptably high). This means they should either increase their capital or buy more reinsurance.

- Five companies do not generate adequate premiums for the expenses they incur (i.e. have unacceptably high expense ratios). Two insurers were in a particularly difficult position.

- The average loss ratio (also referred to as the net claims ratio) is 41%. This compares to an accepted international maximum of 70%. The lowest loss ratio recorded in Zambia was 19%.

Furthermore, the following alarming *reinsurance practices* are revealed[68]:

[67] Zigi Insurance was still included in 2007 data.
[68] Note that reinsurance performance is normally evaluated on a longer term performance, say 5 years. However, the above is representative of reinsurance results over a period of 3 years with a 10% margin of error.

- On average, general insurers ceded 33% of their premiums to reinsurers in 2007. The highest proportion ceded was 56%, while the lowest was 11%.

- Four (out of seven) companies reported no reinsurance commissions.

- Three companies did not make any claims to reinsurers (i.e. did not receive any of their reinsurance premiums back in the form of claims).

- This renders an industry average profit for reinsurers of 74% of the amount ceded (for three insurers this profit rises to 100%). This is very high by international standards and suggests inefficient reinsurance practices and fronting (funnelling profit to a linked reinsurer).

The same detailed analysis was not possible for the **long-term insurance** industry due to gaps in the data reported. We did not obtain data for all long-term insurers and those that are covered have gaps where many of the indicators are concerned. Therefore no industry averages or out-of-range calculations could be made. Nevertheless, for the three long-term insurers for which 2007 data were available (disregarding Zigi Life for the moment), profit as measured in return on equity (RoE) is extremely high. The international standard is between 6% and 12%, but RoE for these three insurers ranged between 59% and 135%. RoE is however not usually regarded as an appropriate measure of profitability in the life insurance industry[69]. Furthermore:

- All three achieved solvency ratios (equity over liabilities) well above the internationally accepted norm of more than 4.5%.

- Two of the three had an unacceptably high variation in terms of net premiums written over the previous year. While the allowable range for change in net premium written is -30% to 50%, it was 138% for one player and -88% for another.

- The net risk ratio (net premium written over equity) was unacceptably high for two players.

No reinsurance analysis was possible for long-term insurers based on the reported data.

All in all, these figures are too patchy to enable meaningful conclusions where the long-term insurers are concerned. It does however point towards a more profitable and more solvent industry than its general insurance counterpart. Indications are however that net premiums are volatile and that equity is not sufficient to cover the liability implied by the level of net premiums written.

Cross-cutting performance conclusions. Despite the limited data, the picture of industry performance that emerges is one of high profitability, but questionable solvency. Insurers are generally small by international standards. Especially general insurers are not capitalising at the same rate as premium growth and therefore appear to be extracting profits (i.e. not

[69] This is because profit is 'declared' by actuaries based on long-term liabilities and therefore somewhat artificial. Analysts therefore generally rather use *embedded value* as a measure of profitability. Embedded value is equal to the net asset value of the company, plus the present value of the projected stream of future after-tax profits on in-force insurance contracts (see, for example, http://www.zurich.com/main/annualreport2006/html/financial_report/shareholder_info.htm). We however did not have the requisite data to calculate embedded value for the Zambian long-term insurers.

reinvesting dividends). Furthermore the general industry, at least, offers poor value to customers. Management costs (expense ratios) are high and loss ratios (pay-outs) are low. The low claims payments may explain why insurers are relatively lax in aggressively collecting premiums, managing solvency and growing their capital base. At the same time, low loss ratios are symptomatic of a lack of consumer awareness and financial literacy. Though no analysis was possible for long-term players, reinsurance operations in the general insurance industry are biased in favour of the reinsurer.

All of this questions the incentives of insurers to grow their business – in contrast to the enthusiasm for low-income market expansion that emerged from the consultations. Indeed, it challenges whether the insurance sector is ready to deliver value to the low-income market. The current low claims ratios suggest low value to the client and low premiums will not accommodate inefficiencies. The insurers have limited retail experience given the traditional corporate focus and have thus far for the most part not looked beyond the broker distribution model. There is furthermore no evidence of reinvestment to build portfolios, as evidenced from the reinsurance practices and profit-taking tendencies. This will have to be a topic of engagement of industry in the strategy process to follow (Section 9).

Informal market

Limited informal activity. If formal insurance can be defined as insurance provided by an entity that is licensed for insurance purposes, informal insurance describes all insurance provided outside of regulated insurers. In practice, one can distinguish between informal community-based risk-pooling and in-house insurance provided by formal institutions who are not registered for insurance purposes. In the latter case, organisations may be *institutionally* regulated (e.g. registered as a healthcare provider, a funeral service provider or an MFI), but not *functionally* regulated (i.e. not registered with or supervised by the insurance regulator). The informal market is not always illegal as regulatory gaps may allow unregulated operation.

Internationally, an informal market often develops where formal sector outreach is limited. This is the case with the vibrant funeral parlour and burial association market in South Africa, the in-house cooperative insurance in the Philippines and the funeral parlour market in Colombia (Bester et al, 2008). However, this is not the case in Zambia.

There are four informal insurance components that may be of interest in Zambia: Community models, funeral parlours, self-insured credit life and medical aid providers.

Community-based risk pooling exists but is limited in outreach. In Zambia, unlike in countries such as South Africa, the Philippines or Ethiopia, there is very limited evidence of informal risk-pooling. Previous demand-side studies (most notably Churchill and Manje, 2002), found limited evidence of so-called "funeral funds", mostly among entrepreneurs in peri-urban market places. At the time, weekly premiums ranged from about US$0.13 to $0.26, managed by elected member committees. The aim of a funeral fund is not to cover the full cost of a funeral. Rather, benefits are provided in the form of food, firewood and sometimes cash as a small contribution to the total expenses. The emergence of such informal funds shows that people are conscious of the need to pool risk and will find innovative ways of doing this in the absence of access to appropriate formal insurance products. The study however found the penetration of funeral funds to be "patchy at best" (Churchill & Manje, 2002).

The relatively limited reach of informal risk-pooling is confirmed by FinScope data as well as the focus group findings:

- Only a single respondent in the FinScope survey indicated that she or he belongs to a funeral fund. Only 28% of respondents have heard of and understand the term "funeral fund". Indeed, FinScope found low usage of informal financial services overall: though 8% of adults (70% of which are female) indicated that they belong to a *chilimba,* a rotating savings club, only 2.3% make occasional use of a *kaloba* (money lender)[70].
- None of the focus group participants belonged to a funeral fund or another risk-pooling group. Though some respondents have heard of informal risk-pooling in the form of what they termed funeral associations (and could explain what it is), these associations are not found in the community in question. Rather, the chilimba plays some implicit risk pooling role in the sense that, when a risk event happens, respondents are confident that they can approach their chilimba members for support, or can swap places so that they are next in line to receive a chilimba pay-out. More detail on the risk-coping behaviour of the market as gleaned from the focus groups is contained in Section 6.

Limited evidence of self-insurance in the funeral service industry. Whereas self-insuring funeral parlours play a large role in the microinsurance sector in countries like South Africa and Colombia, indications are that the funeral parlour market in Zambia is not well-developed and that those that do exist tend not to self-insure. Zambians are said to be hesitant to discuss death and most burials are done informally by the community or family rather than through a funeral parlour. Funeral parlours are also reputed to be relatively expensive and largely outside the reach of the low-income market.

Box 6. The challenges facing the funeral parlour market in Zambia: the case of B3 Funeral Parlour

B3, a large funeral parlour business in South Africa, entered the Zambian market in 2005. They are one of about five major funeral parlours, with others including: Ideal Funeral Home, Ambassadors, Chosen Inheritance and CNC. B3 serves the upper end of the market.

The funeral parlour industry is relatively underdeveloped in Zambia. B3 currently conducts only about 22 funeral services per month, a figure that is growing slowly. Other parlours providing more basic services may each provide up to 100 funerals per month. The total number however remains low relative to the Zambian population and B3 estimates that no more than 20% of all funerals are conducted by funeral parlours. Instead, the majority of families or communities will bury their loved one directly, purchasing a coffin from a carpenter and obtaining a death certificate and burial permit from the authorities.

Expense of a funeral is a significant financial shock to most. This however does not mean that funerals are inexpensive. According to B3 an average coffin would cost at least K1.5m ($277) and the funeral service another K1.5m. When adding the cost of the reception, transport, etc, the minimum amount needed moves up to K5m (just more than $925) – by no means affordable for the average low-income Zambian. This was confirmed by the focus groups, where groups indicated funeral expenses to amount to up to K3m ($555) or more and indicated it as the single biggest financial shock (along with healthcare expenses) that they face.

A reluctance to talk about death. The relative low popularity of funeral parlours can at least partly be explained by the cultural reluctance to discuss death and plan for it. This is a finding that was confirmed by several of the insurers consulted, as well as to some extent by the focus group

[70] Possible reasons for the low overall penetration of informal financial services are discussed in OPM (2008:13).

findings. . The B3 Insurance brochure aptly tries to convince the consumer that "it is not about dying":

> *"Taking out a B3 Funeral Insurance Policy should not make you think about dying. But it should make you think about putting your financial affairs in order to create peace of mind befitting an organised and responsible person."*

Limited funeral insurance through parlours. Funeral insurance provided through the funeral parlour market is limited to its limited client base. B3 is the only funeral parlour to have registered an insurance brokerage. In addition, the Ideal Funeral Home is a registered agent of African life.

B3 has only recently started to sell insurance, making it too early to draw lessons from their sales experience. Their policy, called the Funeral Expenses Insurance Policy, carries B3 Insurance Brokers branding. It is administered by B3 but underwritten by Madison Life. It offers three benefit options with maximum sums assured of respectively K5m, K7.5m and more than K10m.

Limited evidence of self-insurance in the microcredit market. Most banks and some microlenders have credit life underwriting from registered insurers and as described above one microlender has just established its own life insurance company. None of the consultations however indicated illegal self-insurance by those microlenders that do not have underwriting. Rather, they simply price defaults due to death into their interest rates and then carry the risk without insurance. According to one player consulted, only loans with a maturity of more than 6 months are deemed to be high enough risk to warrant credit life insurance. In this way, high interest rates have allowed lenders to cover insurance risk without an explicit insurance mechanism. There are indications that some of the social MFIs do informally self-insure. This is however on a very limited scale.

Medical schemes do provide insurance informally. The only market in which insurance provision by players other than regulated insurers does take place on a significant scale is the medical schemes/aim environment. This will be the subject of a dedicated discussion in Section 5.3.

5.2. Usage and products

Total insurance usage

Profile of insurance usage lags behind bank accounts, cell phones, but follows the same trends. When one looks at the usage of insurance versus bank accounts, cell phones and chilimbas (savings clubs) across the Zambian income distribution as gleaned from FinScope (2005) data, the following picture emerges:

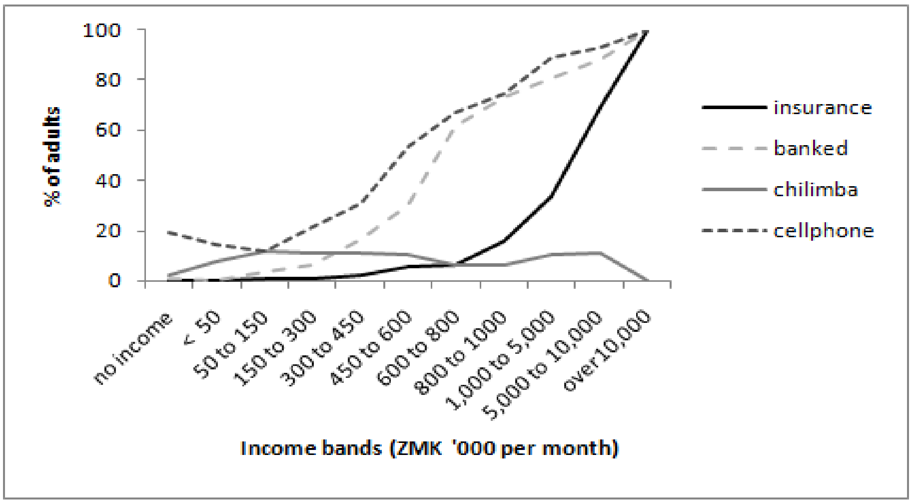

Figure 10. Insurance usage in Zambia versus uptake of other products.

Source: FinScope (2005 data) analysis

The graph shows the percentage of people who indicated their income to fall in each of the bands[71] that also use insurance, are banked, belong to a chilimba or have a cellphone. It therefore indicates usage of products per income category. It is clear that, while some people at the lowest-income end of the spectrum belong to a chilimba[72] and even more have access to a cell phone, virtually nobody has a bank account or insurance. Bank account usage starts to pick up slowly for people with more than K50,000 (~$9.25) personal income per month, with a more pronounced trend from around K600,000 (~$111) per month. Insurance usage only starts from an average income of around K400,000 (~$74) per month, gradually picking up to the K800,000 (~$148) level, before increasing sharply for higher income groups.

Total insurance usage very limited. FinScope[73] survey results reveal the following insurance usage in Zambia:

Type of insurance	% of adult population who have it now
Motor vehicle	2.2%
Travel	0.2%
Domestic/Household	0.3%
Funeral	0.7%
All Risks	0.4%
Medical	1.2%
Health Cover (Doctor)	0.9%
Agricultural	0.2%
Life	1.1%
Personal injury/accident	0.6%
Property	0.8%

[71] Note that the results are not representative of all adults, as about 40% of the sample did not indicate their income levels.
[72] Chilimba usage will come under the spotlight in the demand-side discussion (Section6).
[73] Note that, while FinScope is a nationally representative survey, demand-side surveys suffer from the weakness that people do not always report usage accurately. When considering the insights gained from the consultations, the insurance data from FinScope would however seem to be roughly in line – with the one significant exception of credit life insurance, which is underreported (as is also the case in the other FinScope survey countries).

Type of insurance	% of adult population who have it now
Money	0.1%
Pension/National Pension Scheme Authority	3.6%

Table 15. Insurance usage in Zambia

Source: FinMark Trust, 2006. FinScope Zambia 2005 Topline findings.

As the survey allowed multiple mention (one person may for example have life insurance and a pension as well as motor vehicle insurance), one has to allow for duplication in calculating total insurance uptake, which amounts to **6.6%** of adults (compared to the 14.6% who are currently banked). There are, however, a couple of issues to note in interpreting this figure:

The two largest product categories, accounting for 3.6% and 2.2% of adults respectively, are occupational pension schemes and compulsory third party vehicle insurance. NAPSA (National Pension Scheme Authority)[74], a contributory pension scheme for those in formal employment, operates under its own Act and does not fall under the PIA's jurisdiction. Removing these two products renders a "non-statutory"[75] insurance usage figure of **3.8%**.

To get a better idea of the uptake of various types of insurance, the products in Table 15 can be grouped into the following possible categories:

Category[76]	Products included	Usage
Life insurance	funeral, life	1.7%
Health insurance	medical insurance; health cover (doctor)	1.9%
Health & life	funeral, life, medical, health cover (doctor)	3.0%
Long-term insurance	life, funeral, personal accident, medical, health cover, pensions/NAPSA	5.7%
General insurance	motor vehicle, travel, household, all risks, agricultural, property, money	2.7%

Table 16. Usage of various categories of insurance

Source: author's analysis of FinScope (2005 data)

Credit life is not reflected in survey data. Credit life insurance was not tracked separately in the survey and could therefore be regarded as part of the life insurance figure. When those with credit were asked elsewhere in the survey whether they have insurance on that credit, 82% replied in the negative and a further 2.5% did not know. Experience in other countries shows that people are often not aware that they have credit life insurance, or that it is regarded as a precondition to the loan rather than an insurance product *per se*. For this reason, demand-side surveys often underestimate credit life uptake. Zambia is likely to be no exception.

Though Zambia is fairly unique in that not all MFIs provide credit life – as discussed, some merely price for default risk, especially for loans with short maturities – our back-of-the-

[74] Note that, if NAPSA had covered the total formally employed population, this figure would have needed to be 7% rather than just 3.6%. This could point to underreporting, or the fact that not all formally employed people in practice belong to NAPSA.
[75] Note that this is not a variable contained in the FinScope dataset, but one which we created for the purpose of this analysis.
[76] Each category was created by counting the total number of people who have *either* of the products in the category.

envelope estimation is that the credit life market amounts to up to **250,000** clients, or just more than **3%** of adults[77].

Estimating the current reach of microinsurance

Total current reach of the insurance market equivalent to size of formal sector. Beyond social MFI-microinsurance, insurance uptake is constrained to the formally employed market:

- As discussed, about 6.6% of Zambian adults currently have insurance. A substantial proportion of that is comprised of NAPSA or compulsory third party vehicle insurance and it is likely that the market-driven penetration is as low as 3.8%.

- For simplicity sake, noting that the total figure includes NAPSA (which we deem not to be insurance as relevant for the purpose of microinsurance), but significantly undercounts credit life, we keep the 6.6% total penetration as indicative figure of the current insurance reach in Zambia. This is roughly the size of the current formally employed sector (500,000 individuals).

In the discussion thus far, the various players, products and total uptake in the insurance market were discussed, time and again referring to the potential for certain products or distribution mechanisms to open up the *informal market*, i.e. the all-but-500,000 Zambians who are not employed in the formal sector. This term essentially alludes to microinsurance because, as discussed in Section 1, microinsurance expansion can be regarded as any expansion of the insurance industry into the previously unserved market even without defining a poverty line to distinguish the "micro" market from the rest of the informal market.

But what is the actual reach of insurance into the informal market at present?

Conventional conception of microinsurance as linked to microfinance. Traditionally, microinsurance in Zambia has been regarded as synonymous with insurance distributed by MFIs, specifically social MFIs who are donor funded and follow a group loan methodology. In a case study for the CGAP Working Group on Microinsurance, Manje (2005) found two insurers to be engaged in microinsurance (defined as such) through profit-sharing[78] partnerships with four MFIs. These arrangements are still in place:

- **Madison Life** has a partnership with PULSE Holdings, FINCA, Cetzam Opportunity Microfinance and PRIDE Zambia:

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[77] This figure was calculated as follows:

- As discussed in Section 3.3.2, the total credit market may have anything between 300,000 and 450,000 clients.
- According to consultations, all bank loans include credit life cover as a precondition. A large proportion, but not all, of loans in the conventional MFI and microlending sector is underwritten. As discussed, some players however just price for default risk without insisting on credit life cover, especially on loans with shorter maturities.
- If one therefore assumes that all of the estimated 150,000 bank loan clients and half of the estimated payroll and MFI loan market (of up to 300,000 in total) are covered by credit life, it amounts to 300,000 credit life policies.
- Most of the consultations however cautioned that there may be significant duplication of clients between the banking and payroll market. If we assume 350,000 unique clients (out of a total potential market of 450,000 if no overlap) and apply the same estimated credit life ratios, we postulate there to an upper bound of **250,000** credit life clients in Zambia (just more than **3%** of adults).

[78] At the time of writing, Madison charged 30% of premiums to cover its administrative costs. The balance after paying out claims was then distributed equally between the insurer and the MFI (Manje, 2005).

- FINCA Zambia is a village bank operating on a group lending methodology with groups of up to 20-30 members each. This differentiates it from the solidarity lending group methodology, where groups are generally much smaller. The larger group size enables it to make smaller loans, often less than $100 (Manje, 2005).

- The rest of these MFIs practice a combination of solidarity group lending and individual lending. Individual lending is a more recent phenomenon, following the transformation of the conventional MFI industry into a microlending industry as described in Section 3.3.2.

- **NICO Insurance** provides a Funeral Benefits Insurance Scheme in partnership with Cetzam

Rationale for conventional microinsurance – credit provider more than client protection. In all instances, the products were launched in response to the MFIs' need to protect their loan portfolio. One MFI, PULSE, had experimented with its own in-house scheme to cover risk. While still a project under CARE International, it introduced a Borrowers Protection Fund (BPF) in 2001. It however soon realised that it did not have the capacity to run such a scheme and therefore sought an underwriting partnership. Some MFIs' market research or general experience also pointed towards a need for funeral cover among their clients – hence the inclusion of funeral cover (Manje, 2005).

Very small current outreach. These schemes are ongoing. Their outreach is however low. Today, Madison Life has approximately 20,000 credit life policies on their books. Only 60-70% of these (between 12,000 and 14,000) are however estimated to be microinsurance on what can be defined as microloans. The rest is comprised of top-end loans such as mortgages, vehicle finance, or higher value personal loans. CETZAM (the only conventional MFI underwritten by NICO), had 2,410 active borrowers in 2007 (down from more than 13,000 in 2003) (MixMarket, 2009). As CETZAM's clients will already be credit life clients of Madison, one should however not add this to the total Madison Life microinsurance figure. This implies that the total MFI-microinsurance market (not counting the payroll lending market, as this is confined to the formally salaried market) has **less than 15,000 policyholders** at present.

Market interest in expanding the microinsurance market. Beyond the social MFI microinsurance market, microinsurance penetration is negligible. Even one of the most pro-active lower income market players, African Life, at present only serves the lower-end of the formally employed sector. A number of players are however now considering or actively planning products that will be targeted at the informal market.

Microinsurance products

Group rather than individual policies. Most insurance policies in Zambia are underwritten and sold on a group basis. That is: the risk assessment and pricing is done for a group of clients as a whole (usually aggregated via an employer), who then enjoy uniform premium rates for the same amount of cover. This coincides with most insurers' traditional focus on employee groups. The international literature shows that group underwriting remains the most cost-effective way to provide simplified products to the low-income market[79], even if policies are sold to individuals and not to the group as a whole. It is therefore likely that any microinsurance expansion in Zambia will be on a group basis, be that through affinity groups, networks, or even just as “open” group policies that members of the public can buy.

