Microinsurance NOTE 8

Facilitating an Appropriate Regulatory and Supervisory Environment for Microinsurance

Insurance is a business of trust, where people may pay premiums for many years without making claims. An insurance supervisor that can fully assess the activities of the insurance industry is an important ingredient to maintaining trust in the insurance system. Developing country regulators must be able to manage increasing access, innovation and technological change while ensuring financial sector stability and consumer protection.

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In the case of insurance, Adam Smith's "invisible hand of the market" is not in itself able to protect low-income consumers. These consumers are unorganized, so one small voice expressing a problem or complaint has little impact. They also represent a massive population, so insurer problems can affect a significant part of an economy. Insurance is a business of trust, where people may pay premiums for many years without requiring the insurer to act on the promises made in their policies. However, when a claim is made and an insurer is called upon to cover it, they should react promptly, as promised. Therefore, an insurance supervisor that can fully assess the activities of the insurance industry is an important

[1] German Technical Cooperation

ingredient to maintaining trust in the insurance system.[2]

A primary role of insurance regulation and supervision has been consumer protection. This requires a broad view of the stability and soundness of the insurance sector including:

- Insurer solvency and stability—if the insurer is not financially sound they may not be able to pay claims.
- Management and board capacity—if the management and governance of the insurance company is not capable, they may make decisions that put the company at risk and unable to honor its commitments to policyholders.
- Appropriate policies for a less literate market—if policies are structured in such a way that beneficiaries will be unable to make successful claims, consumers will be cheated.
- Marketing practices—if insurance agents and other distribution channels indulge in mis-selling by intentionally falsifying product information or are not transparent about the coverage of the products they sell, the consumer might be cheated. It is important to note that microinsurance deals with consumers who have poor financial literacy. This results in particular vulnerabilities to marketing abuses and weak service provision.

In several developing and emerging countries, insurance supervision is assuming a secondary role of developing the insurance market. Some supervisors are now expected to be the promoter and guiding force of insurance market development, as well as the protector of the consumer. Many governments, and their insurance supervisors, have recognized that insurance has traditionally been available only to rich individuals and corporations. They also recognize the importance of insurance to the growth and stability of an economy. Thus, there has been an expanding effort on the part of supervisors to support the broad development of the insurance industry. In India, for example, the supervisor is the Insurance Regulatory and *Development* Authority (IRDA). Other supervisory jurisdictions that have taken on a development role include South Africa, Brazil, and the Philippines. Promotion may be through moral suasion, stakeholder dialogue, by fiat through specific insurance or other financial regulations, or even through non-regulatory policy instruments such as fiscal incentives. In some cases, as with fiscal policy, the insurance supervisor may have to motivate policymakers to consider adjustments that are not within the control of the supervisor.

Most importantly, the government has to give a mandate (with financial support) to the supervisor to engage proactively in creating broad-based access to insurance.

This new world for supervisors has generated a dilemma for supervisors in developing markets who are faced with two key challenges:[3]

- **How to manage the promotion of access to insurance in line with financial system stability?** There is a careful balance that supervisors must manage between consumer protection and the flexibility necessary to enable new and better ways to deliver and service new and better products to low-income markets. It is very possible that regulations and supervision designed to completely protect low-income families from insurance pitfalls could deter the development of microinsurance. Consumer protection must not create barriers to access to good value microinsurance products.
- **How to manage innovation and technological change without undermining the financial system?** Microinsurance requires supervisors to take a new look at how products are

[2] The terms insurance "supervisor" and "regulator" are used interchangeably in this note despite the differences that these roles may have in some jurisdictions.

[3] David Porteous. The Regulator's Dilemma. FinMark Trust.

structured, marketed, delivered, accessed, and documented. Microinsurance requires significant efficiencies—the use of simple products and procedures, non-traditional delivery channels, the use of cell phones and other technologies, and new ways to quantify risk and recognize payment and settlement mechanisms as part of the broader scope of monetary transactions, for example – all of which pose challenges to traditional supervisors trying to manage financial sector stability.

