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World Development Vol. 40, No. 8, pp. 1700–1711, 2012

0305-750X/$ - see front matter

http://dx.doi.org/10.1016/j.worlddev.2012.04.010

Bequest Motives and Determinants of Micro Life Insurance in Sri Lanka

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Summary. — This paper emphasizes bequest motives by evaluating participation patterns in micro life insurance against insurance demand and supply side factors. Based on household survey data from Sri Lanka, it presents evidence on the determinants of micro life insurance participation of low-income households, using probit and tobit models. The results provide evidence that micro life insurance is positively correlated with measures of bequest motives such as the number of children or dependents. Besides, better off households are less excluded from micro life insurance markets than their poorer counterparts. The study finds a convincing need for the microinsurance sector to be more responsive to the needs of the poor, with a key role in providing financial education to understand the need for microinsurance.

Key words — financial markets, microinsurance, life insurance, South Asia, Sri Lanka

1. INTRODUCTION

Microinsurance in developing countries is increasingly recognized as key to poverty reduction and social protection. The adverse effects of unexpected events have a significant effect on the income of the poor, as limited resources impede their recovery. A significant potential for microinsurance has been identified as a measure to reduce vulnerabilities among low-income groups, due to little ability to use ex-ante preventive risk management strategies, and mainly rely on informal mechanisms that provide only partial insurance, so that they lack sufficient options to secure against hazards (Bendig & Arun, 2011; Cohen, McCord, & Sebstad, 2005; Loewe, 2001; McCord, Gaby, & McGuinness, 2006).

Shocks to household income, such as death or illness, generate movements in consumption of households that are not perfectly insured, and at the extreme, may lead to deprivation or death. In such cases of household shocks, microinsurance serves as a risk coping mechanism, incorporating measures for consumption smoothing. With a sudden drop in income following personal shocks, a household would then less likely be expected to take up insurance. However, in a long-term perspective, we assume that the experience of a severe hazard in the near past induces households to purchase insurance to prevent the effects of recurrent hazards. While there are different types of insurance relevant for the low-income market, we focus on the risk of death, which is frequently identified—beside illness—as the most severe hazard. A study identifies life insurance as the most widely provided microinsurance policy in the world, as it is the easiest to deliver and manage, for providers (Roth, McCord, & Liber, 2007).[1] Life insurance policies are financial products that mainly consist of two differing components: income replacement for premature death and a long term saving instrument. Life insurance encourages long-term savings and the reinvestment of substantial sums in private and public sector projects. Nevertheless, the debate on the demand for formal insurance in developing countries is scantily prevalent in the literature, except for studies on informal insurance (Churchill, 2006; Dercon, 2002; Morduch, 1995, 1999; Townsend, 1995). Some studies have used quantitative data from household surveys to identify and analyze determinants of insurance participation (Asfaw, 2003; Bhat & Jain, 2006; Cole *et al.,* 2009; Giné, Townsend, & Vickery, 2008; Giné & Yang, 2009; Ito & Kono, 2010; Jütting, 2003). It is the aim of this paper to add to these contributions on the cross-sectional determinants of microinsurance participation of low-income households, using comprehensive household survey data from Sri Lanka.

Our approach differs from current discussions in the following ways. First, we assess the participation in micro life insurance schemes in Sri Lanka, as previous research on microinsurance has been confined to weather, crop, and health. Second, the paper pioneers to estimate if micro life insurance participation is motivated—beside other determinants—by the desire to leave bequests. Standard models of participation in life insurance suggest that life insurance participation is increasing with the present value of the

* The financial support for the research underlying this paper was provided by the British Academy (SG-44036) and we gratefully acknowledge the support of the Institute of Policy Studies of Sri Lanka (IPS) in carrying out the field survey. All errors are our own. Final revision accepted: January 30, 2012.

beneficiaries' consumption. If the household values bequests behavior, we argue that the present value of the beneficiaries' consumption increases with the number of dependents, i.e., micro life insurance participation increases with the number of dependents. Modeling pure term life insurances and combinations of term life insurance and savings plans, we derive bequests using a "joy-of-giving" motive. We argue that bequests can either be intended (desired) (Hurd, 1987), altruistic (Tomes, 1982), strategic due to self-interested exchange with one's heirs (Bernheim, Shleifer, & Summers, 1985) or unintended (accidental) (Hurd, 1994). Thereby, the purpose of the paper is to inform policy makers and insurers on the provision of micro life insurance in developing countries in the context of social protection and the options to support efforts of low-income households to use adequate risk coping measures in the case of a death within the household. The desire to leave bequests might play a key role in the decision-making process of low-income households to contract micro life insurance with either the support of the state or respective insurance providers.