The following products are most likely to break open the microinsurance market:

***Credit life** is the single biggest microinsurance product*. Even from the rough, assumption-dependent calculations of total credit life usage above, it is apparent that the credit life insurance market is likely to significantly exceed the rest of the life insurance market – as measured by FinScope – in number of clients. In fact, it is likely to be the single biggest non-pension insurance product, with even wider uptake than compulsory third party motor vehicle insurance. Nevertheless, there are at least 100,000 microloan clients who do not yet have credit life insurance, presenting significant scope for growth of this market alone. Should this market be regarded as fertile ground for cross-selling of other, voluntary insurance products, the potential is even bigger.

Major players in credit life. All the life insurers engage in credit life. With its large portfolio in the government and other formal sectors, ZSIC is an important player. African Life also has a strong presence in the banking sector, underwriting the loan portfolios of Barclays and Standard Chartered. Madison is the largest player providing “microinsurance” credit life cover to the *social MFI* sector, with riders for e.g. funeral expenses and sickness. With its total loan book of in excess of 75,000 (after the incorporation of Nedfin), Blue Assurance is also set to become a significant player in the credit life insurance market.

Credit life offers generally low value to the consumer. The loss ratio is the value of all claims as percentage of all premiums. It can therefore be regarded as an indication of the value paid back to the client. One of the industry players consulted estimates that loss ratios on the credit life product line are as low as 10%. Another player targets a 25% loss ratio on its credit life insurance. At least one of the insurers consulted however plans to introduce a standalone credit life policy that is sold separately from the credit provider at a lower cost than through the credit channel.

***Funeral insurance** is growing in importance despite traditional apprehension to talk about death*. As discussed earlier, virtually all the consultations indicated that the Zambian population is generally uncomfortable to discuss death or matters relating to it. This is confirmed in the FinScope survey results, where less than 3% of the respondents indicated that they make any kind of provision for future funerals[80]. Nevertheless, based on their market research on the risk-mitigation needs of the markets, insurers and other players are starting to emphasise funeral insurance as an entry product into the mass or informal market – provided that it is simple, affordable and sold in a way that emphasises financial planning and not death. Funeral insurance is therefore the one product currently seeing innovation earmarked for the lower-income market.

[79] For example: Bester, Chamberlain & Hougaard (2008) illustrate, based on the findings from a five-country study, that the individual underwriting process (because it involves whole-life or long-term contracts, thereby tying the insurer to the risk profile of the individual and requiring individual risk underwriting) is expensive and therefore simply not feasible for low-income, low-premium policies. As a result, insurers targeting the low-income market often assess the profile of groups rather than of individuals.

[80] And of those that do make provision, 60% say the provision is that their employer will make a contribution. Only 18% mention funeral insurance as provision and a further 12% a savings scheme. Note, however, that the number of responses is so low as to render the results statistically insignificant.

There is a number of interesting existing or pipeline funeral insurance products:

- Funeral insurance is one of the two products in which **African Life** specialises. It is the leading Zambian insurer providing individually sold funeral policies. Of the roughly 30,000 individual life policies on its book, 90% are funeral policies. It is now piloting an innovative funeral insurance product utilising cell phone distribution and also provides funeral cover via bancassurance channels. A case study is provided in the Distribution discussion (Section 5.3). As already mentioned, African Life also underwrites a funeral policy distributed by Ideal Funeral Home.

- **Madison Life** underwrites a number of funeral insurance products:
    - *Funeral parlour-distributed insurance*. The Madison Life funeral insurance product sold via B3 Insurance Brokers (the sister organisation to B3 Funeral Parlour) was already referred to in the discussion above.
    - In addition, Madison offers a *funeral expenses rider* on a credit life product underwritten for Cetzam Opportunity Microfinance Ltd. This product provides funeral cover of K1m for the principal member (the borrower), K750,000 per spouse, and K500,000 each for a maximum of four children or other dependents living with the principal. Risk premiums range depending on the maturity of the loan: from 0.36% of the total sum assured per family for loans of less than 3 months, to 2.52% of the total sum assured on loans of between 18 and 24 months. The premium is payable in advance in a single instalment (which is paid to the insurer by the MFI, then added to the client's loan amount). No medical examinations are required as long as the applicant appears physically fit to the Cetzam officials when applying for a loan. To guard against adverse selection, the insurance policy is a precondition for all clients to qualifying for the loan.
    - It offers *a similar funeral expenses rider* on the credit life cover provided to individual and group loans by the Ecumenical Church Loan Fund (ECLOF).

  The company now has plans to expand its microinsurance product offering through the MFI network, that is, to provide voluntary insurance products to credit life clients. The reasoning is that clients have slowly become familiar with credit life and rider products as insurance and no longer just as a condition to obtaining a loan. Rising claims imply rising awareness. Therefore Madison sees an opportunity to more aggressively expand into the lower-income market.

- Another player providing a funeral expenses rider on credit life cover to the MFI sector is **NICO Insurance**. What makes this a particularly interesting case is that NICO is a general insurer. It applied for and eventually obtained approval from the PIA to provide a short-term product with life elements (credit life, funeral) to Cetzam Microfinance Opportunities. This set a precedent for a reinterpretation of the Insurance Act along the lines of long-term versus short-term rather than life versus non-life demarcation. This is discussed further under *General Insurance* below.

- **ZSIC Life** (Zambia State Insurance) is also a player in the funeral insurance market. . A**mongst others, it underw**rites a new product by **Cavmont Capital Community Bank** that bundles a funeral policy with a savings account. **The funeral cover is provided** "free" on the back of their Savers Bonus account, though the premium is recovered out of the account fees. The funeral cover is provided as an incentive to opening the account and is marketed as adding value to the account.

In a parallel process, Zanaco has also identified the need for funeral cover among its mass market clients. It therefore introduced a similar bundled savings account and funeral insurance product. A similar product, underwritten by African Life, is provided by Barclays. Its Tonse Transaction Account comes with an embedded funeral benefit of K500,000 (about $92) for the account holder.

The last three cases present an interesting new phenomenon: namely the introduction of "compulsory" bundled funeral cover that is not linked to credit, but to savings. This greatly reduces the distribution challenges of insurance sales, while at the same time adding value to the savings products in question. The development of this market, as well as that for compulsory funeral insurance as rider on credit life, however needs to be monitored to ensure that consumers receive value and appropriate protection, as it may suffer from the same problems as compulsory credit life. Indeed, a 2007 client satisfaction study among the clients of two social MFIs found a general lack of understanding of compulsory funeral insurance products. Clients expressed strong reservations about paying for products that they do not understand (Manje, 2007).

Distribution partners leading the way. A bank rather than an insurer is the product architect in at least two of the examples quoted above, approaching the insurer with an idea and requesting underwriting for it. B3 Insurance Brokers followed a similar route for the funeral insurance product it distributes (as highlighted in Box 6, p.50). In a number of consultations insurers admitted that they have thus far not been proactive in searching for informal market opportunities. This situation is however starting to change. The dynamics around bancassurance and other channels will be discussed further in Section 5.3 (Distribution).

Health insurance *a particular need despite low take-up and low availability of suitable products*. As the demand-side discussion will show, virtually all focus group participants singled out health expenses, alongside funeral expenses, as a significant financial risk – one that prevents them from sustainably building up assets and that can even sink them (back) into poverty. As stated by one focus group participant (Garden Compound Lusaka, male):

- "If for instance my child is sick, I will take my child to the clinic. If the clinic has no drugs, they give you a prescription and then you buy the drugs. What that means is, that there be no savings from the business that week."

Given its unique characteristics, the health insurance environment, its players, products and challenges, are discussed separately in Section 5.3. Section 7.3 considers the scope for health microinsurance.

General insurance *products mostly still tailored to the corporate and high-end private market*. Though stock insurance for small traders was mentioned by industry players as well as in the focus groups as a potential insurance product needed by the low-income market, it is unlikely to become a reality any time soon. Among the four general insurers consulted, the consensus was that the focus thus far has been on the corporate market, signing up companies in the mining, construction or other sectors. Their distribution models are also geared to corporate clients. For most players in the general insurance market, retail business is still virtually non-existent.

Increasing competition for the corporate market has necessitated insurers to undercut one another, leading to the PIA's minimum premium guidelines for general insurance risk premiums issued in 2006. In the face of such strong competition in their current market segment, awareness is growing of the potential of the retail insurance market and possibly microinsurance to grow their markets. The drive to create demand for asset insurance products in the low-income market is however largely not yet present. In one case, a general insurer consulted was approached by a cell phone distributor to develop a retail market cell phone insurance product. It however did not know how to price it and let the offer pass.

Yet some promising market developments, some of them testing the demarcation regime. One general insurer indicated that it is considering the introduction of crop insurance, possibly in partnership with an agricultural aggregator like the Zambian National Farmers' Union (ZNFU). It has also approached ZCSMBA (the Chamber of Small and Medium Business Associations) to provide their members with a product tailored to SMEs. The proposed product package will consist of vehicle insurance, building insurance and employer's liability insurance. It would also be a possibility to add funeral benefits to the overall package. In at least two further instances known to us, general insurers are starting to focus on retail products. Interestingly, both provide (or plan to provide) limited funeral expenses cover as a rider on credit or personal accident insurance. In effect this means that a composite life and general product is provided. At least one general insurer is also considering partnering with banks for the provision of credit life-related policies.

5.3. The medical insurance and medical aid market in Zambia

Due to the complexities of health insurance and its particular market dynamics, including the fact that the provision of health cover in Zambia is not currently limited to registered insurers only, we discuss this market separately.

Providers & products

In Zambia as in many other jurisdictions, one should distinguish between medical or health insurance on the one hand and medical schemes (also referred to as medical aid organisations or societies) on the other hand. In the case of Zambia, the former are regulated insurers, whereas the latter are effectively unregulated at present. Apart from that, the models operate essentially the same: both offer *indemnity cover* (payment of actual medical fees[81]) rather than *capital health insurance* (a fixed pay-out upon a medical trigger such as hospitalisation)[82].

Health insurers required to operate under long-term insurance licenses. Although health insurance is not explicitly mentioned in insurance regulation (see Section 4 for more details), the PIA deems health insurance to fall under the long-term insurance category and requires health insurers in Zambia to register as long-term insurers under the Insurance Act, regulated by the Pensions and Insurance Authority (PIA). However, as will be shown below,

[81] Indemnity cover can be **comprehensive**, can be limited to **outpatient** or **inpatient** cover, or can cover both outpatient and inpatient treatment, but only up to a certain annual limit. This will depend on the particular package chosen.
[82] The only example we could find of this type of health insurance is the sickness rider on some of the Madison Life MFI credit life policies whereby skipped loan repayments are covered in the case of inability to work due to illness.
However, **life insurance** may also include certain benefits such as **disability** or **dreaded disease** that trigger payouts on a specific event related to health. This traditionally falls outside of the definition of indemnity health insurance, which is the business of medical aid schemes and is what we refer to under "medical insurance" as discussed in this section.

the uncertainty created by the absence of specific references to health insurance in legislation has lead to a market developing outside of the regulator's net.

Low overall penetration of both regulated and unregulated health insurance. Whether regulated or not, the penetration of any kind of health insurance remains low. According to FinScope, only 1.2% of adults report having medical insurance *of any kind*[83]. This amounts to only about 90,000 people. The FinScope results indicate that 0.9% of adults have "health cover" from a doctor. 1.8% of all those with insurance furthermore indicated that they belong to a "hospital scheme". Though it is not clear what definition was attached to these terms, it does indicate at least some health scheme activity outside of the registered insurance companies.

All health insurance provided on risk-rated basis. Irrespective of whether the schemes are regulated or not, all health insurance is provided on a risk-rated basis. The implication is that individuals (or rather employer groups) are charged relative to their risk profile. Schemes are also not compelled to provide cover and can, therefore, reject cover to specific individuals or groups and may also cancel cover for those already covered. This type of system is likely to bias coverage against higher risk categories of clients and, if not controlled, may lead to long-standing coverage being cancelled for older clients as their risk profile deteriorates. In designing its overall health policy the government of Zambia would have to consider its long-term objectives of universal access to health care services and how the current system will support this or not.

Box 7. The role of the state in universal health insurance – the move towards a National Health Insurance Scheme in Zambia

The Ministry of Health is planning to implement a national health insurance scheme in Zambia. It would at first be a mandatory contributory system for public sector employees and later be extended to all formal employees. The ultimate goal is to extend benefits to the population at large. According to consultations, such a scheme is however unlikely to be sustainable in Zambia given the very small formal employment base and the high required level of cross-subsidisation that this implies. Therefore, while it remains a government ideal, industry practitioners are sceptical on whether such a system will ever be implemented. The Ministry of Health, in its National Health Strategic Plan for 2006-2010 however budgets for the design and implementation of National Health Insurance by the end of 2010 (Ministry of Health, 2005).

Four types of providers of health financing. Four categories of health financing providers can be distinguished of which only the first category is regulated in Zambia: (i) medical insurers regulated under the life insurance act; (ii) medical schemes not regulated in Zambia, including a voluntary government employee medical scheme, (iii) hospitals offering their own unregulated plans; and (iv) employer-based health fund schemes (which do not technically amount to insurance, but may be administrated by an insurer).

Medical insurers regulated under life insurance act. There are only two registered players in the Zambian health insurance market: Madison Health Solutions (a subsidiary of Madison Life) and Professional Life. Both players are still largely focused on the higher-income end of the market through employer-driven health insurance plans. They offer various in and outpatient cover packages with premiums ranging from $115 to more than $300 per family

[83] The survey did not distinguish between regulated or unregulated, capital or indemnity.

per annum, depending on the limits applied. One more company has indicated its interest in registering as a health insurer.

Medical schemes (as opposed to regulated medical insurers) can take various forms. The most formal schemes may be administered and underwritten by insurers registered elsewhere but not in Zambia, but some are not underwritten at all.

Independent unregulated medical schemes. Schemes that are not regulated for providing insurance by PIA but may have underwriting from foreign insurers include:

- The *Wanthanzi Health Plan*, a product administered and underwritten by Momentum Africa – the African health insurance arm of Momentum, a South African life assurance and financial services company. It is the largest player in this sub-market. Momentum entered the market in 2006 and has 9,990 principal members (through 60 corporate clients) (Mulenga, 2009 – personal communication).

- Another, smaller player is the *Mutual Medical Aid Society (MMAS)*.

Both offer group schemes to employers for their employees. Cover ranges from comprehensive inpatient and outpatient cover to more limited options. Prices will generally be determined on a company by company basis and will differ according to the benefit packages offered. The cheapest option for Wanthanzi (the Essential Plan) is as follows (Mulenga, 2009 – personal communication):

- K74,000 ($13.7) per month for the principal member

- K69,000 ($12.8) per month for the spouse/additional dependent member

- K53,000 ($9.8) per month for each child

A family of four would therefore pay **$46** per month. This entitles them to an annual outpatient benefit of K2.2m (~$407) (with internal limits for optometry and dentistry) and an inpatient limit fixed at K6.6m (~$1221) per year.

Furthermore, government in 2006 put to tender the underwriting and administration of a proposed new Voluntary Medical Scheme (VMS) for public service employees[84] under an agreement reached with the public service union. The contract was awarded to *Premier Service Medical Aid Society* (a large player in the Zimbabwean medial scheme market) in 2007[85]. Under the scheme, employees would choose a package most applicable to them. Government would contribute 60% of the monthly premium and the remaining 40% would be deducted off employees' salaries. The proposed plans, each with a different set of benefits, are:

[84] http://www.tenderboard.gov.zm/bids.php?id=172

[85] http://english.peopledaily.com.cn/200702/06/eng20070206_347726.html. Also see http://www.psmas.co.zw/index.php.56.html for an overview of PSMAS. PSMA is a Zimbabwean society wholly-owned by its members, who are mostly civil servants. It claims to be Africa's largest medical aid society and has a fairly wide branch network across Zimbabwe. It has been on a regional expansion drive, with operations in Mozambique and Zambia and with plans to enter four further markets.

- *Guardian Plan*: K25,000 (about $4.63) per month

- *Excel plan*: K45,000 (about $8.33) per month

- *Premier plan*: K90,000 ($16.65) per month

As far as we could ascertain, this scheme has however not achieved significant take-up.

Unregulated hospital schemes. Apart from these medical schemes, a number of hospitals also offer *in-house schemes* whereby clients can access the medical services at a fixed monthly or annual fee. Private hospitals in Zambia tend to be individually owned and do not operate in a network. Thus the services covered would be limited to the hospital in question. For example:

- The Zambian parliament has a medical scheme with Lusaka's largest hospital, the University Teaching Hospital (UTH) whereby parliamentarians receive medical treatment[86].

- According to press reports Victoria hospital, a private hospital in Lusaka, offered a promotional "scheme" to the members of the Zambian Football Association in 2007 whereby members were entitled to free medical treatment at the hospital[87].

- Though no evidence has emerged on this from the formal sector, a number of focus group participants indicated paying a minimal three-monthly "scheme fee" at public clinics/hospitals which entitles them to free access. Focus group participants indicated that they pay K5,500 (about $1) towards the scheme every three months. Each payment entitles you to three months' access to consultations at the clinic. If you have not paid the scheme membership, K10,500 (about $2) is charged.

Involvement of government in unregulated schemes. It is interesting to note that three of the examples quoted in the preceding two categories were initiated by government: the public service voluntary medical scheme, the UTH (which is a public hospital) scheme and the alleged schemes according to the focus groups. The tendency of government to initiate unregulated medical schemes is therefore a cross-cutting feature.

Employer-based health funds. Furthermore, a number of employers fund their employees' medical expenses directly. Often, this is administered by a third party administrator such as Madison Health Solutions – the health administration and brokerage arm of Madison Life. The employer establishes a fund from which expense are paid. Employees do not directly contribute to this fund. Expenses are limited to the funding available so no risk transfer takes place and the employer has no liability for expenses beyond the value of the fund. This therefore falls outside the definition of insurance.

Box 8. The scope for medical bancassurance – the case of Standard Chartered Bank Zambia's SaveAssurance account as well as other pipeline projects

Standard Chartered Bank harnesses the bank distribution channel to offer health insurance cover. It

86 http://www.parliament.gov.zm/index.php?option=com_content&task=view&id=435&Itemid=131

87 http://www.times.co.zm/news/viewnews.cgi?category=8&id=1090459896

provides a savings account that includes "free" medical insurance cover. Interestingly, no insurer underwrites the accounts and that no insurance policies exist. The bank merely undertakes to pay the hospital bills up to the limit[88] – thereby carrying the risk itself. The savings account, named "SaveAssurance", offers two free health insurance options:

- The first option requires a minimum opening balance of ZMK500,000 ($92.52). The account operates as a normal savings account until a savings balance of ZMK 3m ($555) is reached. Free medical cover up to ZMK2m ($370) per year is then provided for any family member who is hospitalised for at least 48 hours as long as the balance is maintained.

- In the second option, a minimum opening balance of ZMK750,000 ($139) applies. Medical insurance is provided as a reward for customers who maintain a minimum balance of more than ZMK1m ($185). The benefits are for hospitalisation of two days or more only and are subject to a maximum pay-out of ZMK1.5m ($278) per year, made directly to the hospital.

No comprehensive cover is therefore provided and the minimum balances make this a higher-end rather than mass market product. Nevertheless, this remains an interesting bundled model.

At least one retail bank is realising that this principle will also hold for the low-income market. It is considering the introduction of health insurance (to for example cover the cost of medication and limited in-patient and out-patient services) bundled with a mass market savings account. The precedent for such bundling has already been set by funeral insurance.

Challenges

Structure of health insurance may fuel cost increases and bias cover towards compulsory groups of the rich and healthy. Containing costs in a fee-for-service[89] environment presents a significant challenge to health insurance even at the top-end. The private health insurance market works on a fee-for-service basis in Zambia. Combined with the fact that the health service providers are not effectively regulated and prices are not controlled, such a system will make it very difficult for insurers to contain costs. Patients have the incentive to visit the doctor even when it is not really necessary, and hospitals/doctors have the incentive to maximise service to the patient, including scans, tests and hospitalisation, as they are sure to be compensated by the medical insurer.

Because of their inability to control costs and manage relationships with providers, some insurers argue that medical insurance is currently not viable in Zambia. For this reason, medical insurers such as Madison Health Solutions are starting to move towards vertical integration – investing in laboratories, clinics, etc – to contain costs. In effect, this would involve working towards a type of managed care[90] system whereby a network of doctors and hospitals are paid a fixed monthly fee per member of the scheme. Currently, health service providers are unwilling to enter into such an arrangement and the bargaining power of insurers is still constrained by the low health insurance penetration. In an environment like

[88] As confirmed in conversation with Standard Chartered Zambia call centre.
[89] Fee for service refers to the practice in indemnity health insurance of reimbursing the medical expenses of the policyholder (often directly to the hospital or health practitioner) up to the specified annual limit. This is in contrast to the capitation model whereby a health practitioner or hospital receives a fixed amount per policyholder per month from the medical aid and then provides the cover specified in the policy to each on demand. The different models create different incentives: under a fee for service model the healthcare provider has the incentive to maximise treatment and quality. This comes at a high cost. Under a capitation model, the incentive for unnecessary treatment falls away, but quality may suffer, as the healthcare provider now has the incentive to minimise cost.
[90] Also called "capitation".

this insurers would not be willing to move beyond compulsory employer groups, the rich or the healthy and are not compelled to do so by regulation

Premium collection challenges. Apart from the risk management considerations suggested above, medical insurers list premium collection challenges as the reason for focusing solely on the corporate (employer-driven) market at present. Premium collection from individuals, especially in the informal market, is found challenging. The bundled medical insurance product offered by Standard Chartered, as discussed above, however presents one example of how it is possible to overcome this through innovation in the distribution channel used.