It is important to recognize that at this point, the lack of microinsurance regulation is not necessarily the most significant constraint to the development and expansion of microinsurance. As an example, at the recent Microinsurance Annual Conference in Mumbai, a supervisor from Uganda announced to the plenary that "microinsurance in Uganda has been completely a development initiative on the part of the industry." In Uganda, it has been reported that there are over 3 million lives covered by microinsurance, and there has never been any recognition of microinsurance as anything outside of normal insurance business by the supervisor. There are now at least three commercial insurers vying for microinsurance business in Uganda, with one of them primarily focused on health microinsurance. It was the first country in the world to support an exclusive microinsurance broker (the Micro Insurance Agencies). Competition has improved the product range and has helped in bringing down premiums. All of this, with no alternative treatment from the supervisor. So regulatory forbearance is clearly an option for the supervisor who has to consider whether there is the capacity and know-how to deal with microinsurance, or whether they have other even more pressing priorities.

In most countries, regulation or special recognition is likely not necessary at this point, and waiting and learning from the industry and from other jurisdictions might be a better approach for the government or the supervisor than quickly regulating without a clear understanding of microinsurance within the country and of good-practice approaches which are slowly emerging at the global level. Under such a scenario, the role of statistical data and performance indicators assumes significance and a robust database must be put in place to manage the information.

A quicker reaction is only imperative in countries where informal schemes have grown to a considerable size, or where the insurance industry can be expected to offer low-value products without complying with sound industry practices. Both developments can have detrimental effects and destroy the prospects of an emerging insurance market for a generation or more.

CURRENT MICROINSURANCE REGULATIONS AND SUPERVISION

The vast majority of developing countries give no special recognition to microinsurance at the level of financial sector policies or at the level of specific rules. Although supervisors commonly are aware of microinsurance activities, in many countries they turn their heads from deviations from insurance laws. Some, such as South Africa, Nepal, and the Philippines do focus attention in this area. Typically, there is a desire by the governments in general, and the supervisors in particular, to expand insurance into the low-income markets. This trend is clearly observable. In 2006, for example, a survey by the International Association of Insurance Supervisors (IAIS) indicated that very few jurisdictions were interested in microinsurance. Since then, the Joint Working Group on Microinsurance4 (JWG) has experienced strong interest from supervisors. Since its inception in 2005 representatives of 40 jusridictions have attended various meetings of the group.[5]

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[4] The International Association of Insurance Supervisors (IAIS) has established a Sub-group on Microinsurance and this group is working closely with the CGAP Working Group on Microinsurance Sub-group on Regulations, Supervision and Policy Issues in the so-called Joint Working Group (JWG).

[5] The IAIS Supervisors in the Joint Working Group are: Albania,

Changing the face of microinsurance: the obligations of insurers in India

Even before the commercial sector's compulsion to sell insurance to the "social" and "rural" sectors in India, the government there provided subsidies to the parastatal insurers that did offer products to this market. The "Registration of Indian Insurance Companies" regulations of 2000 opened the market to private sector insurance companies. The subsequent "Obligations of Insurers to the Rural and Social Sectors" of 2002 required insurers to satisfy specific increasing quotas for sales in the rural and social sectors of India up to the first five years of operations. This political compromise forced the insurers to begin covering the masses of poor in India.) The MicroInsurance Centre's Landscape of Microinsurance paper showed very clearly the dramatic impact of these quota requirements in getting insurance to the low-income markets.

The 'Obligations of Insurers to Rural Social Sectors' regulation was essentially a quota system that compelled insurers, as a condition of licensing, to sell a minimum percentage or premium value of their insurance policies in specified rural and social sectors. With the great majority of poverty in India located in rural areas, the effect of the regulation was to ensure that insurance reached poor people.

The regulation was imposed directly on new insurers who entered the Indian insurance market after the market was liberalized in 2002. The old public insurance monopolies were not given quotas, but had to ensure that the amount of business they did in the specified rural or social sectors was "not less than what has been recorded by them for the accounting year ended 31st March, 2002".

