
VIII Infrastructure and environment for microinsurance

24 The technology revolution in microinsurance

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The technology landscape in developing countries is changing at an incredible pace. This provides a myriad of opportunities for financial-sector players wanting to expand into previously unreached markets in these countries. This chapter considers the role of technology in delivering microinsurance to low-income clients across the world. While technology can be defined as any tool that assists in delivering better services than available alternatives, this chapter specifically reviews the role of information and communication technologies (ICT), mainly electronic devices and associated software.

The first section takes a brief look at the benefits associated with technology, while also paying attention to some of the risks that it entails. The next three sections describe how technology can support different facets of microinsurance processes: 1) client interfacing functions; 2) transaction processing; and 3) data analysis. The last section takes a current and prospective look at mobile phones as a unique category of technology in microinsurance.

24.1 Benefits and risks of technology in microinsurance

Technology has the potential to help meet several major challenges in microinsurance provision, namely enhancing affordability, reaching clients, especially in remote areas, collecting small premiums and paying valid claims. While addressing these specific challenges, technology could potentially provide a range of benefits along the microinsurance value chain, such as:

Lowering administration costs: Historically, insurance has been a paper-based sector, with marketing brochures, application and claims forms, and policy documents. To streamline systems and lower costs, microinsurance needs to move beyond paper, and technology can make that possible. Increasingly, ICT can be used for efficient, paperless administrative processes, thereby decreasing costs per client. Over time, the efficiency gain could be reflected in lower premiums, leading to higher product sales and thus offsetting some of the technology costs incurred.

Reaching new markets: Low-income households are often unbanked, which has been a barrier to accessing insurance. That is beginning to change. Through mobile phones, smart cards and new payment systems it is becoming possible to collect premiums from clients who do not have a bank account. Microinsurers can also use technology to communicate with clients through voice or text messages where regular communication was previously unviable, reducing travel costs for insured and insurer alike.

Linking to different operations: ICT can provide significant support for microinsurers in expanding their business, mostly by connecting with existing client groups of other operations, such as banks (bancassurance), retailers or microfinance institutions (MFIs). This increases the number and variety of channels that can provide insurance products.

Improving customer service: From the customer's perspective, the process of availing themselves of insurance and its benefits can be daunting. Microinsurance has to bring down the barriers and enhance access. It must be easy to understand the coverage, enrol, pay premiums and submit claims. In this regard, technology can provide a big boost, lowering customers' transaction costs and making it easier for them to receive answers to their questions and have their claims paid more quickly. In turn, this will foster trust in insurance.

Reducing fraud: The identification of insured people and property, particularly in countries without national ID systems or functional addresses, has impeded the development of microinsurance. However, technology is stepping in to help solve that problem, reducing fraud through more effective means to identify customers and their insured assets.

Better understanding of the market: A number of the technologies considered in this chapter enable microinsurers to better assess and manage risk. Furthermore, many of these technologies retain client data, allowing microinsurers and their distribution partners to form a detailed understanding of potential and current clients and their product needs. Being able to access client details, product utilization, costs of services and other essential data supports the development, management and pricing of value-for-money insurance products.

However, there are a number of caveats associated with these benefits. Perhaps most importantly, technology can only deliver these various benefits if appropriate business processes and systems are in place. Other cautions include the following:

- There is a tendency to be overly excited about the next digital solution, but it is important to first understand what the problems are that need to be solved, and then see if technology is a good fit.
- Technology applications have to be tailored to meet the needs of distribution partners operating in specific sectors (e.g. banks and MFIs), and they also need

to be linked to clear performance measures to enable technology users to monitor whether it does indeed add value.

- Technology needs to be deployed in a sequence that allows for learning and the building of capabilities before implementation of the next level of technology.
- Better use of data analysis tools will require greater standardization in the formatting of data and in data collection procedures.
- Sometimes high-technology solutions cannot stand up to the challenging environments with temperature and rainfall extremes in which microinsurance customers often live and work. Poor connectivity can also undermine investment in technology.
- The unreliability of technology providers is another challenge often faced by microinsurance providers who need on-going service to support the technology.
- Technology investments need to be accompanied by complementary investments in human capital to ensure that staff can derive full value from the newly implemented technology.

To help microinsurance providers avoid the risks and take advantage of the opportunities, in 2008 the Microinsurance Network's Technology Working Group reviewed the microinsurance technology landscape (*see Box 24.1* for information on the Working Group's activities). The review identified three main categories of technology relevant for microinsurance: 1) customer interfacing mechanisms; 2) transaction processing including management information systems (MIS); and 3) data analysis, as summarized in Table 24.1. The scope and nature of these three categories of technology are considered in greater depth in the remainder of this chapter.