Tax challenges. The situation is exacerbated by the fact that medical insurance premiums are not tax deductible in Zambia, implying that there is no added incentive on the consumer side to buy health insurance.

5.4. Distribution

Below, we briefly discuss the main distribution channels (current and potential) in the Zambian insurance sector:

Broker-driven group sales dominate. At the end of 2007 there were 24 licensed brokers and 31 registered insurance agencies in Zambia (PIA, 2008b). Along with the tendency for most insurance still to be large corporate contracts, the bulk of insurance business in Zambia is handled by brokers, with about five big brokers accounting for most of the market.

Agency sales on the rise. Following its entry into the Zambian market, African Life has been the pioneer of agent-based insurance sales in Zambia. It has a direct sales agent force of 350 across 10 branches and has sold more than 30,000 individual policies. In addition, ZSIC also employs direct agent-based sales techniques. It currently has more than 300 agents in 53 teams growing monthly individual life sales at a steady pace.

Bancassurance as underutilised market for insurance and a source of product innovation. The proactive role of amongst others Cavmont Community Bank and Zanaco in initiating and delivering bancassurance products underwritten by registered insurers was already discussed. Furthermore, Barclays, in addition to the current funeral cover on its Tonse account, plans to introduce a number of insurance products including education linked products, as well as investment and other protection products.

Alternative distribution channels such as retail distribution not yet in use, but cell phone distribution pilot underway. Currently, no retailer distribution of insurance is found in Zambia and no other passive sales channels are used[91]. African Life is however piloting a product which, if successful, will introduce cell phone distribution of insurance to the Zambian market[92].

[91] "Passive distribution" refers to sales of insurance that do not involve an active sales effort by an individual (e.g. a broker or agent) in interaction with the potential client. An important example of passive sales is retailer distribution. Retailer distribution entails the sales of insurance products "off the shelf" in retail stores, without the involvement of a broker or agent during the sales process. This is also sometimes referred to as "tick-of-the-box" insurance product sales.

[92] In South Africa, various models, not unlike that of African Life, have been tried, but with limited success thus far. The one exception is the sale of Hollard funeral insurance, a simple and trusted product, through Pep, a trusted clothing retailer brand in the low-income market. The difference may come in the fact that African Life employs active rather than passive sales techniques.

Box 9. The African Life cell phone distribution pilot

African Life is nearing the end of a pilot project aimed at testing the viability of cell phone distribution of funeral insurance in Zambia. Though the pilot has proved challenging, questioning the viability of this market at this stage, it nevertheless presents an interesting potential distribution model from which learning can be tapped for future initiatives.

The pilot is essentially based on the "industrial insurance" products that originated in the UK during the industrial revolution. Under this model, also called "penny policies", a single agent would serve a community and go from door to door on a weekly basis to collect insurance premiums. The agent earns both a collection fee and a commission on the policy. He or she builds up a "book" of clients, which then becomes a marketable commodity. I.e., agent X can sell his/her client base (and income stream) to agent Y.

African Life now wants to apply a similar model in Zambia, but with the added feature of a technologically savvy premium payment mechanism. The agent buys a number of vouchers (similar to airtime vouchers) from a cell phone technology company dealing with all the cell phone networks. Each voucher entitles the holder to a certain amount of funeral insurance cover underwritten by African Life. Vouchers are sold to agents at a discounted price, which essentially serves as commission (based on the same model as the airtime reseller industry). The agent sells the voucher at the full amount to the client. The client then dials into a number and enters the pin provided on the voucher to activate the insurance cover for a month. The next month, the process is repeated. Therefore the client essentially enters into a monthly renewable insurance contract with African Life each time a voucher is bought and activated. A six month waiting period applies. Cover simply lapses for whatever period a person should not buy a new voucher.

The agent model is sustained in that the client can only buy the voucher from an agent. In this way, a personal service relationship can be built up and active sales (rather than passive sales through e.g. a retailer or airtime reseller network) can be made. Market research consistently finds that these two factors (face to face interaction and active selling) are crucial to achieving voluntary insurance uptake in the low-income market.

Source: Williams, 2009 – personal communication.

Potential scope for aggregator/affinity group distribution. All the insurers consulted emphasise the challenges of reaching a scattered market and, importantly, collecting regular premiums from the informal market outside of the comfort zone of employer-distributed group policies. This underlines the importance of using existing infrastructure and platforms for insurance distribution purposes. Given the existence of a fair number of networked groups in the informal market (the topic of Section 8), insurers are increasingly realising the potential for affinity or other group-based insurance distribution to the unserved market.

We collectively refer to all affinity groups, industry or farmers' associations, cooperatives, chambers of commerce or other groups as **aggregators**, as they essentially bring together (aggregate) a group of potential individual customers from an insurer's point of view. The term can be interpreted quite broadly to also include the customer base of retail groups or e.g. the Post Office, even if there is no common bond among them. From the insurer's point of view, the main criterion is that a ready touch point to a fairly large group of people is provided for marketing purposes, but also for the collection of premiums and in some instances the payout of claims.

The majority of insurers consulted, especially on the life side, are considering or developing some kind of aggregator distribution model. Potential target groups range from agricultural outgrowers, to the employees of tourist associations, bus and taxi drivers, or church groups. Most emphasised, however, is the scope for targeting marketeers through their associations. For example:

- Professional Life Assurance, in collaboration with Professional Insurance Corporation (PICZ), is developing a product targeted at marketeers belonging to an association as well as to other organised groups such as bus or taxi drivers. It will be a group policy sold via the associations as client aggregators that enjoy the trust of their members. It will provide funeral, personal accident and disability cover. Professional Life is conscious of the unique needs of the target audience. Therefore cash premiums will be collected through the associations on a weekly basis – a more flexible approach than requiring bulky annual or even monthly payments. Furthermore, the plan is to break lump sum benefits for disability insurance up into monthly payments so as to aide income smoothing.

Funeral insurance is the first product of choice for most of the aggregator initiatives in the pipeline. It will be important to track how many of these planned products are actually launched over the next year or two, as well as the take-up experience and lessons learned. Only then can one really conclude on the feasibility of this model in breaking open the low-income market and the real commitment of insurers to do so.

Convergence of commission levels. Though no commission caps apply, commission levels are fairly stable for different insurance products. According to one broker consulted, the following commission bands apply:

Line of business	Estimated average commission levels
Vehicle insurance	12%
Burglary/casualty insurance (household)	15%-20%
Fire insurance	20%
Individual life (long-term)	1-2%
Funeral and health insurance (short-term)	10%

Table 17. Indicative commission levels in the Zambian insurance industry.

Source: Industry consultation

As mentioned in the regulatory review section, the PIA confirmed that industry applies a *de facto* 20% commission level for general insurance, reducing to 12-15% for motor vehicle insurance.

Higher commissions for credit life. Credit life insurance is the one distribution channel reported to be subject to higher effective commissions – anecdotal evidence suggests that it may be as high as 70%. According to some players, banks or MFIs may charge a significant proportion in administrative expenses in addition to the commission. Sometimes profit sharing agreements are also in place. Therefore commission levels may not reflect total distribution cost, as it can be packaged as administration fees.

Role of the broker in product innovation and informal market distribution. The importance of aggregator distribution was emphasised above. This begs the question: is the broker distribution model dominating the traditional market still relevant for the informal market?

The brokers consulted for this study agree that the broker is well-placed to be proactive in product innovation. Brokers have the community-level presence to determine what is viable and what will be in demand and then to approach the insurer to design new products in partnership with them. At the same time, the cost of reaching the informal market may outstrip the benefit to a broker.

There are two possible ways of making low-premium broker distribution viable: (i) by reaching the informal market as a group, i.e. the broker acting as proactive market maker between MFIs, associations, community structures, etc and insurers; or (ii) by achieving large enough volumes to make a type of "broker and runner" model work whereby a broker's agents sell standardised, low-value policies on a commissioned basis with a lean management structure to keep distribution costs down. The precedent for such a model has been set in the 3rd party liability vehicle insurance market[93]. Therefore broker distribution, with some reinvention, is not made obsolete by the potential role of direct aggregator distribution.

6. Demand-side evidence

In this section we draw on the features of the low-income and currently uninsured market as it transpires from the FinScope survey findings, as well as the insights gained from a series of eight focus group discussions commissioned for the study.

Box 10. Focus group research: rationale and methodology

What are focus group discussions? Focus group discussions (FGD) are a *qualitative* market research tool. The central methodology is to form small groups (usually 8 to 10 individuals) and then to test their views and perceptions on a certain matter through interactive discussion between the group and a professional moderator. Group members can be selected randomly or according to gender, age, income or other profiles[94]. As the findings are qualitative, they cannot be used to draw valid conclusions on the population as a whole, but can only give an indication of the experience of the sample.

Role of FGDs. The objective of the focus group discussions was to understand the lower-income market's experience of risk (the severity of different risks) and interaction with insurance, their decision-making criteria (whether to buy or not to buy insurance) and their perceptions of the insurance market. Though survey data can also throw light on these factors, it does not provide the level of qualitative insights required to understand perceptions and the motivation behind behaviour. Focus groups provide the opportunity to probe these issues through discussion.

Features of the participants. For this study, eight FGDs were conducted, drawn from three different locations: two rural, four peri-urban and two urban:

- A total of 84 participants (30 men and 54 women) were consulted. While five groups were of mixed gender, two groups were female-only and one group male-only. The group gender differentiation was not enough to enable conclusions on the differing views of males and

[93] Norwhich Insurance Brokers, for example, has a network of branches in border towns through which agents sell fairly low-premium, once-off 3rd party insurance to vehicles entering the country. The standardised nature of the product keeps the transaction costs per sale down. This model (and distribution infrastructure) could be extended to microinsurance.

[94] For this study, group members were selected randomly, as the market research firm did not have the database or capacity to recruit people of a specific profile to a specific group. This hampers the analysis in that one cannot draw conclusions on the experience or perceptions of one group versus another (for example male versus female, different age groups or different income groups). Such an exercise would have been challenging in any case in a study with only 8 focus groups. Budget constraints prevented us from conducting more focus groups. Given the consistency of the findings across the 8 groups, we are however confident that the findings are relatively representative.

females, though a few general points can be noted.

- Three groups were pre-existing lending groups from FINCA Village Bank (two groups) and another MFI, MicroBankers Trust (one group). The remaining five groups were formed by randomly asking people in the compound[95] or marketplace to participate.
- In total, 13% of the participants were aged 18-25, 52% were aged 26-35 and 35% were above the age of 35. Group members were however not selected according to their age group.
- Household sizes varied from one or two to as high as 13, with the average being six and comprising between one and two income earners, at least one of which is involved in informal trading or agriculture.
- With the exception of certain higher-earning professions, income levels were generally well below $2.50 per person per day, even when adjusted for PPP. It must however be noted that respondents reported only the income from their business, not the total income of the household taking into account the income earned by co-breadwinners.

Focus group report. A Zambian rural market research firm, Ruralnet Associates, was contracted to conduct the FGD research[96]. A copy of the full report is available on request. Here, we summarise the main findings.

6.1. Profile of the unserved market

Differences between the insured and uninsured. Before we consider the demand-side insights rendered by the focus groups and FinScope analysis, it is important to get an idea of the characteristics of the insured versus the uninsured market in Zambia. It is clear from FinScope that the insured are more affluent than their uninsured counterparts. The income distribution of the insured and uninsured, respectively, can be represented as follows:

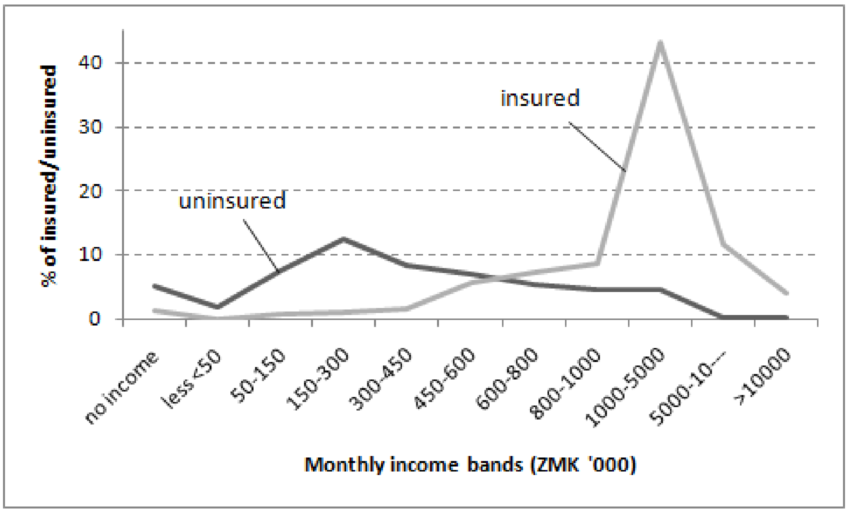

Figure 11. Income distribution of the insured versus the uninsured.

Source: authors' analysis of FinScope (2005 data)

[95] The Zambian term for settlement or township – areas mostly occupied by lower-income individuals.
[96] Cenfri actively participated in drawing up the discussion guide. A Cenfri team member also attended the first three focus group sessions to provide feedback and guidance.

Whereas a negligible proportion of the insured have incomes below K300,000 ($56) per month, 27% of all uninsured individuals earn below this level. 68% of the insured earn more than K800,000 ($148) per month, compared to only 10% of the uninsured.

In addition, the FinScope data sketch the following picture:

Notes
86.4% of all adults have an NRC (National Registration Card, the official identification document necessary for e.g. opening a bank account or purchasing an insurance policy). Therefore, while it is skewed toward those that are insured, NRC penetration is also high among the uninsured
Just 28% of all adults have access to a cell phone and cell phone penetration is skewed towards the insured market. It is questionable whether the 76% of the uninsured market that has not even bought a cell phone will buy insurance.
41% of all adults only have some form of primary education; 45% of adults have up to some form of secondary education, whereas only 14% of all adults have a tertiary education. Therefore insured individuals are significantly better educated than the average Zambian.
Of all females, only 5% are currently insured; of all males, 8% are currently insured. The male-female distribution is even more skewed for general insurance (68% of the insured for general insurance is male), but is more equal for life and funeral insurance, where 55% of the insured is male. For the adult population as a whole, the male-female distribution is 51:49.
Of all those that live in rural areas, only 3% are insured; of all those that live in urban areas, 13% are insured. This may be indicative of supply-side distribution challenges. For the adult population as a whole the distribution is 35% urban, 65% rural.
49.8% of all adults live in informal structures or traditional huts, whereas 50.2% live in formal structures of some kind. Formal accommodation is significantly skewed toward the insured, with only 6% of all insured living in traditional huts or informal structures. Therefore, if somebody still lives in a traditional/informal structure, they are unlikely to buy insurance.
The difference in house ownership between the insured and uninsured is not very marked. It however becomes more pronounced if one looks only at whether the respondent her/himself rather than a family member owns the property: 47% for insured and 14% for uninsured. It also increases when considering only general insurance: 51% of respondents with general insurance own their own house, versus only 15% of those without general insurance.

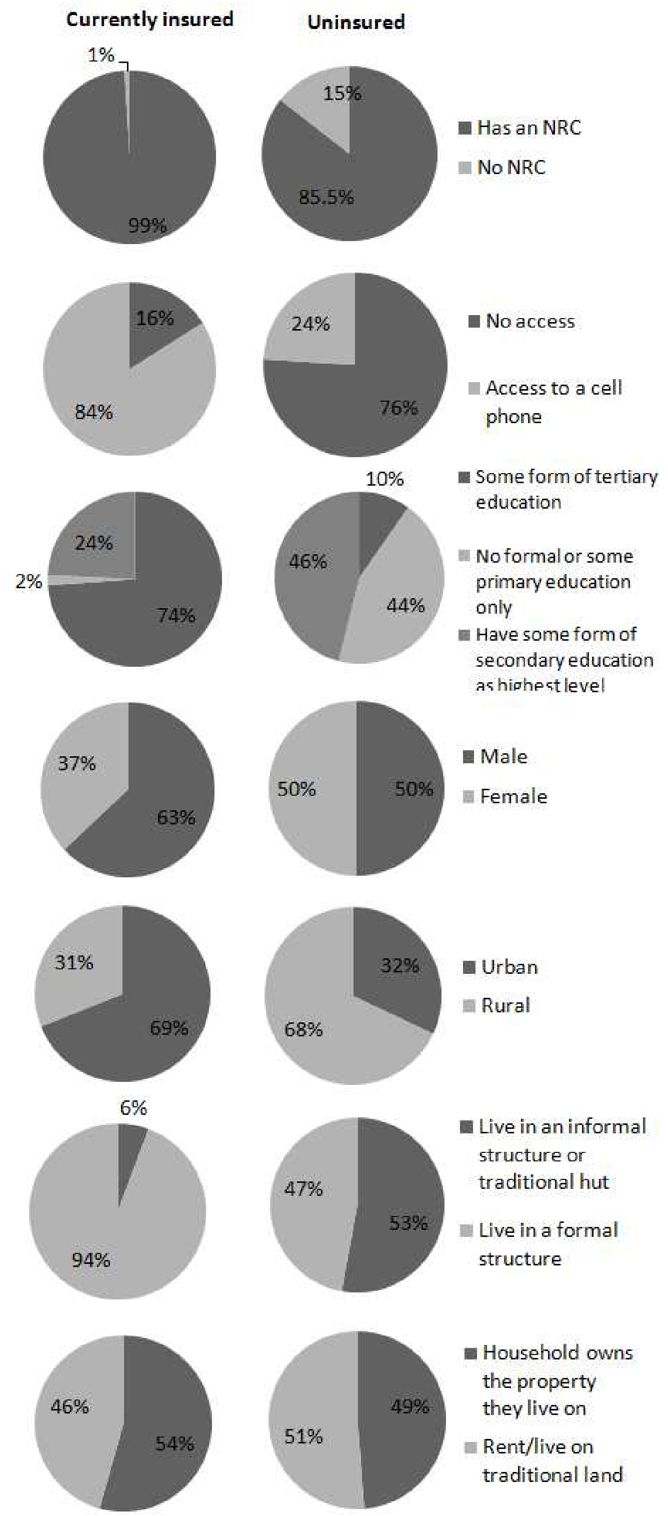

Figure 12. Profile of the insured vs. uninsured market

Source: authors' calculations based on FinScope (2005 data)

Not surprisingly, Zambians with insurance are more likely to be urban, with a higher level of education and more access to amenities than the uninsured. They are also more likely to be male.

In addition, the focus groups highlighted the following features of the low-income market (noting again that focus group discussions cannot render accurate quantification as they are qualitative in nature):

- *Employment is very low, but all participants earn a living in some way through informal trading or agriculture, sometimes to supplement the income of a wage-earning household member*. In urban and peri-urban areas, the informal sector was the largest employer with micro and small enterprises featuring prominently, while in rural areas it was the agricultural sector. Almost everybody is involved in small-scale trading or agriculture – even those who earn their living in urban areas will have a patch of land on which they grow crops somewhere. In a few instances participants indicated that their spouses are formally employed. Out of the whole sample, however, only three participants were formally employed (they were child health promoters appointed by the community). This result is most likely biased by the fact that focus group discussions were held in communities or market places during office hours, thereby excluding those that are formally employed.

- *Even though they are low-income, respondents do have a cash flow and do manage their finances proactively*. Weekly turnover from the FGD participants' trading activities groups ranged between K60,000 and K120,000 for the lower bracket and K350,000 and K1,500,000 for the upper bracket. This amounts to a daily purchasing power parity-adjusted turnover of between $2.4 and $59[97]. In all groups people tended to view their income as their turnover from their trading activities/from agriculture, rather than as their surplus income.

- *Profit margins will depend on the type of activity*. For example: informal welders or people with hardware stalls make less frequent but higher-margin sales than those vending vegetables. As a whole, surplus income from trading activities is however low: for some groups well below the $1.25/day (PPP adjusted) level and for the highest-income group around $9.5/day when adjusted for PPP. This still has to be distributed amongst other household members, implying that per capita income is likely to be below the $2.5 for most respondents.

- *Spending priorities follow the hierarchy of needs and include keeping their businesses afloat*. Participants stated various uses of money, including food, healthcare, school requisites, family needs, funerals, farming inputs, chilimba contributions (see the discussion on chilimbas below) and savings. Food is the main priority, followed by school fees, healthcare expenses and clothing. Most respondents also place a high priority on working capital –cash flow is needed to keep on buying stocks for your stall, therefore reinvestment in their businesses is an important spending priority. For the rural respondents, agricultural inputs are also a large expenditure item.

    - *The importance of rent to urban dwellers*. In the rural area, people tended to own their houses/huts, whereas in the urban areas most respondents rent their homes. For them, rent accounts for one of their largest expenses.

[97] Calculated using the PPP exchange rate as obtained from the latest World Bank International Comparison Program PPP tables released in December 2008. Note that as the PPP figures are for 2005, we deflated the current values to 2005 values using the CPI data available from http://www.zamstats.gov.zm/media.php?id=6, before converting to PPP-adjusted US$ amounts.