The regulation put massive pressure on insurers because it meant that unless they sold microinsurance, they would not be able to sell their more profitable products. The regulator has subsequently fined a number of insurers for failing to meet their targets.

Until 2002, the innovation in microinsurance worldwide came from donors, academics, or MFIs. Now in India, with an obligation to meet microinsurance sales targets, insurers themselves began developing innovative new products and delivery channels, and allocating considerable resources to this task.

A cost-benefit analysis of the Indian approach is urgently needed. Whatever its advantages and disadvantages, there is no doubt that having a regulator paying specific attention to microinsurance has had important outcomes for the wider delivery of microinsurance.

—Adapted from IAIS-CGAP Working Group "Issues in the Regulation and Supervision of Microinsurance", 2007

Additionally, several insurance industry representatives from outside the JWG have been participating in the meetings of the JWG.6 With dismal insurance penetration in most developing countries, the low-income market is seen as both a way to improve insurance penetration as well as to aid in their nation's development efforts.

India has been a leader in setting new rules for microinsurance, thereby motivating the industry to take on this challenge. Through December 2006, the IRDA reports the sale of more than thirty million policies to low income policyholders.[7]

The quota system in India has clearly led to some important efforts by a few insurers to develop innovative approaches to this market and see it as a business opportunity. Most insurers, however, developed products of little value to anyone except for satisfaction of the letter of law (as opposed to the intent of the law). These insurers considered such products simply as the cost of doing business in India. The IRDA has subsequently (April 2007) distributed a communiqué to insurers setting minimum coverage values, fixed policy durations, and other measures intended to mitigate the proliferation of these poor quality products to the low income markets. Weak products are natural business responses to being forced through threat of sanctions, or as a licensing requirement, to serve a market in which the firm has no business interest.

Such issues of compulsion should be very carefully considered by any government planning to push insurers into microinsurance.

Botswana, Brazil, China, Germany, India, Kazakhstan, Malaysia, Morocco, Nepal, Pakistan, Philippines, Romania, Serbia, South Africa. Sri Lanka, Uganda and United States. Other jurisdictions participating are: Bhutan, Cambodia, Chinese Taipei, Colombia, Egypt, France, Ghana, Jordan, Korea, Maldives, Mongolia, Mexico, Netherlands, Nigeria, Papua New Guinea, Peru, Russia, Azerbaijan, Saudi Arabia, Spain, Switzerland, Tanzania, and Vietnam.

[6] These include, ICICI Lombard, Zurich Insurance, and the Group of North American Insurance Enterprises (GNAIE).

[7] Roth, McCord, and Liber. "Landscape of Microinsurance in the World's 100 Poorest Countries"

In “Accessing Microinsurance” Godbole and McCord,[8] suggest that governments that insist on such compulsion with quotas use a system of microinsurance credits that can be used to fulfill quotas. Those insurers that are interested in this market as a business opportunity could convert (on paper) their surplus policies to marketable microinsurance credits that insurers in deficit positions can purchase. Thus, if microinsurance is mandated, those that are seriously interested will be incentivised further through the sale of credits. Those insurers that see this requirement simply as a cost of doing business will have an opportunity to satisfy their quota without creating market-distorting products.

In 2005, India introduced the first microinsurance regulations followed by Brazil (2005), and the Philippines (2006). More recently, Peru has developed internal regulations for microinsurance (2007). Several other countries including Mexico, South Africa, Nepal, Bangladesh and Cambodia are working on specific microinsurance rules. In South Africa for example, a new tier (funeral insurance license) is being considered with reduced entry and compliance requirements. In addition, public-private dialogue in the form of the Financial Sector Charter was carried out resulting in voluntary access targets for the low-income segment by the industry as well as voluntary entry-level product standards.

Some examples of regulatory adaptations to improve the access of low-income people to specialized insurance products are shown in the box below.