Table 24.1

Main categories of technology in microinsurance

<i>Client interface</i>		<i>Transaction processing</i>	<i>Data analysis</i>
<i>Enrolment and premium payment</i>	<i>Loss verification</i>		
<ul style="list-style-type: none"> – Mobile phone with a global positioning system (GPS) – Short message service (SMS) – Smart card – Point-of-sale (PoS) terminal – Subscriber identity module (SIM) – Mobile payments platform – Wireless access service provider (WASP) – General packet radio services (GPRS) 	<ul style="list-style-type: none"> – Radio frequency identification device (RFID) – Biometrics – Weather indices – Spatial mapping technology – Remote diagnosis 	<ul style="list-style-type: none"> – Software as a service (SaaS) – Call centre – Management information system (MIS) – Voice over Internet protocol (VOIP) – Data standardization 	<ul style="list-style-type: none"> – Database analysis – Weather stations data – Satellite imaging data

Source: Adapted from Gerelle and Berende, 2008.

Box 24.1

Microinsurance Network's Technology Working Group

The Technology Working Group focuses on data collection, communication, management information systems and services to support microinsurance practitioners and trainers working with these organizations. In 2008, the Working Group and the ILO's Microinsurance Innovation Facility compiled an inventory of information technologies that could be applicable to the extension of insurance services to low-income households (see Gerelle and Berende, 2008). The objectives of the study were to catalogue and illustrate the technologies used or potentially useable in microinsurance.

In 2010, the Working Group launched an online inventory that reviews software systems specifically designed for microinsurance. The first systems in this inventory fall into the transaction-processing layer of microinsurance technology. The website allows users to search, filter and examine each of the software products listed in the inventory by type, language, institution size, features and location of the provider.

Within the coming years, it is expected that the inventory will extend to include the customer interface and data analysis levels by reviewing technologies such as mobile phones, smart cards, PoS terminals, and biometric and RFID devices.

Source: Adapted from www.microinsurancenetwork.org.

24.2 Client-interfacing technology

The success of microinsurance products relies greatly on the extent to which low-income persons can interact seamlessly with the insurer or its intermediaries, and technology can facilitate this. This section reviews two dimensions of client interfacing technology: 1) enrolment and premium collection; and 2) loss verification and the claims payment.

24.2.1 Enrolment and premium collection

Technology can make a major contribution to the process of client enrolment and premium collection. Different technologies can support these processes, including GPS-enabled mobile phones for client enrolment, and using smart cards, airtime and a mobile payment system for premium payments, as summarized in Table 24.2 and described below.

Table 24.2

Technology in client enrolment and premium payment				
	<i>Mobile phone for enrolment</i>	<i>Smart card</i>	<i>Airtime</i>	<i>Mobile payment system</i>
Characteristics	Vendor uses GPS-enabled mobile phone to register customers and collect first premium payment (in cash, but receipt communicated to insurer via mobile phone)	Value stored on SIM cards can be used to make premium payments	Premium payments take place through direct deduction of airtime; airtime then has to be converted to currency	Premium deducted from customer's m-wallet; payment thus made in form of mobile money
Advantages	Vendors (e.g. small-scale grocery store owners, farm input suppliers) connected through technology offer a network of convenient distribution points	Payments can happen while systems are offline; card can serve as an ID; has storage capacity (e.g. medical records)	Clients do not need bank account to make premium payments	No need for bank account. M-wallet can be used for both premium payments and claims settlement
Disadvantages	Requires vendor to be online or connected to network; not ideal for rural areas without network coverage	Expensive to distribute; smart card readers can be costly	Cost of WASP technology required to convert airtime into real currency can be prohibitive	Mobile payments platform often costly to maintain; if a wrong number is typed and money gets credited to that account, it is very difficult to recover
Example	Take-it-Eezi and Hollard (South Africa), Max Vijay (India)	HDFC Ergo Revive (India)	Cover2go (South Africa), Safari Bima (Kenya) and AKSIttext (Philippines)	M-PESA (Kenya)
<i>Source: Authors.</i>				

The partnership between the South African insurance company Hollard Insurance and the rural vendor network Take-it-Eezi provides an example of **mobile phones used in client enrolment** (Smith and Smit, 2010a). Take-it-Eezi is a branding initiative that enables a network of 18 000 independent agents to sell prepaid airtime, electricity and insurance in areas that did not have access to these products before. Each vendor has a GPS-enabled mobile phone. For insurance sales, once the vendor has collected the client's first premium payment and provided the client with an insurance starter pack, the vendor uploads the policy number and the client's national ID number to a central server using Take-it-Eezi's payment platform operated through the mobile phone. Call centres are also involved in collecting more detailed client information during the enrolment process. In the case of Take-It-Eezi, following the receipt of the policyholder's identity and telephone numbers, a call centre operated by an insurance administrator, the Best Funeral Society, phones the client to collect detailed beneficiary information and/or provide more information on the product.