- *Though public healthcare is accessed via a "scheme", cost of medicine is significant to all*. Where healthcare is concerned, people tend to use public clinics or – if in the vicinity – a private clinic run on a subsidised basis by an NGO. Many of them sometimes pay to use a private doctor, which costs up to K60,000 ($11.1) for a consultation. Interestingly, as discussed, the public clinics seem to run some kind of informal insurance scheme. Both the rural and peri-urban groups indicated that they pay K5,500 (about $1) towards the scheme every three months. Each payment entitles you to three months' access to consultations at the clinic. Those who do not make prepayments are required to pay K 10,500 before they can be attended to.

  Medication however has to be paid for separately – an unplanned expense mentioned in all the groups. This is evident from the following discussion in the male Garden Compound group:

Moderator	*Is there anywhere else you go for treatment?*
Respondent(s)	*Private clinics*
Moderator	*Why do you go to private clinics?*
Respondent(s)	*Sometimes there are delays in government clinics, at other times you are asked to buy your own drugs from drug stores*
Respondent(s)	*Government clinics just give panadol [paracetamol] Unlike government clinics, private clinics provide drugs and the patient does not have to die on the queue*
Moderator	*How much do you pay at private clinics – how much is it to see a doctor?*
Respondent(s)	*K50,000*
Respondent(s)	*This K50,000 is both consultations and injections*

- *Low income constrains but does not prevent saving.* The predominant means of saving by focus group participants was informal means, either through a chilimba[98] (an informal rotating savings club) or by keeping money in the house. In all the focus groups participants were very familiar with the concept of a chilimba and most indicated that they belong to one:

Moderator	*How many are involved in chilimba?*
Respondent	*Isn't it everyone, [laughter] majority?*

Note that this finding is to some extent contradicted by the FinScope survey findings, which indicated that only 8% of adults belong to a chilimba[99].

Very few participants had bank accounts, citing insufficient profits and high cost of living as reasons for not keeping money in the bank. Most people keep some money aside in the house "just for in case". As one respondent put it:

- *"It's not all of us who are part of chilimba. You might just keep K100,000 in the house in case of any problem like a child getting sick. You use the same money to hire a taxi to the clinic or for other things" (Chazanga group 2).*

[98] As explained below, chilimbas are implicitly used by many as collective trade finance rather than savings per se.
[99] This may be explained by the bias of the focus group participant selection towards informal traders – for whom chilimba membership has a trade finance value.

This money, though intended as savings, however more often than not has to be spent to make ends meet. Savings are therefore not accumulated over the long run.

Box 11. Features of chilimba membership in Zambia

How do chilimbas work? Chilimbas in Zambia follow the same pattern as rotating savings associations elsewhere. They however have not, according to the focus groups at least, evolved into also providing credit at interest to outsiders. Each member contributes an agreed amount on a fixed basis (be it daily, weekly, monthly or less often). Depending on the rotation chosen, each member then gets a turn to receive all other members' contributions. For example: in a weekly chilimba of six members, each member will receive a pay-out every sixth week. No money is kept aside as a pool out of which loans can be made with interest or as a type of risk pool. Rather, the full pool is paid out to a member at each chilimba meeting.

Reasons for chilimba membership. The most common reason cited (by 61% of chilimba members) is that it allows them to save for a specific purpose by enforcing the necessary savings discipline. 10% indicated that it allows them to save for emergencies, while 9% indicated that they prefer chilimbas because they are not charged any fees. This was confirmed in the focus groups – people would say that they do not have enough money to save, but would take chilimba membership for granted, almost as though they did not regard it as saving, but as part of daily life. Those who did not understand it as a saving mechanism would initially say they did not save when asked whether or not they saved, as demonstrated by the following responses in Chazanga Tiyezye FINCA group:

- *"No we don't save. Once you have taken out money for food, the balance is used for chilimba, and you remain with nothing".*
- *"If I make a profit of about K150,000 to K200,000 I use some of it on food and then some of it is used in the business to increase the capital. Then I put aside K2,000 in the house or in chilimba".*

Others however immediately mentioned chilimbas when asked whether they save.

Chilimba as business cash flow management tool. Another interesting phenomenon emerging from the focus groups is that participants tend to contribute to chilimbas out of their total turnover rather than out of their personal disposable income. They see chilimbas as a way of managing cash flow for their businesses, using the pay-out towards working capital (e.g. to buy stocks once a month).

Social bond among members. On the whole, chilimba membership seems to be a community activity, with strong social coherence preventing fraud or theft. When asked whether their chilimba has experienced a range of difficulties, the only significant response in FinScope was that people sometimes do not keep to the discipline of regular contributions. Fraud or being cheated by fellow members did not emerge as an issue. In one of the focus groups, however, a participant indicated that his chilimba was disbanded because "there were two members of the group who gave us problems".

Features of chilimbas in Zambia. FinScope confirms that Chilimba members are mostly female. Membership is more rural (59%) than urban (41%). As 65% of the total population is however rural, it implies that there is an urban bias in chilimba membership relative to the total population distribution. 93% of chilimba members belong only to one chilimba.

Most chilimbas follow a monthly rotation. Weekly rotations are the second most popular:

Frequency of contribution	% of chilimba members
Every week	22.1%
About twice a month	6.2%
About once a month	67.2%

About every two months	1.3%
About every three months	2.0%
About twice a year	0.7%
Less often than twice a year	0.5%
Total	100.0%

Table 18. Frequency of contribution to chilimbas: % of members in each category

Source: authors' analysis of FinScope (2005 data)

Average amounts paid per contribution vary widely and are of course dependent on the frequency of contributions. On the whole, 24% of chilimba members pay on average K25,000 ($4.63) per turn; another 23% pay on average K50,000 ($9.25) per turn. This breaks down as follows for different frequencies:

- 32% of those contributing once a week tend to contribute between K6,000 ($1.11) and K10,000 ($1.85), 19% contribute between K31,000 ($5.74) and K50,000 ($9.25) and another 16% contribute between K51,000 ($9.44) and K100,000 ($18.50)
- As contributions become more regular, contributions gravitate towards the K31,000 to K50,000 and K51,000 to K100,000 categories.
- Only for contributions once every three months or less often do significant proportions of adults start to contribute above K100,000

The majority of chilimbas are very small, with between one and five members:

Number of members	% of chilimbas
One to five	87%
Six to ten	10%
Eleven to fifteen	1%
More than fifteen	2%

Table 19. Size of chilimba groups: % of total chilimba members in each category

Source: authors' analysis of FinScope (2005 data)

We now turn to three crucial demand-side questions that were investigated through the focus group research and on which the FinScope results also throw some light:

i. What is the **risk experience** of the potential microinsurance market?

ii. What are the **coping mechanisms** or **risk management strategies** currently employed by the potential microinsurance market?

iii. What are the **usage factors**, the demand-side barriers or disincentives to **insurance uptake** by the mass market?

6.2. Risk experience

FinScope underlines general/asset risks, followed by illness as major risks. The following risks (out of a total number of 24 events listed) rank uppermost in Zambians' minds according to the FinScope results:

Event	% of adults citing this event
Theft, fire or destruction of household/property	38%
Serious illness of a household member that requires expensive medical treatment	22%
Theft or destruction of agricultural crop/livestock	9%
Death of a household/family member	8%
Member of household loses job	6%

Table 20. The five major risks experienced by Zambian adults.

Source: authors' analysis of FinScope (2005 data)

It is interesting to note that death is ranked only fourth. People tend to be more afraid that their business will burn down or their working capital will be stolen than they are of the financial impact of death. If one groups together the various insurable risks into general risks and life-related risks respectively, the finding is that 56% list some general risk as potentially threatening their financial well-being, while only 32% list life risks.

The focus group discussions, in contrast, consistently rank death and illness as the two single biggest threats[100]*.* Both these events pose a financial risk, especially if the breadwinner is affected, and impact the respondents emotionally. Sickness is a daily reality that, as described above, can have a dire financial impact. Government clinics do not always have adequate facilities and especially in an emergency, people will feel obliged to use a private facility for immediate care. One participant narrated his personal experience with sickness and death as follows:

> *"In my case, not too long ago, my child was sick for 3 days and then died. I had to spend all the money I got from the sale of a bed on the funeral. These three things – sickness, funerals and relatives who come unexpectedly are the major problems. "*

Many groups ranked death first:

Moderator: *Why do you fear death most?*
Respondent: *It just comes suddenly. Even today a funeral can happen.*
Moderator: *So why did you put funerals at No. 1?*
Respondent: *Because it costs a lot of money. Also the experience of death …*

Box 12. Focus group evidence on the financial shock of a funeral – what does a low-income funeral cost?

The estimated costs of funerals ranged from K 900,000 ($166.5) to K 3,000,000 ($555.1). The major funeral expense items included the coffin, food, transport, and the burial place. One group had the following to say regarding the cost of funerals:

[100] This confirms the earlier microinsurance demand-side research findings of Manje (2007). One can only speculate as to the reason for the differences between the survey results and the focus group results. It could be that people are more comfortable to discuss the threat of death in the focus group context than to mention it in a survey. Furthermore, the focus groups and survey alike are subject to bias by recent events. A person that has recently suffered losses due to theft, for example, may state theft as primary risk even though the possible impact of the death of a breadwinner may in actual fact be more severe. The findings from the respective ranking exercises should therefore be read with this qualification in mind.

Moderator:	*Going back to the issue of funerals, how much do you actually spend?*
Respondent(s):	*It's a lot of money.*
Respondent(s):	*K500,000 and above*
Respondent(s):	*It can even be K3,000,000*
Moderator:	*Can we itemize the main expenditure items- how much is a coffin for instance?*
Respondent(s):	*K300,000*
Moderator:	*What about transport?*
Respondent(s):	*K500,000*

Another group mentioned:

> "It can go up to K2,500,000. Especially on transport – you may need to hire about 4 to 5 vehicles. So, about K3,000,000."

In a number of groups, the need to provide food at the funeral was emphasised:

Moderator	*How much do spend on food?*
Respondent	*There are usually a lot of people. You may need about 3 bags of mealie meal*
Moderator	*How much is a bag?*
Respondents	*About K60,000. Food costs more that a coffin*

Another group stated that "food pulls a lot of money" and that expenses on food alone could be up to K500,000 ($92.5).

Risk of extended family dependence. The financial "risk" of relatives visiting unexpectedly and making financial demands was commonly named in the focus groups and was even ranked third (after death and illness) in some. One respondent put it this way:

> *"We have visitors who just come unexpectedly and you have to spend money on them…..Relatives – they know that we make money through our work and so they come to ask for money…..Let me give an example. Recently my mother in law came from the village to ask for seeds and fertilizer" (Garden Compound men).*

Many participants also underlined the risk of *road traffic accidents*, which can lead to medical expenses, funeral expenses or the death or disability of a breadwinner.

While asset-related risks were also mentioned, this was not given the same prominence as in the FinScope data. The following asset-related risks were reported:

- **Theft** was a common threat for both rural and urban participants. It was indicated that this took place at both the business and household levels and can force a person to borrow money. It therefore hampers asset-building.

- Participants also indicated that they experience business risks due to **price fluctuations** on the market.

- Participants indicated that **fire** is quite common. It can cause one to lose one's assets and will most likely necessitate borrowing in order to cope. The risk of fire was much more prominent in the minds of rural than urban respondents.

- A few respondents mentioned the risk that their houses will be damaged by **floods** or heavy rains. This was however not mentioned as one of the major risks faced.

- **Crop failure and livestock diseases** were emphasised by especially rural and peri-urban respondents as a significant risk to their financial well-being:

  > "We do not keep cattle. There are very few left in the community. Only one has cattle, the rest lost animals in 2005 due to disease. There has not been any restocking" (Chongwe Kakubo Village).

  Although some urban participants indicated that they engaged in farming, they did not mention agricultural based risks.

6.3. Coping mechanisms

Risk management strategies refer to measures to protect oneself against the impact of risks, while risk coping strategies allow one to deal with whatever impact results. The focus group discussions highlighted a number of risk management and risk coping strategies, which can be grouped into *ex ante* and *ex post* strategies[101].

Ex ante risk management or reduction strategies

Ex ante risk management strategies are measures taken before the risky event takes place. The following ex ante risk management strategies were mentioned by participants:

- *Social networks*. There was evidence that the building of social networks to fall back on in times of need is regarded as a type of ex ante risk management strategy. This ranges from an implicit understanding between traders that the one will help the other out, to church membership (it was emphasised that church assistance is only available to members), to community ties in general. There is a strong expectation of reciprocity. As a Zambian proverb puts it:

  > *"Mama mpape, ne amiwa nkakupapa" (literally translated: "mother, carry me on your back, one day I will also carry you on mine").*

  As the discussion below will show, community and family support is however also an important ex post strategy for dealing with the impact of risk events.

- *Prepayment scheme in government health institutions*. As mentioned when the spending priorities of individuals were discussed, many respondents indicated belonging to a prepayment scheme at government clinics/hospitals at a minimal fee. Though this system has its imperfections, many respondents regard this as an ex ante way of making provision for healthcare expenses.

- *Precautionary savings*. Participants indicated that they fell back on what they had saved in time of crisis. In a minority of cases, bank accounts[102] are used although most people

[101] The specific strategies themselves are not arranged in order of importance, neither does the mention of a given strategy imply the generality or commonality of its application.
[102] This may be due to the fact that the focus group sample is more skewed towards very low-income people.

just keep their money at home - *"we set aside a little for emergencies".* Savings, however, are mostly not adequate to cater for risky events, especially ones that place a heavy financial burden on the victim. There are also competing needs on which savings are used as demonstrated by the following participant's remarks:

> *"Even if we do save, the amounts are too small to assist us in the future. We use the same savings towards business and/or whatever problem one might face" (Chongwe Main Market group1 FGD).*

- *Chilimba membership as implicit risk reduction strategy.* Though chilimba is primarily a means of financial accumulation for the individual member so that he/she can purchase items requiring a bigger financial outlay than would be possible from period earnings, it is also used as a type of precautionary savings mechanism. People know that, should a risk evet happen that has a financial impact, they can be certain of the chilimba pay-out to help them cope, even if the amount is insufficient. Furthermore, a special type of "borrowing" takes place within Chilimba groups in the event that a group member needs immediate finance but is not next in the line for receiving the total group contribution. Chilimba members then often trade places so that the person in question gets the money that should have been received by another group member. No interest is charged and the money does not need to be repaid. Instead, the affected person's payment is just brought forward. Chilimba members may also turn to one another for support or donations. (In this way, a chilimba therefore also serves as an ex post coping strategy, but is not discussed separately below).

Ex post risk management strategies

Ex post risk management strategies are measures taken after the risky event has taken place in order to cope with the impact. Several ex post risk management strategies can be gleaned from the focus group discussions:

Community and family support in times of trouble can be taken for granted, but is often not enough. The extended family and community, though part of the social network (ex ante), also deserves special mention because of its place in ex post risk mitigation, especially in the case of funerals. All the groups reported that they relied heavily on relatives to help shoulder the cost of risky events as illustrated below:

> *"If your child loves you, they may buy a sack of sugar" (Chongwe Main Market FGD 1); Even though donations are made by fellow marketers, family members such as working children help also" (Chongwe Main Market FGD 2).*

Some focus groups indicated that it is common practice for the bereaved family to go around the community or market place showing a photo of the deceased and doing a collection with a container for food and a plastic bag for money. It was however emphasised that community contributions are often not enough:

> *"The collections which are made do not even amount to K50,000. The little amounts collected are between K15,000 and K20,000. The mealie meal on one big dish does not even amount to a 25kg bag, which is not even enough for 2 days. Those who don't have money contribute tomatoes, or kapenta."*

Family or community support therefore has to be supplemented through alternative coping strategies.

Reducing product prices or selling assets. An interesting coping strategy is to change your business tactics (in a way that does not make long-term economic sense) in order to reap the required short-term gains. Participants reported that they are sometimes forced to reduce prices to increase their liquidity (cash) position in order to meet the cost of the risky event. Others will resort to selling off assets. Some participants indicated that the very reason they invest in business is to help them on a rainy day. As one participant in Chongwe put it:

> *"I buy a lot of pots, some of them I do not use. When I die, they will start selling them so that they find a means of survival".*

This implies a "downward spiral" for the traders in question: given their small margins, they make very little profit. After taking care of living expenses, the available money for investing in more stock to expand their business is limited. Therefore their businesses grow very slowly. Selling stock at a loss does enable them to liquidate their assets for the emergency, but may set them back significantly, having to slowly build up reserves again to the level before the crisis. This could be overcome or prevented with some form of 'bridging finance' (whether formal or informal) as such traders essentially need the finance only until they can sell/liquidate their stock at the normal rate. Indications are however that few traders have such options available. Furthermore, small margins may mean that they cannot afford to pay market interest rates on such loans.

Borrowing. In some cases, people are forced to borrow money from friends or lenders in order to meet the financial obligation brought about by risk events. Respondents indicated that borrowing tends to be community-based and that they will only borrow from money lenders (kalobas) as a last resort. We note, however, that people may not always disclose their true borrowing practices in a focus group set-up.

Risk pooling groups not common. Apart from the implicit risk pooling that takes place through chilimbas, no evidence of risk pooling group membership (along the lines of the burial societies found in South Africa and elsewhere) or risk pooling at the community level through mutual, cooperative or other member-owned entities was found. Though none of the participants belonged to funeral associations, at least two of the groups (both urban) were however aware of the existence of such associations in the community:

> *"What I know is that members are supposed to contribute on a monthly basis an agreed amount, for instance K5,000. Should a member die they assist at the funeral and pay for the coffin and provide transport."*

While some indicated that they think such risk pooling societies are a good idea and would like to join the group "at some point", other participants had the impression that these groups make empty promises of assistance, without any guarantees.

Reducing food consumption. Where alternative risk coping mechanisms such as selling off assets, family or community donations, or borrowing and chilimba payouts do not suffice, a risk event may call for more drastic measures. One such measure is reducing your daily food intake in hard times in order to free up cash.

Taking children out of school. An equally drastic strategy is to take children out of school to assist with income earning activities such as trading or even to beg. The following quote illustrates:

Respondent:	*I teach my child, so that if I get sick my child would be able to sell on my behalf.*
Moderator:	*How old is your child?*
Respondent:	*So that you take me to the police?*

These focus group insights are confirmed by the FinScope findings. Out of 27 possible options, the following coping strategies are ranked most highly in the FinScope survey. Insurance is one of the least mentioned strategies – at only 0.2% of adults – but is included for comparison:

Coping strategy	**% of adults citing this strategy**
Borrow money from family/friend	34.9%
Sell assets/dispose of agricultural crop/livestock	15.8%
Wait/ask for donations	9.6%
Cut down on household expenses	8.5%
Take out savings with bank	6.8%
Ask church for assistance	5.3%
Borrow money from other sources	3.2%
Borrow money from employer	2.7%
Claim insurance	*0.2%*

Table 21. Major coping strategies for risky events among Zambian adults.

Source: authors' analysis of FinScope (2005 data)

In total[103]:

- Only 14% of adults cope by getting assistance from somebody else (be it through the church, donations or a government grant)
- 38% of adults cope by borrowing in some form
- 29% of adults cope by drawing on their existing resources (cutting back spending, selling assets or drawing on savings)

FinScope furthermore throws light specifically on coping with death and the costs of a funeral. When asked how they would cover the cost of the funeral if one of their family members were to die, the responses were as follows:

[103] Categories calculated by counting the number of respondents mentioning *either* of the sub-strategies. Each category is therefore not simply the sum of the various sub-categories.

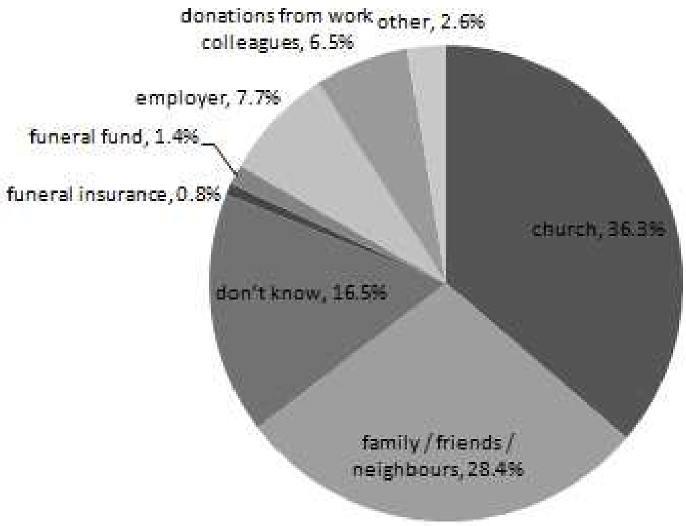

Figure 13. Coping strategies for funeral expenses (% of adults citing each)

Source: authors' analysis of FinScope (2005 data)

The most optimal risk management mechanism or combination of mechanisms will depend on the nature of the risk event and the circumstances of the individual. For some smaller impacts, for example, savings or credit products may be most suitable. Other impacts are however of such a nature that insurance would be the most optimal solution. Yet insurance did not feature as a risk coping strategy in the minds of the focus group participants.