Some examples of regulatory adaptations

1. In India, the IRDA, with its microinsurance regulations, has relaxed agent regulations, promoted linkages between regulated insurers and NGOs, introduced product features and allowed composite insurance services (however, with different risk carriers behind the service);
2. In Brazil, the insurance supervisor has developed microinsurance products for car and life insurance and promoted sector dialogue on microinsurance, both of which motivated the industry to become interested in the low-income market. The parallel tax relief for life insurance has also added to expansion in microinsurance provision.
3. In the Philippines, the Insurance Commission has adapted its regulations of Mutual Benefit Associations (MBA), which are recognized under the insurance law, by creating a new form (or tier) of “Microinsurance MBAs” with specific rules. Such rules include simple products, stipulated requirements to comply with performance standards, and defined eligibility criteria for microinsurance products based on the benchmark of the minimum daily wage for non-agricultural laborers. Compared to traditional MBAs, MI-MBAs are subject to lower entry requirements such as a lower guarantee fund.
4. In Peru, the supervisor has issued a microinsurance regulation for the insurance industry and its agents such as microfinance institutions, trade unions and others. The new rule includes e.g. a definition for microinsurance, requirements for simple products, for group and individual insurance, for claims handling, and for simplified reporting to the supervisor.
5. In Senegal and Mali, a regulation on micro health insurance has been adopted. From 2004 to 2006, in a participatory process, eight UEMOA (Union Èconomique Et Monétaire Quest Africaine) West-African jurisdictions were engaged in order to draw legislation on mutual social health organizations. The draft regulation is currently under review at UEMOA. This work aims at taking into consideration the specificity of those institutions (private institutions, that are non-profit, based on solidarity, covering a social risk). The rules, in particular prudential, were drafted with the aim of protecting the individual consumers but also of not putting too much burden on still new and fragile institutions.

—Adapted from Arup Chatterjee, Presentation to the Regional Workshop on Access to Insurance for the Poor. (Rio, May 2007)

DIFFERENCES BETWEEN TRADITIONAL INSURANCE AND MICROINSURANCE, AND THE IMPLICATIONS FOR REGULATION AND SUPERVISION

Insurance regulators and supervisors must work to understand the differences between conventional and micro insurance so that they can address the specific needs of

[8] Godbole, A.M. and Michael J. McCord. “Accessing microinsurance.“ Businessworld (India). 31 December 2007, p. 56.

microinsurance in ways that improve both access and consumer protection. Some of the key differences between conventional and micro insurance as well as some key implications for supervisors are noted in the table below.

The implications in this table represent considerations if a traditional insurance company Some examples of regulatory adaptations In India, the IRDA, with its microinsurance regulations, has relaxed agent regulations, promoted linkages between regulated insurers and NGOs, introduced product features and allowed composite insurance services (however, with different risk carriers behind the service); holds the microinsurance risk. Significantly different issues—such as minimum capital requirements, solvency ratios, and management capacity—must be reconsidered if a new tier of microinsurance provider is developed as in the case of the Philippines or as planned in South Africa.

The question of whether small regulatory adaptations for microinsurance provision, or a completely new regulatory framework for microinsurance, is better to stimulate the market and protect policyholders depends on the particular situation of a jurisdiction and the capacity of its supervisor.

	Conventional Insurance	**Microinsurance**	**Implications for supervisors**
Delivery Channels	Sold by licensed agents or brokers to wealthy, middle class, or companies that typically understand insurance	Often sold by unlicensed non-traditional agents to low-income persons, preferably in groups	Calls for alternative requirements for agents including: institutional agents; and local agents with limited education to sell simple products.
Controls	Screening requirements may include adherence to "Know Your Customer" anti-money laundering guidelines or medical examination, or other tests	If there are any screening requirements, they are very limited to minimize costs	Requires acceptance of alternative adjustment, screening by proxy, and insurance policies with few to no exclusions.
Premiums	Typically regular annual, quarterly, monthly. Based on age or other specific risk characteristics, and collect regularly	Frequent or irregular premium payments. Group pricing with links to other services. Different risk structures.	Requires recognition of odd repayment periods, calculations based on different risk structures, and un-differentiated premiums.
Policies	Complex policy document, many exclusions, usually annual terms	Simple language, few to no exclusions, terms appropriate to market	Requires acceptance of policies of one page or less, and alternative recourse methods for the insured such as an easily accessible microinsurance ombudsman.
Claims	Claims process for large sums insured may be quite difficult	Claims process for small sums insured is simple yet still controls fraud	Requires acceptance of alternative settlement mechanisms such as settlement by delivery channel.