Third, we estimate the determinants for micro life insurance participation by using the actual use of a micro life insurance and respective premium amount as dependent variables in probit and tobit models. The actual use of insurance, i.e., the actual provision, is determined by the demand and the supply of insurance (World Bank, 2008: 28), [2] so that we control on the access to life insurance in Sri Lanka by identifying the socioeconomic characteristics of the life insurance user and nonuser. Premium expenditure has been typically used as the measure of insurance consumption and coverage in prior research in developed country contexts (Browne & Kihong, 1993; Burnett & Palmer, 1984; Truett & Truett, 1990). Premium data do not allow observing the actual amount of insurance coverage purchased, as the premium amount is a combined measure of price and level of coverage. Nevertheless, it provides an indication of insurance coverage, so that the combined usage enabled us to control for a more holistic picture of insurance participation, including both the insurance ownership and coverage (Beck & Webb, 2002).

The paper is structured as follows: Section 2 depicts the microinsurance market, specific life insurance contract features and institutional details in Sri Lanka. Section 3 discusses determinants of life insurance participation, and states hypotheses to be tested. Section 4 outlines details of the survey and the methods used in the estimation. The descriptive statistics, the results of the estimations and policy perspectives are discussed in Section 5. Section 6 concludes.

2. MICROINSURANCE SECTOR AND THE ROLE OF MICRO LIFE INSURANCE IN SRI LANKA

Despite spurt in the global growth of insurance markets, commercial insurance services are still negligible among low-income households. The potential of the microinsurance to reduce vulnerabilities of the poor and in contributing to economic growth is gaining significant attention gradually. [3] Akin to many developing countries, Sri Lanka has an infant microinsurance market in terms of penetration [4] (1.48% [5]) and density (16.3 US$), as it ranks 75th in terms of penetration and 82nd in terms of density (Rajivan, 2007). It is plausible that the low penetration and density, indicating limited access to and provision of insurance, might be one explanation for the reduced outreach of insurance in Sri Lanka. Nevertheless, Roth *et al.* (2007) suggest the possibility of a significant increase of microinsurance provision due to the factors such as the higher interest of insurers in the market, increased demand for risk management strategies among the low-income households and the significant presence of potential intermediaries to offer microinsurance products.

In Sri Lanka, the origin for microinsurance schemes was funeral aid society concepts, which provides assistance in the case of death to the member and family. In 1991, All Lanka Mutual Assurance Organization [6] (ALMAO), one of the apex microinsurance schemes, was started by seven cooperating Funeral Aid Societies (FASs). Though 14 private insurance companies and 45 insurance brokers are registered and regulated under the Insurance Board of Sri Lanka (IBSL), the unregulated organizations such as mutuals and NGOs (such as YASIRU and SEEDS), dominate the microinsurance market by offering the majority of products such as life insurances in rural areas (Enarsson & Wirén, 2006; Roth *et al.,* 2007). Micro life insurance is the most widely provided microinsurance policy in the World, whereas in Asia, only 67.2 million people are so far covered (Roth *et al.,* 2007). A number of characteristics of the life insurance business are identified as the foremost reasons for this fact: the most demanded forms of cover related to the importance of family-related hazards, easy to price, resistant to problems of fraud and moral hazard and its independence from infrastructure compared to health.

From a generic perspective, micro life insurance can offer two services: income replacement for premature death, and a long-term savings instrument (Beck & Webb, 2002; Black & Skipper, 2000). Only policies offering mortality coverage are generally referred to term life insurance. [7] Those providing a combination of mortality coverage with a savings component—called the cash value—within the same contract are known as permanent, endowment, universal, and whole life insurance. [8] Policies in the second category, accumulate funds, similar to a savings account holding with a bank, are available to the policy owner. Additionally, these insurances earn interest, which is returned to the consumer through policy dividends, cash-values on termination of the policy, or endowment sums on maturation of the policy.

Although micro life insurances have the highest outreach among the microinsurance products in Sri Lanka, there exists public apathy to contract life insurance, mainly because of past incidents in which the high inflation rates have reduced the maturity value of term life insurance policies. Nevertheless, there exists several microinsurance products offering death benefits, which can be interpreted as a term life insurance, or providing a wide variety of other schemes such as accident, hospitalization, health, and other benefits. [9] In the household data set used here, the predominant micro life insurance product is a term life insurance providing only mortality coverage mainly for the policy owner. We suggest that the remaining micro life insurances can be understood as cash value policies incorporating substantial amounts of mortality coverage and variable savings components (see Table 1).

The five MFIs under study here have different micro life insurance schemes, which vary in terms of premiums, benefits value, duration of membership, age at the entry, or in terms of the number of clients covered by a micro life insurance policy. For example, Sanasa Insurance Company has three types of micro life insurance, namely "Sithumina," "Divithura," and "Pilisarana," which offer death benefits that are different in terms of premium and benefit amounts. Women's Development Banking Federation (WDBF) offers two types of life insurance based on the duration of membership Wiksith and Wisal. Members whose membership is older than 5 years are eligible for Wisal insurance scheme, while those who have been members for less than 5 years in the society are eligible for