6.4. Awareness and willingness to pay for insurance

Knowledge of insurance is generally low. The FinScope survey indicates that about 60% of Zambians have never heard of or do not understand the term "insurance". More than 80% have never heard of or do not understand the term "premium":

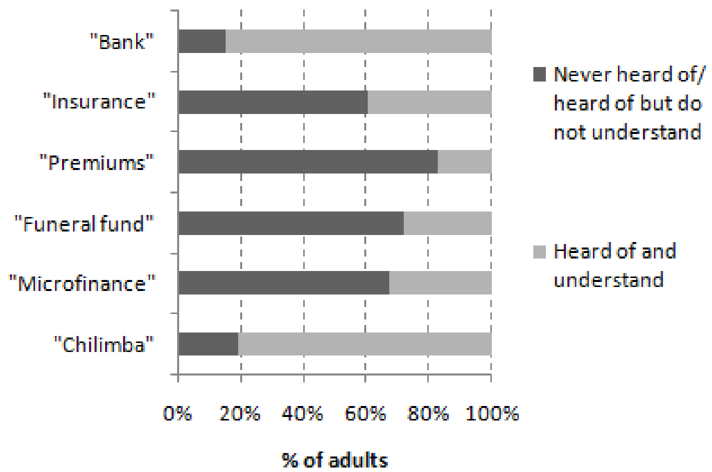

Figure 14. Awareness and understanding of selected financial sector terms.

Source: authors' analysis of FinScope (2005 data)

Awareness of insurance is therefore much lower than that of the term "bank", which more than 80% of adults know and understand. It is also interesting to note the level of awareness of different informal financial services. Understanding of the term "funeral fund[104]" is very low, confirming the low penetration of informal risk pooling. Chilimbas are however very well known, even if used by less than 10% of the sample. Surprisingly low is the understanding of microfinance. Almost 70% of adults have either not heard of or do not understand what it means.[105].

The focus group research confirms these findings:

- *Credit life perceived as condition to loan rather than insurance product*. Though the respondents in two of the three groups all had credit life insurance, insurance was never mentioned spontaneously as a way of coping with risk events. When the insurance topic was raised, almost all were however aware of the fact that they have credit life cover and even knew what the premium is (1.5% of the loan) and that it is capitalised upfront. Yet they see the credit life more as a condition to the loan than as a protection mechanism for themselves.

- *Only limited awareness of insurance*. There is a general understanding of insurance as "being protected". In one group (male, urban), awareness was particularly high. One of the participants defined insurance as follows:

  > *"Insurance is contributions made which you are paid back when you are in an emergency. You register children and if one dies, you go to the insurer and you will be given money"*

  Insurance was however **not** spontaneously mentioned as a coping mechanism without some probing from the moderator. For the most part at least one or two individuals per group have heard of vehicle insurance but their knowledge of the other types of insurance was limited and in some cases nonexistent. Apart from those with credit life insurance none of the participants had insurance (currently or previously). A few participants, however, indicated that they knew people who had insurance. This confirms the earlier findings of Churchill & Manje (2002) that a lack of awareness or impartial knowledge, as well as attitudes based on misconceptions (such as that insurance is only for the rich), undermine the insurance potential in the low-income market. This highlights the need for effective and broad-based consumer financial education with regard to insurance.

- *Willingness to pay for insurance*. Once the concept of insurance was explained, most participants expressed interest and some willingness to pay for protection against risk. Only in one rural group did respondents feel that it may be "money in the water". Though it is not certain that they would actually buy insurance at these premiums, the following amounts were mentioned as maximum premiums the various groups are willing to pay[106]:

[104] This may reflect a terminology issue. In the focus groups people referred to *funeral associations* rather than *funeral funds*.
[105] This figure reduces to 21% for rural and increases to 55% for urban adults, supporting the fact that microfinance is mostly understood as payroll lending in the formal (urban) sector.
[106] Willingness to pay for insurance was tested in the following way: the moderator explained insurance and then asked participants whether this is something they would be interested in. If the answer was yes, he would then ask how much they would be willing to pay for it. If no spontaneous mention, he would prompt: K5,000? K10,000? And so forth until they would indicate that they would not pay any higher.

District	Group	Location	Max premium/month
Chongwe	Chongwe Main Market 1	Peri-urban	K10,000 ($1.85)
	Chongwe Main Market 2	Peri-urban	K20,000 ($3.7)
Lusaka	Chazanga	Peri-urban	K50,000 ($9.25)
	Chazanga FINCA group	Peri-urban	K50,000 ($9.25)
	Garden Compound men	Urban	K20,000 ($3.7)
	Garden Compound women	Urban	K10,000 ($1.85)

Table 22. Willingness to pay for insurance

Source: RuralNet Associates (2009), focus group research summary report.

The results of Churchill & Manje (2002) however suggest that there are a number of hurdles to be overcome before willingness to pay will be put into action. Their interviews and focus group research indicated that people have an inclination to invest in financial services for which they get cash back, indicating a lack of understanding of the insurance value proposition. Furthermore, the trade-off between "peace of mind" and "bread on the table" will always be particularly pronounced for the low-income market. All of this once again underlines the need for financial education.

- *The need for community-based distribution*. Once the moderator explained the concept of insurance, respondents asked very relevant questions: what will the insurance cover – both my life and my business? Where can we buy it? How do you pay your premiums? How do you claim? This interest and willingness to consider insurance is however not translated into actual demand due to the fact that insurance is not perceived to be within easy reach of their community. The general impression was that insurers need to come to the community to sell insurance, using local structures and networks such as chilimbas or loan groups. If they require the community to come to them (i.e. to travel into town to visit an insurance branch office with which they are not familiar), it is likely not to happen.

7. The potential market for microinsurance

Understanding the scope for insurance expansion. The discussion in Section 5 highlighted the scope for microinsurance growth and discussed the players and products likely to enter the microinsurance market. This potential is however not boundless. There will always be some part of the market that is simply too poor to afford insurance, or who are too hard for insurers to reach viably. This concept can be explained with the help of the access frontier - a conceptual tool for understanding market potential. Developed by Porteous (2005), it maps the current and potential reach of the market, as well as the areas where the market is unlikely to ever reach and where state social welfare is therefore called for. The access frontier can be pushed out by technological innovation to bring down cost or facilitate innovation, or by a more facilitative regulatory framework. In the end, it will however be constrained by the income profile of the target market. Appendix 3 explains the access frontier concept in more detail.

7.1. Scope for market development in life and asset insurance

Insurance penetration has the scope to grow almost three-fold[107]. What, then, is the potential for microinsurance expansion in Zambia, i.e. the limit of the access frontier? The discussion thus far has shown that there are at least two first order areas of potential insurance expansion:

- Cross-selling insurance to all of those that are **currently banked** (almost 15% of adults or 1.1m individuals according to the first FinScope survey).

- In addition, Section 5.3 highlighted that there are significant **pockets of networked individuals** in the informal sector and that these groups can be targeted for insurance distribution purposes. As postulated in Section 3.2, this is can amount to in excess of 210,000 individuals.

Therefore the insurance frontier potentially encompasses at least the full banked market (1.1m people), as well as almost a quarter of a million people in the informal market. This presents a total potential market of more than 1.3m clients. Compared to the current insurance client base of about 497,000 individuals (6.6% of adults), it implies that the insurance sector has the scope to almost triple in reach[108].

Figure 15 attempts to map the potential insurance frontier (and the various groups it encompasses) against the Zambian income distribution:

[107] This estimate is based on a combination of those with enough income and those who are networked – or would be viable from an insurance distribution point of view.
[108] Note, however, that we have not accounted for possible overlap between the banked market and the networked informal market. This may change the equation.

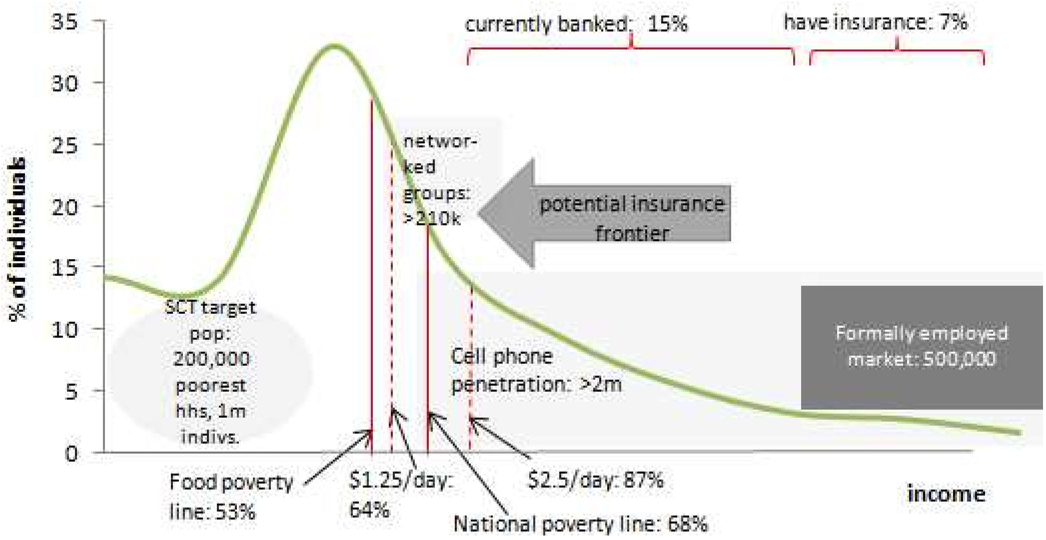

Figure 15. Mapping the Zambian adult population and potential insurance target audience

Source: authors' representation based on income distribution data from CSO's Living Conditions Monitoring Survey (2004), the Labour Force Survey (2005), FinScope (2005 data), Langhan et al (2009), as well as various inputs from consultations.

Note: the sizes of the shapes do not reflect actual population or income level estimates, but should be regarded as an indicative representation only. The actual income distribution[109] for all paid Zambians, as documented in the 2005 Labour Force Survey, was used as a proxy for the total population income distribution[110]. We use the total population poverty estimates as approximation for adult population poverty estimates. Furthermore, the blocks are not necessarily fixed vis-a-vis the others: e.g. not all of the formally employed necessarily are high-income, have insurance or have a bank account.

Substantial proportion of the Zambian population beyond the reach of the insurance market. Four poverty lines and one especially vulnerable group are indicated on the diagram:

- 53% of the population fall below the **food poverty line,** defined by the Central Statistical Office (CSO) to denote extreme poverty

- 68% of the population fall below the **national poverty** line (comprising a basket of food and essential non-food items) as defined by CSO

- 64% and 87% fall below respectively the **$1.25** and **$2.50 per day** poverty lines applied internationally by the World Bank to indicate absolute and moderate poverty.

- The "**SCT target population**" circle refers to the social cash transfer target population. This is a Government of Zambia social welfare programme aimed at assisting the most

[109] Note that 14.3% of those surveyed stated their income to be zero. A further 14.1% did not state their income.

[110] Though the 2004 Living Conditions Monitoring Survey (LCMS) provides income distribution data for the population at large, it does so on a household rather than an individual basis. A few matters to note: the income distribution compiled from the LFS is for all paid Zambians, totalling 3.18m. It was used as a proxy for all Zambians, but it should be noted that this is a likely over-estimation of income levels, as only those who earn some form of income were considered. The income distribution data provided by FinScope (2005) could be a more representative alternative. However, 41.3% of all respondents in the FinScope survey indicated that they do not know their income. This skews the income distribution, as it is only representative of 58.7% of respondents. In the LFS, only 14.1% of the sample did not state their incomes, so the income distribution is representative of 86% of the sample.

vulnerable and incapacitated households in local communities and represents a scale-up of the five pilot social cash transfer schemes currently run by the Ministry of Community Development and Social Services, with funding from a range of international donors (Langhan et al, 2009). The most vulnerable households were estimated at 200,000 in 2006. According to the Living Conditions Monitoring Survey, 200,000 households represent roughly 1m individuals[111].

The Social Cash Transfer target population is one way of segmenting the likely market redistribution zone of the access frontier – that part of the population that is unlikely to ever be a viable target market for pure market-based insurance. Another way of defining this zone would be to consider all those who indicated in the FinScope survey that they sometimes or often go without food: only 36% of adults rarely or never go without enough food to eat, while 64% often or sometimes go without enough food[112]. This is roughly in line with the \$1.25/day poverty line cut-off. Therefore one could argue that only the top 36% of adults could be considered as within reach of the traditional insurance market.

To do this will require a gradual expansion of the market in a way that gains the trust of the low-income population, significant financial education of the target audience, as well as distribution innovation. To reach those beyond the top 36% of the population would require government or donor support, as market forces alone may not suffice[113]. Although product innovation and efficiency gains may allow further extension into this space, much of this group will, therefore, remain the responsibility of government's social security system and is likely to continue using informal risk mitigation mechanisms.

Box 13. The role of microinsurance vis-a-vis broader social protection strategies and mechanisms in Zambia

In protecting the low-income market against vulnerability, thereby increasing welfare, microinsurance serves the overarching objective of social protection. As microinsurance provided on pure market principles cannot realistically be expected to reduce the vulnerability of the whole population, it is important to regard it within the broader range of social protection interventions, thereby delineating the role of the market vis-a-vis the state and donors in social protection.

Social Protection Strategy to guide and coordinate social protection interventions. As one of the central pillars of its Fifth National Development Plan (FNDP) for 2006-2010, the Government of Zambia, through the Ministry of Community Development and Social Services, in 2005 developed a Social Protection Strategy which was then included as Chapter 5 of the FNDP. The strategy defines social protection as: "policies and practices that protect and promote the livelihoods and welfare of people suffering from critical levels of poverty and deprivation, and/or are vulnerable to risks and shocks" (MCDSS, 2005). The intention of the Social Protection Strategy is to harmonise, prioritise and improve existing approaches to social protection, as well as integrate new ones (MCDSS, 2009). The ultimate goal is to "protect and promote the livelihoods and welfare of the critically poor and of people with the greatest vulnerability to risks and shocks" (MCDSS, 2005).

Great challenges in practice despite attempt at coordinating strategy. There is a wide range and a large number of social protection interventions targeted at low-capacity households in Zambia. Implementation however remains a challenge and often there is not even sufficient knowledge of

[111] The average household size, calculated by dividing the total population according to the LCMS (2004) by the total number of households in the same survey, is 5.02.

[112] Of all those that are currently insured, 25% do sometimes or often go without food (FinScope analysis). It is therefore not an absolute poverty line. Nevertheless, of those that always, often or sometimes go without food, only 2.6% have insurance. This rises to 14% for those who rarely or never go without food.

[113] Note that one of the reasons that the <\$1.25/day population is not likely to be a target market for insurance is that there is also little penetration of MFIs in this segment. If the MFI sector were to develop, insurance may extend on the back of that.

the numbers and needs of the poor to be targeted (Holmes & Slater, 2008). The various schemes have very limited coverage and are on the whole not very effective, with only transitory coverage of a few people per scheme. There is furthermore limited if any coordination between individual interventions. Interventions include (Holmes & Slater, 2008):

- social assistance, mostly through a variety of public works programmes and input transfers, e.g. agricultural seed and fertiliser scheme named the Targeted Food Security Pack – TFSP. Some programmes have been mired by fraud and corruption controversies;
- social insurance programmes, which however mostly only cover formal sector employees; and
- capacity-building programmes to improve economic productivity, of which there is a very limited number, with extremely limited coverage.

There is therefore still a significant gap between those covered by social protection and those that can be protected via the microinsurance market mechanism. This calls for innovative approaches by government and the donor community to involve the private sector protecting a greater proportion of the population.

Limited potential for synergies between microinsurance and social cash transfer scheme. One pipeline government initiative (currently at pilot stage) to provide broad-based social protection deserves special mention. As discussed above, the social cash transfer (SCT) programme is a central part of the Government of Zambia's social protection activities. It aims to protect the poorest of the poor against vulnerability and, if implemented efficiently, stands the chance to overcome at least some of the weaknesses of the currently fragmented social protection system.

From an insurer's perspective, the SCT programme also presents a ready touch point for reaching 200,000 households. Could it be a viable channel for microinsurance distribution? When one considers the features of the programme, the likely conclusion is no. The grant is simply too small and the target market too poor to make insurance distribution via this channel possible, unless extremely low-cost products that offer real value to this target market can be found: Each household will receive K50,000 ($9.25) every two months. This amounts to only K25,000 ($4.63)[114] per month (Langhan et al, 2009). Therefore the social cash transfer programme is likely to complement (rather than enhance) any microinsurance initiatives in that it provides some protection against destitution to a part of the population that is likely never to be within the reach of the microinsurance market.

Given the important role of the agricultural sector in Zambia and the demand for and unique characteristics of health insurance, we now pause at each of these two sectors to discuss the scope for microinsurance.

7.2. Scope for agriculture insurance

As the largest source of livelihood in Zambia, the agriculture sector's potential importance in microinsurance expansion is irrefutable. Not only does it present the main source of income and potential network for reaching people but all of these farmers also face widespread drought, storm damage and disease risks on their crops and livestock.

[114] The average household size among the target population is four. Therefore the individual-equivalent of the household grant would be just more than $1 per month.

Limited to no agricultural insurance in the Zambian smallholder and emerging farmer sector. Of all those earning an income in agriculture in Zambia, only 4% have insurance (FinScope, 2005 data) and this is likely to be health or asset insurance other than agricultural insurance. With the exception of one multi-peril product, there are currently no agricultural insurance products that we are aware of targeting specifically the smaller farmer market. In fact, in the total FinScope survey, only 6 respondents (out of 3998) indicated having agricultural insurance[115]. Where agricultural insurance (for crops or livestock) does exist, it is exclusively in the domain of large commercial farmers or agribusinesses. In the emerging farmer sphere there is some credit life insurance provided on a compulsory basis on the back of loans. So, for example, the ZNFU provides the linkages between a commercial bank and farmers for a credit scheme. This scheme is underwritten by ZSIC for credit life.

Index insurance as response to challenges of multi-peril insurance. Agriculture and development are intricately linked. Crop insurance can theoretically play an important role in stabilising the incomes of the rural poor. The multi-peril agricultural insurance models applied in developed countries are however ill-suited to the developing country context. This does not mean that developing country farmers are not vulnerable to weather risks. Indeed, it can be argued that smallscale farmers are even more vulnerable than large commercial farmers. This has prompted a move away from insuring against poor crop yields on an individual farm basis, in favour of insuring against adverse weather in the area as a whole – in the form of the development and testing of different, innovative *weather index insurance* for the smallholder market (Roth, McCord et al, 2007; Devereux et al, 2008). Examples include two drought insurance products with a rainfall trigger in Ethiopia, drought and flood index insurance linked to lending in India and Bangladesh, as well as an ongoing pilot in Malawi (see Roth, McCord, et al, 2007, for a full list of case studies).

Box 14. Weather index insurance as response to the challenges facing multi-peril agricultural insurance: international evidence

Multi-peril insurance unsuitable for smallholder agriculture. Traditional crop insurance is expensive to underwrite: in determining the sum assured based on the projected value of the crops, but importantly also in assessing the damage at claims stage (individual farm-level loss adjustment). The latter is often simply not feasible in a smallholder farmer model and particularly not if the farmer is not well networked within the agricultural value chain. Furthermore, trying to provide financial services to small unit households can be inefficient and moral hazard, fraud and adverse selection are common in traditional crop insurance (Roth, McCord et al, 2007). It is also an insurance product subject to covariant risks (drought affects a whole region), calling for reinsurance or participation in catastrophe (CAT) pools[116]. Furthermore, transaction costs are high and delayed payouts may undermine the value of the product for the smallholders. For these and other reasons, traditional crop insurance for smallholders has failed (Devereux et al, 2008).

Index insurance to overcome multi-peril limitations. In response the failure of multi-peril agricultural insurance, a number of weather index pilots have been launched. Under an index approach, certain parametric triggers are defined upon which fixed payouts will be made. Therefore the insurance contract is written not against harvest failure, but against a local index (e.g. rainfall) that is correlated with harvest outcomes. For example, a rainfall index that uses measurements taken from secure weather stations is commonly used as an indicator of crop performance. Too little rainfall and too much rainfall can both result in poor production outcomes. Indices can also be constructed from

[115] This rose to 8.55 after sample weighting had been applied – still too few to be statistically significant.

[116] "CAT bonds are marketable securities with earnings tied to specific catastrophic events. Investors receive favorable rates of return if the catastrophic event does not occur or they stand to lose earnings or even up to 100 percent of the principal if the event does occur. The funds are used by the seller of the CAT Bonds to fund payments to insureds. Some CAT bonds have been structured using parametric indexes such as the Richter scale for earthquakes" (Roth, McCord, et al 2007).

aggregate statistics such as area yields (Devereux et al, 2008; Roth, McCord et al, 2007).

Index insurance has a defined threshold and a limit that establishes the range of values over which indemnity payments can be made. The threshold marks the point at which payments begin. Once the threshold is reached, the payment increases incrementally until the value of the index reaches the pre-defined limit. The payment rate for an index insurance contract is the same for each policyholder who has the same contract, regardless of the actual losses sustained by the policyholder. The amount of indemnity payment received will depend on the sum assured (Roth, McCord et al, 2007[117]).

Advantages to index insurance. Because the index is exogenous to policyholders, index insurance removes any moral hazard or adverse selection concerns. It also greatly reduces administration costs: it is easy to administer as it entails standard contracts and monitoring costs can be greatly reduced. Most importantly, no individual farm-level loss adjustments/claims assessments have to be made. This provides the scope for quicker payouts. This is often of utmost importance for smallscale farming in helping them to smooth income and to prevent expensive coping strategies such as selling of assets. By lowering transaction costs, index insurance can therefore bring agricultural insurance within affordable reach of smallscale farmers (Roth, McCord et al, 2007; Devereux et al, 2008).

Limited viability on a purely private basis. Despite these advantages, it is not clear that index insurance is a viable private insurance product. Where such models have been introduced, this has mostly been on a subsidised/public private partnership basis, or with financial support or technical assistance from donors or NGOs. On a commercial basis, premiums would be too high for smallholders (Devereux et al, 2008). Though intrinsically an attractive model for smallholder agriculture, index insurance poses significant cost-raising market challenges. It is best suited for correlated risks (severe, widespread events such as droughts and floods) and may not be an appropriate tool in all circumstances (Roth, McCord et al, 2007).