Clear and conducive rules for dealing with microinsurance with the final aim of consumer protection are critical for microinsurance development; however, open minds are more advisable than a "rush to regulate." In any case, a situation must be avoided where risk carriers or intermediaries fail to satisfy agreements, offer low value for money products, or have sales staff who are not transparent and reliable as this will have a detrimental impact on the low-income market and their future acceptance of insurance products.

KEY ISSUES IN MICROINSURANCE REGULATION AND SUPERVISION

Some questions that supervisors and policy makers are confronted with and which need to be examined in further detail are mentioned below. Policymakers, supervisors and promoters (such as donor agencies and local associations) should be able to find solutions

to these questions by joining the global learning process and working on innovative policy and technical solutions:[9]

1) **Should insurance supervisors assume responsibility for promoting micro-insurance?** In some jurisdictions, policymakers and supervisors have already developed innovative approaches to promote microinsurance. In others, microinsurance has developed on its own without supervisor or other government prodding. In the recent Mumbai conference, it was agreed that a clear signal from the government is important to give a development mandate to the supervisor. The signal can come from the policy side, but supervisors can also act proactively on their own and motivate policymakers towards the promotion of microinsurance.

2) **What about the issues of policyholder protection versus access?** Which particular regulations related to market conduct could protect microinsurance policyholders, who by definition are unaware about the details of insurance products and thus may have limited options to address inappropriate actions by an insurer? Which regulatory approaches have proven effective in balancing protection with broad accessibility? Eliminating a low-income family's access to microinsurance in order to protect them is not appropriate. Likewise, compelling disinterested insurers to offer products in this market will also have undesirable results. Thus, the two extremes of protection and accessibility are not good solutions for this market. The answer is somewhere in the middle with some appropriate protections coupled with some promotion of insurers offering products to this market. The South African approach offers an example. A combination of different policy instruments have been tested in South Africa, such as voluntary industry targets in the form of a Financial Sector Charter, a special market-conduct regulation protecting policyholders[10] and a new type of specialized microinsurance provider for previously informal microinsurers.

3) **Can a tiered approach to microinsurance regulation work?** In order to include microinsurance activities by those without an insurance license, a tiered approach for microinsurance regulation might be appropriate. Second and even third tier insurers (as opposed to the first tier)

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[9] These questions are adapted from the paper "Issues in Regulation and Supervision of Microinsurance" June 2007 by the IAIS.

[10] The Financial Advisory and Intermediary Services Act (2002). This Act regulates the provision of advice and intermediary services (e.g. agents and brokers) and the entities that may provide it. The Act includes fit and proper requirements, code of conduct and certain exemptions. It aims to protect consumers by regulating the institutions or persons selling insurance, as well as the way in which insurance products are sold (provisions regarding the contents and structure of advice).

have lower cost levels and simpler institutional designs, which allows them to serve the low-income market where premiums are substantially lower than in the formal market. This is associated with less regulation, simpler products and often, innovative collection and distribution systems. The Philippines's Mutual Benefit Associations are examples of second-tier institutional types. However, one should be aware of the fact that creating a new institutional type requires significant time and investments in capacity and systems of the supervisor and the new providers.