Similarly in Brazil, the technology company Vayon has developed a simple mobile phone enrolment system that enables the agent to send an SMS with the new customer's ID number to a national database, which then automatically populates the application form with the relevant data, including date of birth, employment and marital status and address. Not only does this streamline the enrolment process, but it also reduces data entry errors.

The advent of **smart card** technology means that clients can pay premiums without having a bank account. Smart card technology enables money to be stored on an integrated circuit chip, and payments can take place without the client having to be online or connected to a network. This is particularly important if microinsurance is to function effectively in areas with limited connectivity. For example, in India, customers of HDFC Ergo's Revive personal accident policy can pay their premiums using smart card technology provided by FINO.¹

Ordinary airtime is also being used to facilitate premium payments. Unlike smart cards, an airtime payment requires the client to be connected to the mobile phone network, so the client's phone can communicate with the payment intermediary (mobile network operator) or insurance company. A number of personal accident products have emerged using this approach, including by Metropolitan in South Africa (Cover2go), Kenya Orient (Safari Bima), and Philam Life in the Philippines (AKSItext – see Box 24.2). These policies can be initiated via text message, with the premium payment taking place through a deduction from airtime.

For both the Cover2go and Safari Bima products, a wireless access service provider (WASP) is responsible for converting the **airtime** into real currency. The experience of these two products indicates that the WASP takes a big bite out of the premium, as the commission can cost up to 40 per cent. While technology makes distribution of the product possible by enabling premiums to be paid, in this case it has a significant impact on the actual risk premium available to provide cover for the client (Smith and Smit, 2010c).

Box 24.2

Premium payments through airtime deduction: The case of AKSItext

Philam Life's AKSItext accident insurance product is purchased by sending a text message containing the individual's name, birthday and physical address to a specified number. Cover commences 24 hours after receipt of the confirmation message containing the individual's policy number. Premiums of US\$0.25 provide cover worth approximately US\$250 for 15 days, and are automatically subtracted from available airtime if airtime billing is prepaid, or added to the policyholder's postpaid bill. Claims are paid out directly from Philam Life offices by cheque that can be cashed at any bank.

Source: Adapted from Smith et al., 2009.

¹ Financial Information Network and Operations Ltd (FINO) is an India-based technology payments platform provider (see Box 25.6).

The fourth arrangement uses a mobile wallet or **mobile money platform** to facilitate premium payments via mobile phones. A mobile money platform, like M-PESA in Kenya (*see Box 24.4*), leapfrogs traditional banking and money transfer technology, and is particularly relevant in regions with little or no infrastructure where the population is largely unbanked. For insurance, it provides a convenient mechanism for premium collection, as illustrated by Syngenta Foundation's Kilimo Salama weather-index insurance product in Kenya (*Box 24.3*).

Box 24.3

Role of technology in sales and premium collection: The case of Kilimo Salama

The experience of Kilimo Salama clearly illustrates how technology can be used for different functions in making a microinsurance product viable. Kilimo Salama is an index-based agriculture insurance product that was piloted in March 2009, initially covering only 200 maize farmers and drawing on data collected by two weather stations. The project has since grown and now uses 30 weather stations and covers 22 000 farmers who grow maize, sorghum, cotton, beans and coffee.

Kilimo Salama (which means "Safe Agriculture" in Kiswahili) is a partnership between the Syngenta Foundation, Safaricom, the largest mobile network operator in Kenya, and UAP, a large general insurance company. The product covers farmers' agricultural inputs (e.g. fertilizer, seed and pesticides) in the event of drought or excessive rainfall. The product is index-based, meaning that payouts are triggered by rainfall amounts. During the planting season, actual rainfall is measured using a solar-powered weather station in each area. If rainfall is below or above predetermined thresholds, a payout is made. The value of the payout is a function of how much the recorded rainfall deviates from the threshold.