Susceptibility to basis risk imposes data requirements. The most notable disadvantage is that there will always be some variance between the index and the actual losses incurred – a phenomenon that is called basis risk. When designing a product, it is crucial to minimise basis risk by finding one or more indices whose movements correspond as closely as possible to changes in the value at risk. This requires long-term, accurate data on both changes in the value at risk, e.g., changes in crop yields, and changes in the index, e.g., rainfall. Only with accurate data can accurate pricing be achieved, which is in turn crucial to ensure solvency. The data requirements for developing a weather index product include (Roth, McCord et al, 2007):

- Preferably more than 30 years of weather data
- Limited missing and out of range values, with preferably less than 1% of weather data missing
- Data integrity
- Availability of a nearby station for verification
- Consistency of observation techniques: manual vs. automated
- Limited changes of instrumentation/orientation/configuration
- Reliable settlement mechanism
- Integrity of recording procedures
- Little potential for measurement tampering

Obtaining this data may be fairly difficult – and expensive – in developing countries.

Agricultural insurance will remain a challenge for Zambia. Due to these challenges, the insurers consulted do not consider agricultural insurance for smallscale farmers to be viable in Zambia at this stage, at least not without explicit government or donor support. Even NICO Insurance, though exposed to weather index insurance in Malawi through its Malawian parent company, regards the Zambian environment as different to that of Malawi and does not think that the same product would necessarily work in Zambia.

[117] Selectively quoted directly.

Box 15. Weather index insurance: a case study from Malawi

Source: Roth, McCord et al (2007); MicroInsurance Agency (unknown date)

This insurance pilot, launched in 2005, provides loan-linked index insurance with a rainfall trigger to groundnut farmers who are members of NASFAM (a smallholder farmers' union; farmers are organised into clubs of 15-20 farmers). During the 2006/7 season, it was also expanded to maize. It has now been rolled out in four areas. The pilot partners are: NASFAM, two lenders and the Insurance Association of Malawi. The project is coordinated by the Microinsurance Agency (now known as MicroEnsure – Opportunity International's microinsurance intermediary[118]). The World Bank also provided technical assistance.

Features. The insurance enables policyholders to qualify for credit to buy certified seed. Premiums are around 6-7% of the loan value. The rainfall trigger relates to rainfall patterns during the critical periods of groundnut production, with different triggers set for different stages of the growth and harvesting process. Farmers who purchase the product enter into an agreement to deliver their crops to NASFAM. NASFAM then acts as a delivery channel for both the loan and the insurance pay-out and deducts the amount for the loan from its payments to farmers for their yields.

Success. Investments in infrastructure including a new weather station and the installation of digital weather stations have allowed the project to expand. By the end of 2006 the 2006/7 season, more than more than 2500 policies had been sold to 1710 farmers[119] and premiums to the value of more than $10,000 had been generated. Lenders purchased group policies on behalf of their members, thereby enhancing access to credit and also facilitating insurance take-up.

Challenges. The pilot however suffered from a lack of a demonstration effect during the above-average groundnut crop of the first season. No payouts were triggered, and the high groundnut yields depressed prices to the extent that many farmers no longer found the premium affordable. Uptake has furthermore been disappointing. Indications from consultations are that this scheme would not be viable without continued donor support.

Credit-related agricultural insurance as one possibility. Nevertheless, index insurance remains a first step in creating an enabling environment for rural financial services. Should one want to pursue agricultural insurance for smallholders, it may be most efficient to start with a product that covers the portfolio risk of rural lenders (and hence indirectly of their clients), should crop failure lead to an inability to repay loans. By targeting the aggregate portfolio of e.g. a microfinance institution (MFI), lower administration and product delivery costs are achieved than by providing direct coverage to smallholder households. Furthermore, reducing the portfolio risk of rural and agricultural lenders is one way to ease the constraints to greater and more efficient complementary rural financial services (Roth, McCord et al, 2007). Such a pilot is however unlikely to be viable in Zambia (or to be initiated by an insurer) without public or donor support.

Scope for mitigation of non-agricultural risks. There may be more concrete opportunities to support agricultural development through *other types* of insurance. According to the Zambian National Farmers' Union, farmers often have to sell off some of their livestock (often their primary assets) or tend to sell their crops at suboptimal times because they need money for healthcare, funerals, school fees, etc. There is therefore a need for insurance among the farming community. This need can be translated into willingness to pay for insurance premiums if the distribution, premium payment and claims mechanisms are tailored to the particular needs of farmers. For example, as many farmers only earn a cash

[118] MicroEnsure provides the link between insurance providers and client facing groups such as MFIs. It provides back-office support and has a product development role. It currently serves more than 3m people globally (MIA, 2007).
[119] 1710 farmers are groundnut policyholders, of which 826 also have maize policies.

income once or twice a year (at harvest time), premiums would have to be tailored accordingly.

Pockets of opportunity offered by value chain programmes and other networks. These opportunities for insurance in the agricultural sector are based on the existence of value chain networks and support programmes under development. These include:

- The **National Farmers' Union (ZNFU)** as apex body for farmers' associations. It claims to reach 350,000 people, most of which are smallscale farmers. These farmers can therefore be reached via its network of district and commodity-based associations[120].

- The value chain-based **outgrower schemes** discussed in Section 3.4 deserve special mention. They represent a ready opportunity for insurance distribution. In the cotton industry alone, some 100,000 outgrowers deliver their harvest to a processor. Existing payment mechanisms and communication channels are in place that can facilitate insurance distribution, premium collection and payouts.

- Furthermore, according to the Directory of Private Sector Intermediary Organisations in Zambia (CBPSD Project, 2008), there is an **Agribusiness Forum** with 20 members. They have links to the smallholder farmers as input suppliers, farm equipment and machinery dealers, development agencies and outgrower schemes servicing the smallholding sector

- As mentioned in Section 3.4, the **Zambia Cooperative Federation** has a membership base of about 2m, concentrated almost exclusively in the agricultural sector. The cooperative industry is however currently very fragmented and many cooperatives have only been formed to receive subsidised inputs from government. It is unlikely to form a viable insurance distribution network as it currently stands. Nevertheless, there are now moves to "clean up" the cooperatives industry and restore their role in the sector. This would push up the potential reach.

- Government is considering introducing an input **voucher scheme**, to be distributed through an innovative technology-driven mechanism outside of the traditional cooperative channel, directly to the targeted beneficiaries. The plan involves a phased approach, starting in 2009, and may offer distribution opportunities and the basis for exploring product opportunities. No details have however been finalised.

- The **Zambian Agricultural Commodities Exchange (ZAMACE)** was established in 2007 as a response to a demand among stakeholders in the agricultural sector for some form of market mechanism that addresses the market imperfections that stifle growth in the agricultural sector, such as high transaction costs, poor market information and low

[120] The farmers' union comprises:
- *54 district farmers' associations*, of which 10 are a mix of commercial, emerging and small, and 44 are predominantly smallscale farmers.
- *16 Commodity or Specialised Associations*, including cotton, tobacco, poultry, a fisheries association, the Zambia Farm Employers' Association, etc.
- *7 National Commodity Committees* – groups not yet large or strong enough to become an association, including: beef, pork, seed, wheat & barley; fruit & vegetables
- *21 companies represented in three Agribusiness Chambers*, including agrochemical companies, seed companies, fertiliser companies, etc. Each brings a potential employee group to target for group insurance.
- *39 corporate members:* large companies, primarily in production, e.g. Zambeef, Zambia Sugar, Dunavant, etc. Such companies can once again be targeted for their employee groups, as well as for their smallscale farmer suppliers, for example through outgrower schemes where applicable

levels of transparency and trust. Through its brokers, ZAMACE provides a trading platform and a structured, transparent trading environment for buyers and sellers to transact, governed by a set of rules to ensure integrity in the market place. Over $12m of trading business has been transacted across the Exchange since its inception. One component of the risk mitigation services that the Exchange provides is an insurance package that effectively 'guarantees' settlement of any ZAMACE contract. Furthermore, as a conduit through which trade is conducted, ZAMACE provides another aggregation point through which individual farmer or trader insurance can be offered (USAID/PROFIT, 2009 – email communication).

- There is a growing network of privately owned **agricultural storage facilities** certified as public warehouses by ZAMACE that can be used for storage and aggregation of smallholder and small trader crop output for quality and quantity accreditation and onward sale across ZAMACE**.** As part of the certification procedure, the warehouse operators require comprehensive insurance for their stored product to ensure that the depositor is under no risk. Currently there are five warehouse operators in the process of being certified, but the intention is to scale this up to over 20 over the next three years. This offers a potential insurance opportunity for warehouses as aggregation point for farmers, as well as payment system for farmers. ZAMACE may also be incentivised to insure the crops stored.

Potential not yet utilised. These channels of aggregation form the backbone of the potential for microinsurance distribution to small and emerging farmers. This potential is however unutilised thus far, as insurers have focused on "easier" target markets such as the formally employed. As the insurance market starts to look to the informal market for expansion, the opportunities posed by the agricultural sector should however come to the fore.

7.3. Scope for medical insurance

Absence of regulation of underlying health insurance model presents challenge to microinsurance. As discussed in Section 6, adding an insurance funding mechanism to a health services market that is largely unregulated will be a challenge. Particularly challenging will be the inability to assess and control costs in such an environment. There is no regulation of pricing practices in the healthcare market. In a sense, doctors and hospitals have the incentive to "over-treat", or give more expensive treatment than is necessary to those with medical insurance. Given the low medical insurance volumes, insurers are not in a favourable bargaining position to bring down costs. This is aggravated by high administrative expenses.

For all these reasons, the current medical insurance players find it challenging to make the product work even in the high-income market. They therefore do not regard the introduction of medical microinsurance as feasible. Madison Health Solutions, for example, was approached to extend its microinsurance product offering through MFIs to include health cover, but has thus far not been able to provide such an offering (Chakonta, 2007).

Yet low-income demand implies scope for complementary medical cover. Government provides fairly accessible public healthcare services and in some cases there are in-house informal medical schemes at public hospitals or clinics. This may reduce the scope for private medical insurance for the largest part of the population. The focus groups however indicated that public healthcare does not cover the cost of medicines and that there are ancillary costs, such as transport to the hospital, that also impact on the low-income market. It furthermore indicated a strong need for health risk mitigation among the low-income market. This presents an opportunity for complementary cover over and above the service offering of the state, for example a type of limited health plan. While the absence of regulation of medical insurance models was noted as a constraint above, it also has a positive side in that it provides room for experimentation, for example with regard to the benefits included (as regulation does not prescribe a minimum set of benefits).

At the moment there are no insurers specifically targeting the low-income health insurance market. One player that has ventured into this space is Madison Life. It provides a sickness benefit on some of its credit life policies to MFIs. The benefit is however not for healthcare *per se*, but is a rider on the credit life policy that covers the loan repayment, should a person be certified as ill (i.e. cannot earn an income to make repayments) for a certain number of weeks.

Distribution partners driving search for health microinsurance solutions. As with agricultural microinsurance, aggregation of individuals (be it through employer groups, community structures in the areas around hospitals or clinics, or through the established agriculture and market networks named in previous sections) will be important to make products and distribution models viable. Bancassurance may also play an important role. For example: Zanaco's market research has indicated a real need for health insurance cover among their mass market clients. This holds true for individual clients but also for MSMEs who have the additional challenge of effectively managing their business and their workforce in the face of illness (of themselves and of employees). Zanaco therefore sees scope for bundling some type of health cover with a low-income market savings account, as well as for an MSME-targeted product. No products are however in the pipeline yet.

8. Market development drivers and opportunities

In this document, we scoped the insurance market in Zambia based on a general understanding of the Zambian context: the role of the informal sector, especially informal small businesses; the rise of the low-income credit market and the likely future dynamics around that; the state of the agricultural sector and the level of organisation; as well as the state of the health services market and the need for health financing mechanisms. We then discussed the regulatory framework applicable to insurance provision and considered the insurance market: current structure, products, usage and dynamics. We also considered the demand-side insights rendered by the FinScope survey and the focus group research.

This led us to conclude on the scope for microinsurance expansion, with separate mention of the scope for micro health insurance and for microinsurance in the agricultural sector. It showed that, even under fairly conservative assumptions, there should be scope to almost triple the reach of the current insurance market. Though this by no means implies an optimal level of insurance coverage, it presents a first-order opportunity.

Salient features and drivers of market development

In summary, the market features highlighted thus far suggest the following key drivers of the development of the insurance market:

Low incomes, hard to reach. The bulk of the Zambian population is very poor, making affordability a real constraint to large-scale microinsurance expansion. Furthermore, 65% of the population live in rural areas. The formal sector infrastructure and payment system, e.g. the bank network and/or retail store footprint, is still relatively limited in rural areas. This challenges insurance distribution.

Government as driver of employment. Indications are that a large proportion of the formal sector is employed by government/parastatals. This has meant that government is the main partner for credit providers and insurers (life, health) alike in signing up client groups. There is however little further room for growth in the public employee sector, necessitating insurers to look for new client groups. The same holds for the rest of the formal sector.

Scale of informal market undermines insurance growth. The Zambian labour force is characterised by a high level of informality. There is a myriad of small, fragmented employers in the informal sector. Furthermore, a large proportion of the population is engaged in informal agriculture and many operate as individual traders. For insurers, the informal sector is more difficult to reach than formal companies. Furthermore access to bank credit by informal enterprises and employees is constrained (as e.g. proof of income in the form of a formal payslip is needed). This constrains the scope for credit-related insurance growth on this front.

But networked nature offers some means of accessing informal market. Despite the challenges posed by the high level of informality, the analysis indicated a number of networked pockets of individuals that present scope for insurance distribution. However, the networked groups are fragmented, with many small organisations. It is not clear what the real cohesion is within such groups and it is likely that only a handful will have the capacity to be viable insurance distribution partners.

Questions about awareness and demand. Zambia is fairly unique in the relatively low level of organised informal risk pooling[121]. Low awareness of insurance outside of compulsory third party vehicle insurance is emphasised by the FSDP's Contractual Savings Working Group and the insurance industry alike. This is confirmed by the FinScope findings on familiarity with concepts and the generally low levels of awareness of insurance found in the focus group research. This raises questions about the level of demand for insurance. Yet communities do manage risk in various ways through reciprocal support and chilimbas and the focus group insights regarding risk experience, coping mechanisms and willingness to pay for insurance provide some positive signals for microinsurance development. Though low-income, the microinsurance target market is still proactive managers of their finances. Microinsurance however calls for consumer education efforts, as well as product and distribution innovation on the part of providers.

Underdeveloped funeral service market reduces demand for financing and offers limited distribution opportunity. In countries like South Africa and Colombia it has to a large extent been the demand for funeral services and the vibrant funeral service provider industry that has fuelled microinsurance development. This is however not the case in Zambia. The small size of the funeral parlour market provides only limited scope for insurance distribution via service providers. Traditionally, communities or families prefer to bury loved ones

[121] Note, however, that informal risk pooling may simply not be picked up fully in the data, or that risk pooling is informal to such an extent that people do not find it worth mentioning during the survey interviews.

themselves. There is also a reluctance to talk about death or plan for it. Therefore there is no ready funeral parlour market as distribution channel for insurance. In the absence of derived demand for insurance sold via the funeral service providers, funeral insurance is a harder sell.

Yet scope for funeral insurance push. Despite the limitations in the funeral service industry and the demand-side reluctance to discuss death, the discussion has shown that industry is increasingly emphasising the scope for funeral insurance market development. As indicated in the product case studies, most low-income market targeted innovation is currently around funeral insurance. This is for good reason: despite the traditional reluctance to talk about death, the risk of death and the associated funeral expenses remains one of the most material risks facing low-income households, with the potential to plunge them (further) into poverty and erode the capital of their small businesses. The focus group research indicated that privately held funerals still come at a significant expense – beyond what individuals can cope with by drawing on savings or community support.

*Insurance industry: the game is changing***.** The traditional industry inertia is being transformed into interest. The industry performance analysis suggests that, though small, the insurers in Zambia are generally profitable. For the general insurance industry at least, this has thus far largely been based on the corporate book. However, cannibalistic competition has set in for the relatively small pool of corporate clients (giving rise to the PIA's guidelines on minimum risk premiums) and indications are that the retail market will gain increasing prominence. The result is that, after more than a decade post-liberalisation of only focusing on the top end of the market, insurers are now starting to consider the opportunities that the "informal" market holds. A number of planned products were mentioned, especially on the life insurance side.

But industry performance suggests that microinsurance expansion may not be first-order priority. There is however no evidence so far of a concerted move into the microinsurance market. While many players talk of microinsurance expansion, the proof will be in the pudding. The industry performance analysis also does not bode well for actual microinsurance development. Despite the limited data, the picture that emerges suggests short-term profit-taking with little investment in long-term industry growth. Especially general insurers are not capitalising at the same rate as premium growth and therefore appear to be extracting profits. This questions the incentives of insurers to grow their business. Indications are that, going forward, regulation will place increasing pressure on inefficiencies.

Can the insurance industry deliver value to the low-income market? Industry data show that risk rates and especially management expenses are quite high in the Zambian insurance sector, while loss ratios are generally low. This implies low value to the consumer, as only a low proportion of premiums is paid back in the form of claims. While the issue of poor value has not yet emerged as an issue from the insurers' and government's point of view, disillusionment with poor value policies will undermine trust in the industry and can become a barrier to the development of the microinsurance sector.

Modernisation required to deliver microinsurance. Though the larger insurers in Zambia have electronic management information systems, some of the smaller players still have paper-based systems. According to one insurer consulted, an IT system can cost up to $500,000 depending on the level of sophistication required. For smaller insurers this can be a significant capital outlay, especially if industry practice is to pay out dividends rather than to reinvest in systems.

New entrants likely to introduce new dynamics. The entry of African Life into the market has impacted significantly on the development of the retail life insurance market. It was the first insurer to build a distribution model based on tied agents and it has done so successfully, growing its book to become the 3rd largest player in the life market in only a few years. In addition, Blue Assurance has just been registered (the first credit provider to enter the insurance space), and another foreign insurer plans to enter the Zambian market. This represents significant new entry in a small market and is likely to introduce some interesting new competitive dynamics into the sector. Not only is it spurring the growth of the life market vis-a-vis the traditionally dominant general insurance sector (thereby providing an answer to the concerns over the increasingly saturated corporate market), but it will also introduce and test new distribution channels.

Experience and de facto local CEO requirements challenge new entrants. Under Section 26(4)(b)(i) of the Insurance Act, the PIA shall only approve the appointment of a person as chief executive officer (CEO) of an insurance company if that person has a minimum of 10 years' experience in the insurance industry. This, according to some industry players, may be a barrier to new entry. Whereas they concur that it is important that at least one person in the insurance firm has 10 years of insurance experience, the argument is that the CEO should not necessarily be that person and that financial management and marketing experience may be of equal value. Furthermore, though the Act only states that the CEO must be resident in Zambia, the PIA has a strict local CEO requirement in line with the objectives of the Citizens' Economic Empowerment Act. This is the single biggest challenge to new entrants to the market currently.

Life beyond payroll lending: opportunity for credit-backed expansion limited by need for reinvention in the low-income credit sector. The credit channel is currently the single biggest channel for microinsurance distribution, but needs to reinvent itself due to market and, potentially, regulatory forces. On the market side, indications are that the microlending market is nearing saturation, with signs of overborrowing that risk collapse. On the regulatory side, experience in South Africa, where a Consumer Credit Insurance Inquiry was recently concluded, has shown that unscrupulous practices can lead to a consumer outcry, with consequences for industry[122]. Though the situation in Zambia is not as far advanced, the chance of a regulatory clampdown on credit practices cannot be ruled out. The payroll channel is therefore under pressure. On the one hand this implies a constrained growth opportunity for credit life insurance. On the other hand it indicates an incentive by microlenders to diversify their product offering by also distributing other insurance products in search of new sources of revenue. Should there be regulatory pressure to extend the term of loans, it could also imply greater demand for credit life insurance among credit providers[123].

[122] At the same time, a review of practices in the credit industry and concerns of overextension of borrowers led to the implementation of strict regulation of credit practices in the form of the National Credit Act, which came into effect in 2007. As a result, the consumer credit industry has had to reinvent itself.
[123] In consultation, it was indicated that microlenders generally do not regard credit life insurance on loans with a maturity of less than 3 or sometimes 6 months as necessary as their risk exposure is low enough.

Distribution challenges remain paramount. Regardless of the positive market dynamics, insurers do not see the informal market as an "easy target". The move to retail and life insurance is unveiling certain problems in the industry. As competition increases and players have to move to low-premium, low-margin business, inefficiencies are starting to impact on insurers. Furthermore, the lack of retail distribution infrastructure or experience is proving challenging as insurers are trying to find ways of selling to this new market. Insurers are for the most part concerned about the scope for efficient premium collection from the informal market. Success would require product and distribution innovation to tailor insurance to the needs of the low-income market (including revisiting the practice of charging upfront annual premiums in favour of more frequent, lower premiums that allow some flexibility for those with irregular incomes) and enhanced efforts at consumer education/insurance awareness creation.