4) **Is there capacity within the supervisor's office to supervise adequately the microinsurance activities that it deems important to regulate?** Creating rules to govern microinsurance without the ability – in terms of both people and knowledge – to enforce those rules will undermine the authority of the supervisor. Therefore, supervisors should consider carefully the options to change the regulatory framework. A gradual approach to microinsurance regulation can start with allowing new delivery channels and creating effective consumer recourse mechanisms. Supervisors can also approach international development agencies for technical support.

WHAT CAN SUPERVISORS DO TO ENHANCE THEIR CAPACITY FOR EFFECTIVE MICROINSURANCE REGULATION IN THEIR JURISDICTION?

There are several key activities that can make a supervisor's office more capable of assessing the role it will take in microinsurance. These include:

- Review of the IAIS-CGAP WG "Issues in the Regulation and Supervision of Microinsurance".[11] This document clearly identifies important supervisory considerations. It helps supervisors in working through the areas that any particular jurisdiction, within its particular environment, might need to adjust in terms of its structure of insurance rules.
- Review the regulatory activities and results from other jurisdictions. There are a growing number of countries, mentioned in this Note, that have substantial microinsurance activities and accordingly, have developed regulatory approaches. Additionally, more detailed documentation on the rules surrounding microinsurance is being developed. For example, the IAIS-CGAP Joint Working Group is nearing completion of microinsurance policy studies for The Philippines, India, Uganda, South Africa, and Colombia. Based on these studies, this Working Group will be drafting Guidelines for the Regulation and Supervision of Microinsurance.
- Supervisors are invited to join the IAIS-CGAP Joint Working Group to participate in this learning exercise and contribute with their concerns and experiences. The Working Group meets several times per year in different places, and also works virtually.
- In many countries, several regulations may govern some aspect of

[11] In the Issues Paper, the Joint Working Group on Microinsurance has reviewed the IAIS's Insurance Core Principles (ICPs) in terms of issues that arise from the principles that might need some additional thought in terms of microinsurance development. The resulting paper on "Issues in Regulation and Supervision of Microinsurance" (IAIS-CGAP WG on MI, June 2007) is an important tool for supervisors in all jurisdictions in learning more about microinsurance and its issues at the insurance sector but also at supervisors level. It should certainly be a key input to any consideration of regulation or policy development, as well as supervisory processes.

microinsurance activities. The insurance supervisor, other financial sector supervisors such as banking or securities, the health ministry, the cooperatives ministry, the social security agencies, the tax authorities, and the supervisor of the companies act may individually have some role in microinsurance development and regulation and supervision. It is important to assess the particular authorities involved within each jurisdiction and to make efforts to coordinate their activities so that microinsurance objectives are consistent throughout the government. A clear mandate on microinsurance given to the insurance supervisor from government policymakers will facilitate such a process.

- In most countries, there are some varying levels of microinsurance activities. Much can be learned by initiating a dialog between different supervisors (and other relevant government agencies) and microinsurers (those regulated by the insurance laws and those that are not), as well as sector institutions such as industry associations and delivery channels. Such a dialog can lead to the development of critical knowledge for all participants and can spur the reform process by making it practice-oriented and well-understood. In some jurisdictions, it may even be appropriate to begin collecting data from microinsurance providers on a voluntary basis in order to develop specific knowledge and capacity within the supervisor's office in advance of any rule setting.

These steps lay the groundwork for the development of an enabling regulatory environment for microinsurance. They can help to prepare supervisors for a role in microinsurance that is appropriate for their jurisdiction without starting too early to produce regulatory solutions that are later found to be irrelevant or overly cumbersome. By entering in a dialog process with sector participants, the supervisor could start understanding the issues in a broad sense. The process of learning lessons from other supervisors either on a country-to-country basis or in global forums should go in parallel. The next step is to assess the domestic policy, including the regulatory environment, and begin to coordinate based on a clear government mandate. Finally, supervisors would work with those actively selling microinsurance to understand the specifics of microinsurance operations, markets, and channels. From this base of knowledge, policymakers and supervisors will be better prepared to begin the process of constructing appropriate rules for microinsurance to ensure the sustainable access to value-for money insurance for the low-income market.