CGAP WORKING GROUP ON MICROINSURANCE

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Role of Governments

Governments can play various roles in creating an environment that encourages equitable access to insurance. Some middle and high income governments equate insurance to social protection and provide it by way of, for example, mandatory and universal health insurance, or a requirement to be affiliated with an old-age pension scheme. However, in most developing countries less than 20% of the active population is usually included in regular social security systems due to fiscal constraints. Consequently, extending protection to under-served segments could be enhanced through the regulation of the insurance industry.

In addition, governments can promote the development of supply and demand for microinsurance through a variety of other mechanisms, including: a) creating an enabling legal environment, b) education and social marketing, c) strengthening institutions, and d) providing financial assistance.

Creating an enabling legal environment

The primary function of insurance regulators and supervisors is to protect consumers. This is manifested in three ways:

1. **Protecting policyholders in general** by ensuring the solvency of insurers, which includes determining that insurance may only be offered by licensed entities that remain financially sound and meet their obligations.
2. **Protecting individual policyholders**, including prospective policyholders, from mis-selling and improper handling of claims, and ensuring that their grievances are redressed in a timely fashion.
3. **Developing inclusive insurance markets** by extending outreach to include persons who are currently unable to access or afford insurance.

Insurance authorities do not attach equal importance to these three aims. Much of their work is concentrated on the first two. To fulfil the third role, their development function, authorities can mandate insurers to serve the low-income market, use moral persuasion to impress upon insurers the need to widen their reach, or decide on a middle course. The starting point for creating inclusive markets is for supervisors to have a mandate to do so.

Each jurisdiction has its specific features and there is no one solution that fits all. For example, India compels insurers to serve the poor and has made some critical regulatory adjustments by reforming its broker or agent regulation. South Africa is cautiously approaching its enormous informal insurance industry on its way to a new framework for microinsurance. The supervisor wants to extend consumer protection to those who have informal insurance, but does not want to regulate the schemes out of existence. The Philippines' solution is to build on the strength of mutual schemes that maintain guarantee funds that are tied to volumes, and therefore do not require substantial initial capital.

It is difficult for supervisors to provide consumer protection while at the same time encouraging innovative solutions to respond to the insurance needs of low-income households. Adjustments to regulatory frameworks are often perceived as being in conflict with prudential principles and risk of creating distortions in the market place. Therefore, supervisors have to find a balance that promotes inclusion – which means extending insurance to the huge low-income market while protecting their investments and confidence – without putting an undue burden on supervisors.

The creation of a new tier of institutions might be a major step forward, but it could require some time and effort. The revision of agent and broker licensing requirements could be the easiest way of stimulating increased provision of insurance services. It is useful to consider allowing alternative distribution channels; retailers, cell phone and utility companies – any organization that engages in financial transactions with the low-income market – to distribute insurance. In addition, the emergence of third-party administrators could be important, since microinsurance is a high volume, low margin business that requires considerable administrative expertise.

It is important to note that the enabling environment for microinsurance extends beyond insurance regulations. By identifying possible environmental or infrastructure obstacles that impede the development and expansion of microinsurance, governments may be able to make adjustments through limited investments that could significantly increase the availability and quality of insurance to the poor. Besides adjustments to insurance regulations, other regulatory issues include the legalization of cooperatives, the use of tax incentives, and appropriate accounting requirements.

Education and information

For regulatory adaptations to work, there needs to be a significant investment in education at many levels. Policymakers and supervisors have to understand the risks and potential of microinsurance, therefore know-how transfer and dialogue are primary concerns.

Donors and other promoters are also learning and have to be prepared to finance and technically assist supervisors as well as microinsurance providers.

Microinsurance providers could include employers' and workers' organizations, service providers, professional associations, civil society groups and cooperatives, yet most insurers are not used to collaborating with such organizations. Governments could facilitate links between insurers and potential delivery agents and develop a legal framework conducive to such collaboration.

Finally, the customers who demand microinsurance services are often not well-educated. **Information campaigns,** including social marketing, are another way governments can build awareness and understanding about insurance, help overcome the market's mistrust of insurers, as well as highlight the significance of risk prevention and risk avoidance.

Strengthening institutions

Certain services need to be in place for the insurance industry to function properly, including research outputs and statistical data, to enable microinsurers to determine appropriate prices. Another critical contribution governments can make is the provision of adequate healthcare facilities, without which health microinsurance is not possible. If microinsurers want to minimize claims costs, they need to maintain a close relationship with healthcare providers that are partly or wholly subsidized by the state.

Whenever appropriate, governments should encourage the creation of **microinsurance associations and training institutions** or support existing ones. For microinsurers to be successful, local, occupation-based units need to be linked to larger network structures to enhance representational functions and widen their risk pool. Associations can play a key role in providing advisory services and training, as well as a support structure for internal control and performance-monitoring. Since many of these associations do not collect enough from members to support their costs, support to associations might be an effective use of government subsidies.

In addition, while microinsurers might want to look outside their country for financial support, they may not have the capacity or professional networks to negotiate terms of assistance with potential donors. These organizations will need to rely on the government to play an intermediate role between the two sides. The government's interest in microinsurance can influence the volume and scope of external donor assistance.

Providing financial assistance

Since market-based microinsurance is unlikely ever to reach the poorest and most destitute members of society, financial assistance is often required to extend the outreach of microinsurance schemes. Given this need for financial assistance, governments have to decide if they are going to make such investments, and if so, how they can be designed most effectively.

For example, governments could include the provision of transfer payments to the poorest citizens unable to pay for insurance. **Targeted transfers** to the poor have an important welfare impact and a political decision needs to be taken relating to the subsidy of recipients.

Overall, based on a country's needs, administrative capacity, banking system and political priorities, transfer payments can be:

- Given directly to individuals to acquire insurance;
- Provided to support new schemes;
- Given to the social or community-financed microinsurance schemes;
- Given to providers to cover investments or uninsurable services or
- Provided in the form of tied transfers, i.e. subsidies that encourage the use of preventive care.

In providing subsidies for microinsurance, governments need to understand the effects on non-members as well as on members.

Social reinsurance techniques could also be used to improve the viability of small risk pools typical of informal microinsurance schemes. The government may encourage and support the development of reinsurance mechanisms either by reinsuring microinsurers directly or by subsidizing the premium microinsurers would have to pay for reinsurance, and by facilitating the creation of a pool of reinsurers willing to offer reinsurance capacity to microinsurers.

The International Labour Organization (ILO) and the Munich Re Foundation published **Protecting the Poor: A Microinsurance Compendium** on behalf of the CGAP Working Group for Microinsurance. This authoritative book analyzes the experiences of more than 40 microinsurance providers and is based on the **Good and Bad Practices** project led by the Operation subgroup and funded by DFID, GTZ, the ILO and SIDA. The translations into French and Spanish are financed by ADA.

The content of this note is based on chapters 5.2 and 5.3 in Churchill (ed.) 2006. Protecting the Poor: A Microinsurance Compendium, (Geneva: ILO) – ISBN 978-92-2-119254-1