Increasing recognition of the role of client aggregators. The realisation is taking root that even the informal sector has money at hand and can be reached on a group distribution basis. Inroads into the microinsurance market can be made if existing networks such as farmers' or small business industry associations, affinity groups, marketeers associations, taxi and bus drivers associations, etc can be reached. This is particularly the case where such a network feeds into a value chain: for example where an agricultural processor has an existing relationship with smallholder farmer suppliers. In a sense, insurers are "sticking to what they know" by looking to banks and aggregators for distribution, as this is not dissimilar to the traditional corporate employee client group model. This market is however still largely untapped and distribution challenges persist. Therefore it is likely that insurers will have to also start dealing with individual clients at some stage. On the up side, however, one funeral parlour is already acting as an insurance agent and another as a registered broker. Insurers are increasingly looking at experiments in the retail and low-income sectors, with an emphasis on distribution models. The question is therefore who will manage to break open the low-income distribution market first.

Banks leading the way. The bancassurance examples quoted in the Distribution section underlie a larger opportunity to the insurance sector. As the discussion thus far has shown, insurance penetration is still significantly below bank account penetration. Given the aggressive retail expansion strategies of some of the banks, insurers have the prospect of growing their client base alongside that of banks, should effective bancassurance partnerships be forged. With the exception of a few examples, bancassurance is however currently largely limited to credit life insurance and it is the banks, rather than insurers, who are expressing interest in expanding the scope and reach of bancassurance. Insurers have expressed some concerns that it is the banks that essentially own the clients, putting them in a favourable bargaining position vis-a-vis insurers. Banks, on the other hand, express frustration at the lack of engagement by the insurance industry. Though insurers have a key offering to the bancassurance market in terms of product development and innovation, some banks argue that insurers have delivered poorly on this thus far, with banks having to initiate and develop products for underwriting. Indeed, the topic of bancassurance has emerged as one of the most contentious issues in the insurance industry currently.

Agency limitation in regulation challenges, but does not prevent bancassurance growth. The one-insurer-per-agent requirement on the intermediation side implies that for example a bank can only act as an agent for either a life or a general insurer and cannot offer both types of insurance. This has not been an obstacle in practice for most, as the agency requirement has not been strictly enforced up to now. Indications are, however, that this will become an issue going forward[124].

Limited consumer recourse. A last factor, important from the client angle, is the absence of an insurance Ombudsman in Zambia. This means that there is no dedicated independent system for managing consumer complaints and may have implications for the level of consumer protection. As the microinsurance market grows, this will become increasingly important, as the low-income population is often most vulnerable to abuse and may be the least well informed of their rights.

Regulatory drivers

Regulatory uncertainties and challenges constrain growth. As the discussion in Section 4 showed, the most notable challenges relating to the Insurance Act are the lack of clarity on the definition of short-term life insurance, as well as the absence of any mention of health or medical insurance (to be discussed below). Two further elements are proving challenging to microinsurance development: each agent is limited to only one insurer (long-term or general), which has potential ramifications for especially bancassurance[125], and new entrants must have a local CEO with at least 10 years of insurance experience.

Despite these regulatory challenges, the regulatory regime in general is likely to facilitate market development:

Financial inclusion emphasis. The government of Zambia places specific emphasis on financial inclusion through the Financial Sector Development Plan (FSDP). This has created a pro-inclusion atmosphere in the financial sector. This now needs to be extended intro microinsurance through the work of the FSDP's Contractual Savings Working Group as joint industry and government platform.

No direct regulatory barriers. The insurance regulatory framework is also for the most part not hampering insurance market development. Anti-money laundering "know your customer" requirements are not currently applicable to the insurance industry[126], capital and registration requirements do not place a high barrier to entry and compliance requirements are generally not perceived as onerous by the market.

Ad hoc regulation increases cost and undermines transparency. Nevertheless, some regulatory uncertainty is created by the inconsistencies in the Insurance Act. This is to a large extent overcome by the way in which the PIA applies the Insurance Act[127] and its willingness to accommodate innovation in certain instances. The fact that it has created the precedent

[124] During our consultations the requirement under the Insurance Act of "one insurer per agent", as discussed in Section 4, was raised as a challenge to the development of the bancassurance market. Upon closer inspection of the PIA's records of licensed insurance brokers and agents, it however transpires that only three banks and no MFIs are among the registered insurance agencies (PIA, 2008b). According to Manje (2005), MFIs are treated as policyholders under a group credit life scheme, thereby falling outside the ambit of intermediation regulation. In practice, they however perform the functions of agents in return for a commission to cover administrative costs or some profit sharing arrangement. This is also the case for bancassurance. The PIA has indicated its intention to more strictly enforce the agency requirement for bancassurance.

[125] This was evident from the discussion at the Stakeholder Workshop. See Section 9.

[126] The fact that AML requirements (often over and above what is required locally) are enforced strictly on foreign banks from head office level may however restrict their ability to open bank accounts, indirectly restricting ability to cross-sell insurance.

[127] A reading of the Insurance Act suggests uncertainty around the definition of short-term life insurance such as funeral insurance. In practice, this however does not appear problematic, as the PIA is clear in its application of the long-term insurance license category as containing all life-related risks.

for allowing general insurers to underwrite short-term life (funeral) insurance products (thereby in effect relaxing the demarcation requirement) bodes well for the creation of a composite microinsurance product category[128]. The PIA is therefore pragmatic and generally uses its judgment to manage potential problems introduced by uncertainties or loopholes in the legislation in a way that is favourable to microinsurance development. This however risks an ad hoc style of regulation. Exemptions are not transparent and are not available to everyone. For example: the relaxation of demarcation for short-term life policies has been done on an individual exemption basis and it is not clear that it has been consistently applied. It also means that every player must dedicate legal resources to petition the PIA for such exemptions rather than simply building on the precedent set or guidance issued. If the loopholes in the legislation itself are not closed, the risk is that market uncertainties will be created in future at the expense of the broader development of the sector.

Pockets of opportunity

These drivers and dynamics highlight a few key pockets of opportunity for microinsurance expansion. Below, we expand on each:

Life and funeral insurance market. The demand-side insights and preliminary trends in the low-income insurance market (notably the funeral insurance pipeline or pilot projects) show that it is possible to cross cultural barriers to grow the funeral insurance market and that this could form a platform for the growth of micro life insurance beyond just funeral cover to offer enhanced value to customers. Funeral insurance is therefore likely to be the lead product in the low-income market.

Credit market. The microlending market, as our analysis in Section 3.3.2 showed, has an estimated 350,000[129] clients, up to 250,000 of which may be covered by credit life insurance. There is therefore scope for insurers to expand their client base in partnership with MFIs. A number of dynamics play in on the incentives for credit life expansion in the MFI industry:

- *Market practices do not necessitate credit life from providers' point of view*. The ability to charge high interest rates disincentivises the use of credit life insurance by lenders. Not all lenders place a high priority on credit life insurance. Especially on shorter maturity loans, many choose to internalise the default risk. This means that, for those providers, it would need to be the insurers that are proactive in pursuing partnership opportunities. This may change as loan maturities increase.

- *The need for improved value and consumer protection*. Credit life as such will not be enough to promote microinsurance and lead to market expansion beyond compulsory cover unless it is perceived by the client to offer real value to them. Given the generally low loss ratios on credit life, this is currently not the case. There is a need for greater disclosure to consumers (perhaps verbally and not just in the fine print of insurance

[128] According to the general insurers consulted, there is a real need for the provision of composite microinsurance products, all written on a short-term basis, or at least for general insurers to be able to underwrite short-term life microinsurance products. Market research shows that funeral insurance is the one product with the potential to trigger demand. If provided as part of the larger product offering, it can be used to market non-life policies such as asset insurance or weather-indexed agricultural insurance as well.

[129] Dependent on certain assumptions on duplication as well as extrapolation of market data based on data given by a few participants. This should therefore not be regarded as an authoritative figure, but as an estimate of likely order of magnitude, indicative of a potential opportunity.

contracts) of what they are covered for and what the premium is[130]. Greater consumer awareness and education is also required within the MFI sphere. Currently, regulation does not require consumers to be given a choice of credit life insurance provider and they can be forced to take the product offered by the credit provider. This creates the scope for excessive pricing as it essentially locks in the market.

- *Scope for other insurance products distributed via MFIs.* Apart from credit life, the MFI client base also offers a ready target market for the cross-selling of other insurance products, as some players are now starting to experiment with. Examples of funeral and disability insurance riders on credit life as well as free-standing products already exist. Interestingly, most of these products are offered on a compulsory basis. Where they have been offered voluntarily outside of the loan agreement, insurers have struggled to achieve uptake thus far. This will however be a significant growth market to push – from an insurer's point of view in terms of expanding its client base through existing aggregators, and from the MFIs' point of view in terms of diversifying their service offering, thereby attracting customers.

- *Growth constrained by saturation of microlending market*. As discussed above, there is little room for growth in the payroll lending market. Nevertheless, even with the current client base, there is still significant scope for growth from an insurer's point of view[131].

Banked market. According to FinScope data, the banked market is more than twice as large as the insured market and already has a client base in the informal sector. The potential for cross-selling of insurance to bank clients (bancassurance) is underutilised and provides a ready market for insurers:

- *Low-income market expansion drive*. Banks are the leaders in terms of low-income market innovation and distribution, offering much potential learning to insurers. One bank, for example has a sales agent force of 1,500 at its disposal. Various banks are following aggressive bank roll-out strategies, some of them in high-density "informal" areas such as marketplaces. One bank has recently launched an innovative m-banking account target at the mass market. All of these present opportunities to insurers for partnerships. Most banks have a fully computerised database of clients and a call centre through which clients can be reached for marketing purposes.

- *Insurance as diversification opportunity for banks*. With diminishing interest spreads, banks are under pressure to generate non-interest sources of income. They have grown their retail books significantly and some are now looking to enhance their value offering to clients through bundled or standalone insurance sales.

- *Regulatory challenges not insurmountable*. As discussed, the agency restriction may pose a barrier to large-scale bancassurance growth, especially in offering clients a full range of insurance products. Should the PIA decide not to amend this provision or make explicit allowance for bancassurance, this can however still be overcome by working

[130] As a counterpoint to this argument, it must be noted that the focus group discussions did indicate a fair level of knowledge about being covered by credit life, what the premium is and how it is charged. It was however still not perceived as an insurance product that they have bought and can deliver value to them, but just as a condition to the loan.
[131] As indicated in Section 5.2, our rough calculations estimate there to be only about 250,000 credit life policies. This amounts to just more than 70% of the credit clients, implying that there are still at least 100,000 unserved credit clients.

through a third-party broker, or even by banks setting up their own brokerage companies.

Agricultural market. Though the scope for agriculture insurance such as crop or livestock insurance is not clear and would require weather index triggers and extensive weather data, the agricultural sector nevertheless presents the largest touch point for non-agricultural insurance.

- *Scope for distribution of non-agriculture insurance products*. As is clear from the discussion above, the existing groupings of farmers offer a real opportunity for insurance distribution – not of agricultural insurance *per se*, but of life and potentially health insurance tailored to the needs of this market. Given the fragmented nature of agriculture, the only potential for agricultural (crop) insurance would be through the value chain related networks, probably linked to credit and provided on a weather index basis. Based on international lessons, this is however unlikely to be viable without donor support. Most insurers have also not expressed any direct interest in crop insurance.

- *Importance of tapping into the value chain*. The agricultural value chain would play an important role in intermediating insurance to end-user farmers. Processors to whom produce is delivered have existing payment mechanisms in place through which premium payments could be routed. As credit providers or even just as buyers of produce, they also have an incentive to protect farmers against risk (life and health risks may be just as damaging to productivity as weather or disease-related agricultural risks). It is therefore possible that insurers would find ready agents in the agricultural value chain of various crops/produce, most notably cotton, but also dairy as a growing market, as well as pockets of more viable farmers in the maize market.

Informal and MSME market. Though agriculture accounts for the largest proportion of the informal labour force, there is nevertheless a large pool of people who are active in the informal market outside of agriculture: be it as self-employed traders or as employees of unregistered businesses. As the current reach of the insurance sector covers largely the formal market, expansion will of necessity entail breaking open the informal market. As discussed above, this market is traditionally challenging to financial service providers. But the analysis in Section 3.2 showed that, even if the MSME and informal market at large may remain outside of the reach of insurers, there are nevertheless existing pockets of networked people that we estimate to reach more than 200,000 individuals in total – a significant number from an insurer's point of view. This opportunity is shaped by the following characteristics:

- *Focus on life, health*. The most relevant insurance products for this market are likely to be life (funeral) and health. The focus groups confirmed that these risks not only have an impact on the personal resources of individuals, but also impact their earning ability and the capital of their businesses. Asset or stock insurance will also be relevant for the bulk of the market. It is however a more difficult product to provide at low cost (given the costs of loss adjustment).

- *More fragmented than agriculture*. The difference between this sector and agriculture is that here the decision to buy insurance is more likely to be an individual decision. There is no strong value chain as in agriculture where individual farmers can be sold insurance via a processor or other buyer that also has an interest in its farmer-suppliers being insured. It may therefore require more sales and marketing effort to convince e.g. individual traders to buy insurance than for farmers belonging to an outgrower scheme.

- *Scope for success if ensuring value proposition for partner*. Nevertheless, the network structures at least create a communication channel to individuals. From an association's point of view, an insurance offering could be marketed as enhancing the offering of the association to members. In some instances, the networks also already collect contributions from individuals (e.g. market stall fees in the case of traders, or membership fees for other organisations). This infrastructure could be employed for premium collection, should an insurer come to an agreement with a network organisation. Furthermore, each association represents a particular group of people and an insurer can assess the risk of the group and price the product accordingly, thereby reducing the costs of individual underwriting. Organisation of the client base invariably reduces the cost of insurance and of distribution. To ensure success, the insurers should however ensure that there is a value proposition and hence incentive to the partner network.

Affinity groups. Though limited information was collected on the scope for affinity group distribution to individuals in their private capacity (i.e. not through market or agricultural associations), indications are that this is also a potential aggregator to explore. Affinity groups can include churches (provided there are large church networks), NGO networks or for example associations for female empowerment. Such groups are normally trusted by members. This means that they would be credible intermediaries of insurance, should a partnership be formed. They are also in touch with the realities on the ground of the community and would be able to give valuable inputs to insurers to ensure correct pricing and relevant product features. At least one insurer is already considering the scope for affinity group distribution.

Health market. The scope for health microinsurance was discussed in Section 7.3. Given the expressed demand for health risk mitigation in the focus groups and the FinScope survey findings alike, this is an important market for microinsurance development. Though the public health network if fairly accessible to the bulk of the population, it is generally of low quality and does not cover all expenses, for example medication. Therefore a potential demand for alternative health financing emerges. This is facilitated by the fact that regulation currently places no restrictions on benefit design. Therefore health financing benefits can be tailored to the target market to be affordable. Traditionally, the health insurance market has however been limited to the high end of the income spectrum and has been undermined by high service costs in the fee for service environment. The fragmented health services industry structure will also complicate financing and, as with other microinsurance products, aggregation and appropriate distribution partners will be essential. All of this poses challenges to this particular pocket of opportunity in Zambia.

Uncertainty on health regulation. Furthermore, the absence of any mention of health insurance in the Insurance Act creates uncertainties in the market and creates an unlevel playing field between registered health insurers and those entities operating outside of the insurance regulatory framework. This calls for coordination between the PIA and the Ministry of Health and a holistic review of the health services regulatory environment to find an optimal solution. The PIA needs to be the proactive player. Care should also be taken to integrate the private health insurance market with whatever national health insurance system[132] emerges.

Not all of these pockets of opportunities can or should necessarily be pursued at the same time. It may be necessary to start with simple products before moving on to more complex products.

9. Towards a strategy for insurance market development in Zambia

Need for coherent strategy. The analysis indicated:

- A high level of awareness of the need for inclusion and microinsurance, although not much has been acted on.

- Several pilots, pipeline or possible project plans showing increasing interest by industry (without any external push). There is however a number of industry forces that may threaten this trend.

- A positive regulator, but with some complications, notably an ad hoc and not detail-orientated style.

This suggests a distinctive need for a strategy process to pull all stakeholders together in developing the microinsurance market.

Possible strategic interventions. Without determining or pre-empting the prioritisation of strategic interventions, this study serves as information base to guide decisions. Below, we therefore set out a list of possible strategic interventions for industry and other stakeholders to explore based on the analysis presented in the body of the document:

1. *Microinsurance policy position.* Through regular interaction, support the regulator to develop a microinsurance policy position and to link it with the microinsurance strategy process. Provide it with examples of microinsurance policies elsewhere.
2. *Selective regulatory reform*. In the context of the microinsurance policy position and strategy, address the key areas of legislation that can be improved or changed to facilitate microinsurance development. Include consideration of:
    - The need for a **consumer protection and recourse** framework.
    - The inconsistency in the **definitions** applied in the Insurance Act.
    - Steps towards **comprehensive health sector regulation** and to define the role for the insurance market within the broader health financing environment. As a first step, it is recommended that a specific review of the health financing environment be conducted that can form the basis for discussion.

[132] Even should plans for a national health insurance system come off the ground over the next few years, it is unlikely to ever reach the informal sector. It therefore does not diminish the need or scope for micro health insurance.

- The need to specifically allow for **bancassurance** and, if necessary, to adapt the one-agent-one-insurer requirement. Here particular emphasis should be placed on facilitating dialogue between the insurance, broker and banking industries to derive a suitable way forward

- The reconsideration of the entry challenges posed by the de facto **local CEO** requirement as well as the minimum qualification requirements (taking into the account the need for sufficient skills to ensure consumer protection).

2. *Inter-departmental cooperation*. In parallel to the review of the health financing environment, the necessary political buy-in should be achieved for an action-oriented inter-governmental engagement process on the topic. Likewise, a strategy for engagement on relevant issues across other departments is called for, such as with the Bank of Zambia (for example with regard to the regulation of consumer credit practices and the choice of compulsory credit life insurance provider) and possibly the Registrar of Cooperatives, should the position of cooperatives improve over time.

3. *Align proposals with FSDP and parallel strategy processes*. Take the proposals on microinsurance development and the issue of medical insurance into the FSDP process with the view of obtaining support and buy-in from broader financial sector development objectives and to facilitate inter-governmental coordination. Also create a feedback loop into the World Bank FSAP and FSDP Secretariat strategy support process. This is an immediate opportunity for impact.

4. *Create a platform for dialogue*. One of the most important aspects of the strategy will be to convince the market of the importance of microinsurance. It is therefore important to facilitate dialogue between different stakeholder groups, including insurers, banks, MFIs, value chain aggregators and the regulator. This platform should seek to overcome trust and competitive issues.

   - Bring potential **aggregators** into the discussion and explore their capacity and reach to get a true sense of the potential offered by aggregators. To do so, commission a study to specifically consider the **scope for and feasibility of the informal market through aggregator distribution and MSME networks**. This study should be based on extensive engagement with insurers and potential aggregator groups and should ideally directly lead to a pilot project or approach.
   - As part of this process, the international **Microinsurance Conference** in Senegal in November can be marketed to insurers and regulators alike.

5. *Catalyse innovation*. Stimulate ideas by conducting further research on key areas of opportunity and disseminating this to players through dialogue and targeted workshops. As part of this process:

   - Document and disseminate **case studies** of existing microinsurance experiments (in Zambia and elsewhere) among stakeholders. The Zambian experience can also be documented for international learning or for replication domestically.
   - Support access to **outside skills/expertise,** e.g. by sponsoring an expert to host a training workshop on microinsurance distribution or product development.

- **Partner** with insurers on pilots without necessarily getting involved in product design or implementation (for example, sponsor focus groups in exchange for case study information that can be disseminated).
- Develop and promote **FinScope**. The FinScope survey is a powerful market research tool to highlight opportunities and challenges. The engagement with industry indicated that it is underutilised at present. It is therefore necessary to facilitate conversation with lead insurers to get their questions and to raise interest in FinScope.

6. *Explore demand-side aspects*. It is necessary to build a better understanding of informal risk mitigation. Look at ways of exploring this further, including understanding of the reason for low funeral fund/association penetration as well as a better understanding of the chilimba mechanism. Furthermore do a profile of how burials are conducted in urban and rural areas and the impact this has on the family.

7. *Pre-empt credit blow-out*. Pro-actively engage with the Bank of Zambia on potential changes in the low-income credit market to minimise negative consequences for the insurance industry and also to explore how insurance can support and enhance reforms in this space. Encourage proactive regulatory action on consumer protection, once again emphasising a light touch to avoid a knee-jerk reaction and high costs on the industry. Bring microlenders into the discussion and push product extension.

8. *Specific suggestions regarding the agricultural sector*. Discuss the scope for microinsurance expansion in the agricultural sector. Two particular areas should be explored:

    - The scope for a pilot project for agricultural or life/health insurance through outgrower schemes or other value chain organisations. In this regard, discussions with USAID/PROFIT, an existing on the ground entity with a wide network and knowledge of the sector, can prove helpful.

    - Possible collaboration with the proposed input voucher scheme or commodities exchange to ensure that it supports insurance delivery

9. *Educate the target market*. Consider the need for and viability of a consumer financial education campaign focusing specifically on insurance and explore the possibilities for partnerships with government and other entities in this regard. The demand-side evidence highlights the need for contents dedicated to understanding the insurance concept and value proposition, as well as the processes around paying of premiums and, importantly, claiming. Any resulting financial education project should be firmly grounded in a review of most appropriate channels, materials and methodologies from international literature. Evaluation of impact on actual understanding and behaviour will be central and an appropriate evaluation strategy should be a prerequisite to any financial education campaign.

This list is not intended to be exhaustive or to present any particular order of priority. Rather, it sets out the universe of possible interventions from which the stakeholders can choose or to which they can add alternative projects.