Kilimo Salama is sold through two channels: key accounts and retailers. For key accounts, the product is sold through corporate entities, including seed companies, cotton millers, banks and microfinance institutions, which have an interest in the insurability of agriculture yields and/or inputs. Through the retail channel, the product is sold on a voluntary basis through 110 agro-dealerships, which rely on technology to support the enrolment and premium collection process.

The administrative backbone of Kilimo Salama is a fully automated, paperless technology developed by the Syngenta Foundation, which uses mobile phones with tailor-made Java software as registration devices at the points of sale. The mobile phones transmit customer information to a central server using GPRS technology. The server in turn communicates with the insured farmer via SMS. The "backbone" technology is linked to Safaricom's M-PESA mobile payments platform to facilitate payment of premiums and settlement of claims.

The following steps highlight how technology supports enrolment:

- Farmers visit a local agro-dealer who offers Kilimo Salama for a premium related to their expected harvest or the cost of inputs purchased from the agro-dealer.
- If a farmer decides to buy Kilimo Salama, the dealer scans a bar code on the bag of seeds using a specially-designed mobile phone application.
- The application then informs the dealer of the premium the farmer should pay, which is currently between 5 and 15 per cent of the cost of inputs.
- The agro-dealer captures the farmer's details – name, mobile number and cover amount – on the dealer's mobile phone and transmits this information via GPRS to the insurer through a central communications server.
- The farmer then receives a text message with the policy number and cover details. Provision has been made for farmers who do not have mobile phones: the policy number and cover details are sent instead to the dealer's phone and the dealer then passes them on to the farmer.

Source: Adapted from Goslinga, 2011.

24.2.2 Loss verification and claims payment

Technology can be used to facilitate payments in the other direction as well, from insurers to policyholders in the form of claims. Claims processes are sometimes an afterthought in the development of new products and pilot tests, which tend to be more focused on marketing, sales and enrolment. However, effective claims procedures are absolutely critical to the success of micro-insurance, which must demonstrate to the low-income market that insurers will deliver expediently on their promises.

The actual financial transaction is a piece of the process. For example, the M-PESA e-money system is used to make payouts for various insurance products in Kenya (*see Box 24.4*). In Ghana, the partnership between Hollard and UT Life led to a mobile insurance product, Mi Life (*see Box 24.7*), which uses MTN Ghana's mobile payments platform to collect premiums and pay claims.

Technology also facilitates the claims process by making verification significantly less expensive for livestock, agriculture and property covers, and by improving access to benefits in the case of health insurance.

*Box 24.4***M-PESA mobile money product in Kenya**

M-PESA is the product name of a mobile payments platform operated by Safaricom, Kenya's biggest mobile network operator and a subsidiary of Vodafone. M-PESA, which means mobile money ("M" stands for mobile and "PESA" is Kiswahili for money) was launched in March 2007 by Safaricom with assistance from the UK Department for International Development (DFID).

Every M-PESA customer is required to open an electronic money account at an authorized M-PESA retail outlet. The electronic money account is linked to a mobile phone number and accessible through a SIM card application. Customers can deposit and withdraw money by exchanging cash for electronic value at a network of retail stores. Once customers have money in their accounts, they can use their phones to transfer funds to other M-PESA users, pay bills and purchase mobile airtime credit.

As at May 2011, there were a total of 14 million M-PESA customers served by a network of 28 000 retail outlets.

Source: Adapted from Mas and Radcliffe, 2010; M-PESA Resource Centre, 2011.

Livestock

In July 2009 IFFCO-Tokio, an Indian general insurance company, piloted a cattle insurance project targeting more than 25 000 poor farmers. As described in Box 12.2, the IFFCO-Tokio model uses RFID technology to reduce the occurrence of fraud that frequently occurs in traditional cattle insurance models where animal identification occurs via ear tags, which can easily be lost or removed. The RFID chip, the size of a grain of rice, is injected under the animal's hide. By helping reduce fraudulent claims, the technology can benefit farmers through faster claim settlement and lower premiums. While the project is still in its pilot stages, the claims ratio of 35 per cent is one-fifth of the claim rates experienced with traditional ear tags, suggesting that the new technology is working and may even pay for itself (Microinsurance Innovation Facility, 2011a).

Agriculture

The agriculture weather-index insurance product Kilimo Salama, described in Box 24.3, uses the amount of rainfall as a trigger for claims. During the planting season, rainfall is measured using solar-powered weather stations, which send the precipitation data via a GPRS connection to UAP. The insurer enters it into a weather-index application that outlines the rainfall requirements for each crop. The application calculates the claim percentage, if any, and then UAP transfers the claim amount to the M-PESA account of the farmer or dealer.