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Appendix 1: Meeting list

	Organisation	Person met	Position
1	Goldman Insurance (General)	Tobias Milango	GM, Corporate Services
2	International Labour Organisation	Gerry Finnegan	Representative for Malawi, Mozambique and Zambia
3	Bank of Zambia	Gladys Mposha	Financial Sector Development Plan Secretariat
		Ernest Chisonga	
		Musapenda Phiri	
4	Pulse Financial Services Limited	Martin Villemure	MD
5	Association of Microfinance Institutions Zambia (AMIZ)	Webby Mate	Executive Director
6	Meda Development Organisation	Lemmy Manje	Field Product Manager
7	Cavmont Capital Insurance (General)	Stephen Chikovore & colleague	Acting General Manager
8	ZCSMBA (Zambia Chamber of Small and Medium Business Associations	Max Sichula	CEO
		Penias M Chabwela	Membership, Monitoring and Evaluation Coordinator
9	Zambia Association of Chambers of Commerce and Industry	Justin Chisulo	CEO
10	Professional Life	George Silutongwe	Managing Director
		Ian Malilwe	Deputy GM
11	Professional Insurance (General)	Ashok Chawla	Managing Director
		Cynthia Simeza-Munkombwe & colleague	Manager: Motor Claims
12	Reliable Insurance Brokers	Geoffrey Sakulanda	Managing Director (and Insurance Brokers' Association of Zambia Chairman)
13	Madison Life	Victor Munalula	MD
		Agnes Chakonta	Deputy GM
		Apparao Adivi	Company Actuary
14	Bank of Zambia, FSDP Contractual Savings Working Group	Chris Kampamba	CEO, Alexander Forbes
		Titus Nkwale	Manager: Policy and Analysis, Pensions and Insurance Authority (PIA)
		Simomo Akapelwa	MD, Elite Insurance Brokers Ltd
		Ernest Chisonga	Bank of Zambia FSDP Secretariat
		Steve Williams	MD, African Life
		Geoffrey Sakulanda	IBAZ/Reliable insurance Brokers
15	Pensions and Insurance Authority	Chris Mapipo	Registrar/CEO
		Muyoya Chibiya	Deputy Registrar: Insurance
		Martin Libinga	Deputy Registrar: Pensions
16	Madison Health Services	Jane Kabwela & colleague	MD
17	Prima Reinsurance	Representative of Mrs Exhuldah Lumbwe	MD
18	Norwhich Insurance Brokers	Lydiah Sibanda	MD
19	Nico Insurance (General)	Titus Kalenga	MD
		Charles Madziva	Deputy General Manager
20	Cavmont Capital Bank	Helen Temba	Head: Community Banking
21	ZSIC (Zambia State Insurance Corporation) Life	Simachila Makwembo	MD
22	COMESA Secretariat	Berhane Giday	Chief Programme Officer: Trade in Financial Services

	Organisation	Person met	Position
23	African Development Bank	Christopher Banda	Private Sector Specialist
24	African Life	Steve Williams	CEO
25	Barclays Bank	Twaambo Hamusute	Business Development & Strategy Manager
26	B3 Funeral Parlour/B3 Financial Services - brokers	Mr Nixon	Manager: funeral parlour business
27	Zambia Cooperative Federation	Mary Ngoma	MD
28	Zambia National Farmers' Union	Hamusimbi Coillard	Liaison Officer
29	Zanaco (Zambia National Commercial Bank)	Daisy Diangamo	Senior manager: marketing and business development
30	World Bank	Sam Maimbo	African Finance and Private Sector
31	Microcare	Carolijn Gommans	Responsible for setting up Microcare in Zambia
32	Blue Financial Services (and Blue Assurance)	Deon Verster	MD

Appendix 2: Regulatory scheme

Different categories of regulation are used to influence the behaviour of participants in the insurance value chain. These are collectively referred to as the insurance regulatory scheme, which can be captured in the diagram below. The report uses this scheme to analyse the impact of policy and regulation on the development of the microinsurance market.

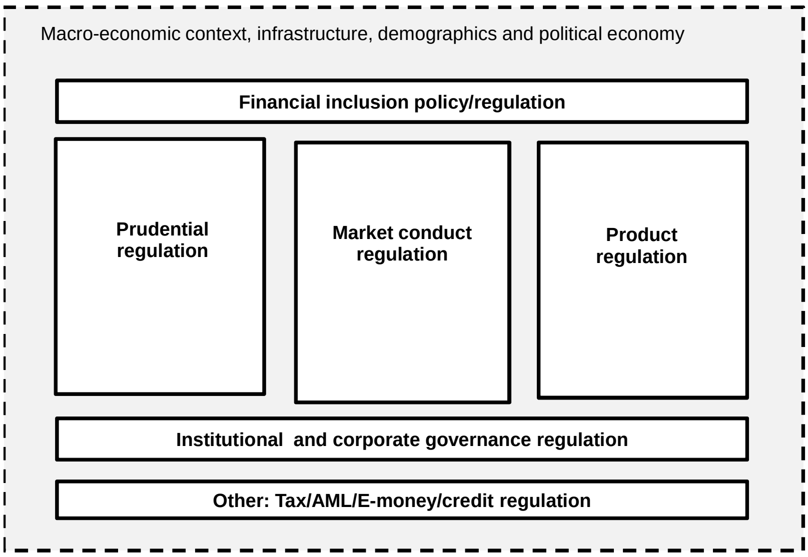

Figure 16. The insurance regulatory scheme

Source: authors

Financial inclusion policy/regulation refers to policy or regulation promulgated with the objective of extending access to and usage of formal financial services by persons who are either excluded from or who do not use formal financial services (provided by registered/licensed and supervised financial institutions). Such regulation can take various forms, for example compulsory or consensual quotas targeting defined population segments, financial literacy provisions, tax incentives, extending the reach of the formal payment system, etc. Sometimes a government may choose not to regulate financial inclusion, but simply to adopt financial inclusion policies with the explicit aim that financial institutions would pursue inclusion on a voluntary basis. Although these do not have the force of law, they will directly impact the conduct of providers.

Prudential regulation seeks to ensure that insurers are able to meet their contractual obligations to their clients. This is done by, for example, setting minimum entry requirements such as minimum levels of capital and requiring compliance with a set of prudential regulations governing the functioning of the insurer.

Market conduct regulation refers to the regulation of the distribution or intermediation of insurance products. Regulation of this kind could include requirements as to who can intermediate insurance, fit and proper requirements for agents and brokers and other intermediaries, regulation of the selling process, including disclosure requirements and giving of advice, regulation of the payment of commission, statutory requirements that make the take-up of certain types of insurance compulsory (for example credit life insurance may be declared compulsory when taking out a non-collateralised loan), etc.

Product regulation can be distinguished from prudential and market conduct regulation in that it does not relate to the insurer or the sales/intermediation process, but rather to the product in question. While provisions relating to product regulation are usually contained within either prudential, institutional or market conduct legislation, it therefore represents a distinct regulatory angle. Product regulation aims to ensure stability and consumer protection by regulating the nature and structure of insurance products. In the most basic form, regulatory systems are often structured around definitions of specific products or product categories.

Box 16. Aspects of product regulation.

Product regulation may involve one or more of the following:

- *Registration/ approval*. In some jurisdictions, regulation stipulates that products need to be filed with the regulator/supervisor, with a window period for response by the supervisor, before the product is launched. If no objection is made by the supervisor within the stipulated time frame, the product is automatically approved. In other instances, explicit approval is required by the regulator before products may be offered. This may be used as a means of compensating for an otherwise light regulatory burden and to allow innovation.
- *Standards*. Regulation may require microinsurance to meet specific standards on simplification, standardisation, documentation, cool-off periods, term, exclusions, etc. In some instances, requirements relating to terms and provisions may be quite onerous; in others it may facilitate innovation.
- *Price control*. Regulation may set specific minimum or maximum prices for product categories. Premium floors are mostly aimed at trying to ensure solvency of the insurer by avoiding price competition, whereas premium ceilings are mostly motivated by consumer protection considerations (though in practice they often serve to protect insurers against intermediaries with bargaining power, rather than protecting the consumer.
- *Demarcation*. Regulation may also prohibit the provision of insurance products by particular players (e.g. non-corporates) or may determine that certain types of products may only be provided by certain types of providers (demarcation).Creating a product-based approach to microinsurance where a regulatory space is created for those who can comply with product standards is therefore a further instance of product regulation. The intention is to limit the risk, thereby justifying different market conduct and prudential standards.
- *Compulsory products*. Lastly, regulation may compel insurers to offer specific products.

Institutional regulation, which includes corporate governance regulation, refers to those statutory requirements that determine the legal forms or persons, for example public companies and cooperatives that can underwrite insurance, as well as the regulatory corporate governance requirements applicable to these legal forms. The nature and extent of the corporate governance requirements normally determine whether that particular legal institution is suitable to manage the risks inherent in underwriting insurance. The institutional and corporate governance regulation is generally not specific to the insurance sector (although some countries have a tradition of passing specific statutes for individual insurance firms, especially mutuals), but generic across sectors.

Other regulation. A number of other regulatory requirements could also impact the development of the microinsurance market. Although not insurance-specific, they impact the underwriting and intermediation of insurance products. Examples include anti-money laundering provisions, taxation, regulation of the payment system (that impacts the ease whereby premiums can be paid), regulation of the microfinance sector and credit regulation generally.

It is not only regulation *per se* that impacts market developments. The absence of regulation can play an equally powerful role. Similarly, even if regulation exists, a supervisory approach of “benign neglect” or “forbearance” can allow the market to develop in ways that cannot be foreseen ex ante by a regulator.

Appendix 3: The access frontier

The access frontier can be represented as follows:

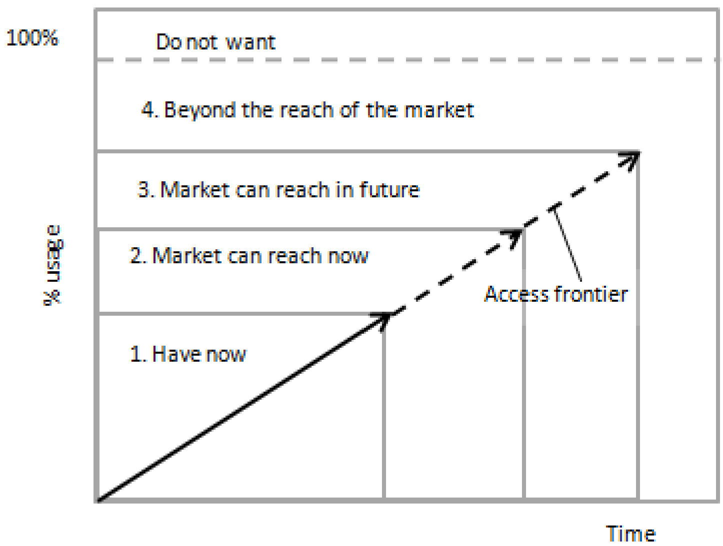

Figure 17. Access frontier map

Source: Porteous, 2005

The various blocks in Figure 17 can be explained as follows:

- **"Have now":** The *current market* is defined people who are currently using the product, i.e. a measure of usage or effective access.

- **"Market can reach now":** The *market enablement zone* comprises all the people who have access to the product but are not using it. As there are no explicit access barriers, this group is the most susceptible to improving the levels of inclusion for financial products. They could be incorporated into the market by addressing usage factors[133], without any regulatory changes needed.

- **"Market can reach in future":** The *market development zone* includes all the people who do not currently have access to the product because of reasons such as proximity, affordability, eligibility, terms of the product or knowledge of the product. Regulatory changes, as well as product and distribution innovation, can be used to extend the reach of the market to this segment.

[133] One can conceptually distinguish between *access* and *usage* factors. Access factors may explicitly exclude people from using a particular service (referred to as access barriers) or may discourage users from using a particular service even if they are not explicitly excluded (referred to as usage barriers). At least five factors can present access barriers: five factors that impact on access: physical proximity, affordability, eligibility, appropriate product features/terms and regulation. Usage, on the other hand, focuses on factors that may discourage individuals to take up formal financial services even if they do not present an absolute barrier. Usage factors may include the value proposition of the product and perceptions of products and institutions. It also includes the level of financial literacy of the target audience (Bester et al, 2008).

- **“Beyond the reach of the market”:** The *market redistribution zone* is made up of all the people who are outside the scope of the market because they are simply too poor. These people cannot sustainably be reached by the market without support from government and may remain dependent on social security. It can however not just be assumed that government will provide social protection to these people. Often, it calls for innovative partnerships between government, donors, community-based organisations and private insurers to find a solution to the social protection needs of this market.

Implications of the access frontier: The access frontier is represented by the diagonal line on the diagram and represents the frontier beyond which market provision can sustainably reach. A proportion of the market is left, with people in this group dependent on social security and other government support. The diagram also shows the natural progression of market provision from block one, to block two and eventually to block three. The logical process of market extension is therefore to move along the access frontier rather than to jump over the next most profitable market segment to the very poor.

Source: adapted from Porteous (2005).

Appendix 4: Industry performance tables (2007 data)

General insurers:

	Ratio	Description	International standards	Professional	ZSIC	Madison	NICO	Goldman	Cavmont	Zigi	Industry average	Out of range
1	Return on Equity ROE	Net income for the year/equity x100	Market	21%	29%	44%	30%	4%	-30%	11%	34%	1
2	Change In Equity	Current year equity - Prior year equity)/prior year equity	-10 to 50%	26%	34%	15%	52%	5%	-2957%	1%		1
3	Net Trade Debtors to Equity	Net trade debtors/equity x 100	Max of 50%	55%	827%	72%	141%	201%	208%	345%	169%	7
4	Loss Reserve Ratio	Outstanding Claims Reserves/Equity	Max of 2	4%	52%	212%	313%	63%	63%	0%	41%	1
5	Current (Liquidity) Ratio	Current Assets/Current Liabilities	Min of 1.25	143%	117%	94%	191%	256%	121%	165%	108%	4
6	Change in net writings	(Current year Net Premium written - Prior year Net Premium Written)/Prior year Net Premium writtenX100	-33 to33%	59%	30%	36%	37%	110%	139%	18%	61%	4
7	Change in gross writings	(Current year Gross Premium written - Prior year Gross Premium Written)/Prior year Gross Premium writtenX100	-33 to33%	25%	34%	34%	26%	106%	109%	-100%	33%	4
8	Gross Risk Ratio	Gross premium written/Equity	Max of 7	323%	457%	558%	871%	637%	521%	0%	445%	1
9	Net Risk Ratio	Net premium written/Equity	Max of 3	142%	406%	460%	474%	474%	375%	386%	299%	4
10	Net Claims Ratio	Net claims incurred/Net premium earned	Max of 0.7	34%	35%	43%	44%	47%	15%	20%	41%	0
11	Expense Ratio	Total expenses/Net premium earned	Max of 35%	17%	49%	33%	41%	39%	102%	63%	41%	5
12	Underwriting Result	Underwriting profit (Loss)/Net earned premium x 100	- 10 to 35%	29%	5%	13%	6%	8%	-3%	4%	14%	0
13	Debtors to asset**	Trade debtors/total assets	Up to 50%	45%	57%	53%	24%	55%	47%	86%	52%	4

Long-term insurers:

	Ratio	Description	International standards	Professional	ZSIC Life	Madison	Zigi
1	Retun on Equity ROE	Net income for the year/equity x100	6 to 12%	135%	59%	70%	2%
2	Change In Equity	Current year equity - Prior year equity)/prior year equity	5 to 12%	N/A	146%	82%	82%
3	Benefits paid ratio	Benefits Paid/Net Premium Written	45% to 70%	13%	N/A	N/A	N/A
5	Surplus Relief Ratio	Reinsurance Commissions/Equity * 100	up to 15%		N/A	N/A	N/A
6	Solvency Ratio	Equity/Liabilities * 100	> 4.5%	36%	28%	16%	82%
7	Investment in mortgages & real estates	Investments in Mortgages and Real Estates/Equity * 100	150% to 300%	415%	N/A	N/A	N/A
8	Mortgages default ratio	Mortgages in Default/Equity * 100	up to 30%	N/A	N/A	N/A	N/A
9	Non-investment grade ratio	Non-investment grade bonds/Equity *100	15% to 50%	N/A	N/A	N/A	N/A
10	Affiliated investment ratio	Affiliated investments/Equity * 100	< 30%	N/A	N/A	N/A	N/A
11	Change In net premium written	(Current year Net Premium Written-Prior year Net Premium Written)/Prior year Net Premium Written]X100	-30 to 50%	43%	138%	-88%	95%
12	Net Risk ratio	Net Premium Written/Equity	up to 5.5	10.3	6.4	0.5	1.2

Note: not possible to calculate industry average and out of range indicators due to missing data for some insurers.

Appendix 5: Stakeholder workshop attendance list

	Organisation	Name on RSVP list	Present?
1	Access Bank	David Chewe	Y
2	African Banking Corporation	Venansio Mumba	y
3	African Development Bank	Christopher Banda	y
4	African Life	Charles Banda	y
5	Alexander Forbes	Hyden Mwiya	n
6	Alexander Forbes	Chris Kampamba	y
7	AON	Maiwase Sakala	?
8	AZIEA (Alliance for Zambia Informal Economy Association)	Manas Chiwala	y
9	AZIEA (Alliance for Zambia Informal Economy Associations)	Victor Phiri	y
10	B3 Funeral Parlour & B3 Financial Services (registered broker)	Durkson R Kaluba	y
11	Bankers Association Zambia	Annie C. Kalulu	y
12	Barclays (Business development/bancassurance division)	Twaambo Hamusute	y
13	Blue Assurance	Florence M Kaunda	y
14	Blue Financial Services	Geoffrey Mkandawire	y
15	Blue Financial Services	James Lungu	y
16	BoZ	Chisa Mwanakatwe	y
17	BoZ	Musapenda Phiri	y
18	BoZ	Ernest Chisonga	n
19	Cavmont Capital Bank Community Banking	Helen B Temba	y
20	Cavmont Capital Bank Community Banking	Jessie Seketa	y
21	Cavmont Capital Life	Yoram Chulu	n
22	Celim - Empowerment Microfinance Institution	Gianclaudio Bizzotto	y
23	Cetzam	Clayton Machingaifa	y
24	Commodities Exchange (ZAMACE)	B Tembo	n
25	Commodities Exchange (ZAMACE)	N Samangwe	n
26	DFID country office	Clare Harris	n
27	Elite Insurance Brokers	Simomo Akapelwa	y
28	Invited by C Mapipo	Golden Ziba	y
29	Finca	Keith Sandbloom	n
30	Ideal Funeral Home	Felix M. Mumeka	y
31	ILO Country Office	Gerry Finnegan	y
32	ILO Country Office	Adrian Shikwe	y
33	Madison Health Solutions	James Simon Maonde	y
34	Madison Life	Victor Munalula	y
35	Madison Life	Agnes Chakonta	y
36	Meda Development Organisation	Lemmy Manje	y
37	Micro Bankers' Trust	Bernard Lusale	y
38	Microcare	Carolijn Gommans	y
39	Ministry of Finance	Bernard Domingo	y
40	Ministry of Health (MoH)	Collins Chansa	n

	Organisation	Name on RSVP list	Present?
41	NICO Insurance	Titus Kalenga	y
42	NICO Insurance	Clara Shindano	y
43	Norwich Insurance Brokers	Lydiah Sibanda	y
44	Norwich Insurance Brokers	Evans Ndhlovu	y
45	Nova Capital Partners/Business Management Services	Clemio Machingaifa	y
46	PIA	Chris Mapipo	y
47	PIA	Nicolas Mbuya	y
48	PIA	Nkandu Chilombo	n
49	Prima Reinsurance	Exhildah Lumbwe	y
50	Professional Life	George Silutongwe	y
51	Professional Life	Ian Malilwe	y
52	PTA Re	Shipango Muteto	y
53	Pulse	Martin Villemure	y
54	Pulse	Noah Halwindi	
55	Pulse/consultant	Nathan De Assis	y
56	Reliable insurance brokers	Geoff Sakulanda	y
57	Stanbic	Louis Zulu	y
58	Standard Chartered	Chileshe Mpunga Chilufya	y
59	UNDP Lusaka Office	Anock Kapira (on behalf of Viola Morgan)	y
60	UNDP/UNCDF	Makarimi Adechoubou	y
61	USAID Profit	Rob Munro colleague	n
62	ZACCI (Association of Chambers of Commerce and Industry)	Justin Chisulo	y
63	Zambia Federation of Employers	Mwenya Kapasa	y
64	Zanaco	Daisy Diangamo	y
65	Zanaco	Melvin Malambo	y
66	ZANAMA (National Marketeers Association)	Mr Elvis Nkandu	n
67	ZBTA (Bus and Taxi Drivers' Association)	Gabriel Tembo	y
68	ZBTA (Bus and Taxi Drivers' Association)	James Liambai	y
69	ZCF (Cooperative Federation)	Mary Ngoma	y
70	ZCF (Cooperative Federation)	Tiras John Banda	y
71	ZCF (Cooperative Federation)	Sikawala Hamwela	y
72	ZCSMBA (Chamber of Small and Medium Business Associations)	Markham Hamalambo	y
73	ZCSMBA (Chamber of Small and Medium Business Associations)	Penias Chabwela	y
74	ZNFU (National Farmers' Union)	Hamusimbi Coillard	n
75	ZSIC Group Risk & Pensions – New Business	Fuckson Ngulube	y
76	ZSIC Life	Simachila Makwembo	y
		Total attendance	**63**

Access to Insurance Initiative
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