While Kilimo Salama's success is mostly attributable to the use of a familiar trusted technology, the mobile payments platform, to sell a less familiar and less-trusted product like agricultural insurance, the use of technology has also posed certain challenges:

- While weather station technology allows for the design of a viable insurance product, it also makes the product more complex to understand. Farmers are on average 20 kilometres away from the nearest station, which could lead to a misunderstanding by farmers as to whether they are entitled to a payout if the rainfall recorded on their farms differs from the local weather station. This basis risk (*see Chapters 4 and 11*) increases the need for appropriate and extensive client education.
- Multiple technologies are required to minimize the error margin in constructing weather indices. Reliance only on weather station data is unlikely to provide an accurate picture of the rainfall patterns experienced in a particular area. This is all the more difficult if weather stations are few and far apart. To overcome this challenge, Kilimo Salama is experimenting with satellite mapping systems, and devising better ways to collect and track yield data. This will allow for the cross-validation of weather data and the selection of more accurate product parameters.

Property

Stand-alone property cover is not a common microinsurance product. It is often added as a rider for other products, such as fire insurance for microenterprises linked to credit life (*see Chapter 9*). In South Africa, Hollard is trying to use technology to make a stand-alone version viable, selling it through call centres and using a network of “pre-assessment runners” that survey the assets covered by a household structure and content insurance product. The runners are equipped with mobile and spatial mapping technology to capture the state and location of the insured house and its contents. The pre-assessment of claims and data collection on policyholders' assets (i.e. confirming that the assets actually exist and recording the quality and nature of the building) helps to reduce fraud and the overall cost of claims management, while also overcoming the challenge of some clients not having formal addresses.

Health

In health insurance, where benefits are provided in kind in the form of healthcare services, technology has a very different role in facilitating claims. One way is to use technology to extend those benefits to remote areas. For example, instead of rural villagers spending time and money to go to a clinic to seek treatment, some schemes include a “dial-a-doc” benefit that provides some initial filtering to prevent unnecessary travel expenditure.

Besides call centres, ICTs can permit a remote diagnosis of clients' conditions, on the basis of which specific health care is then prescribed. CARE Foundation, a non-profit healthcare organization in India, is currently experimenting with hand-held devices for the remote diagnosis of patients with an outpatient insurance product. Village Health Champions (VHCs), staff members recruited from within the local community, are trained to use a hand-held device to collect biometric and symptomatic data of beneficiaries and then to transmit this to a doctor for remote diagnosis (Microinsurance Innovation Facility, 2011b). The use of this technology has the potential to reduce the cost of healthcare delivery dramatically.

Also in India, biometric smart cards are used by some mass health insurance schemes, such as Rashtriya Swasthya Bima Yojana (RSBY), which extend social protection to low-income households. Since the card is preloaded with the insured benefits, it gives policyholders the portability to access "cashless" benefits at all empanelled healthcare providers. Each hospital has an RSBY desk with a smart card reader, which uses the policyholder's fingerprint to verify their identity. Not only does this reduce fraud, but it can also improve health care through competition among providers, enhance customer services through shorter patient waiting times, and facilitate record-keeping and data analysis. These benefits, however, come at a cost. An analysis of RSBY's first-year data shows that 17 per cent of the premium went to cover the cost of the smart cards, whereas 49 per cent was spent on claims (Krishnaswamy and Ruchismita, 2011). Presumably, if the cards can be used for several years, then these costs can be amortized over time.

24.3

Transaction processing

Transaction processing is the middle layer of the information-processing chain, and relevant for all microinsurance products and types of organizations. Although client-interfacing technologies such as mobile phones and smart cards have the ability to fundamentally change insurers' interaction with clients, these potentially game-changing front-end systems will not fulfil their potential without effective back-end systems to manage information.

Software that assists in the collection and management of client and policy information, while linking different business operations (i.e. those of the insurer and the distribution partner), has had a major impact on all back-office business processes. Given the importance of this technology in microinsurance, several providers are selling both standardized and customized software, as illustrated in the Microinsurance Network's online database.

One of the most significant impacts of information technology for microinsurance today is in the area of transaction processing. It provides the analytical

and operations management technologies needed to support a large client base. As illustrated in Box 24.5, the software needs of organizations change over time as companies grow, diversify their offerings and expand capacity.

Box 24.5

Evolution of software systems at the DHAN Foundation

The Development for Human Action (DHAN) Foundation is an Indian grass-roots organization that builds thematic institutions to address key development issues, such as income generation and water management. This is achieved by testing innovative ideas, and scaling up successful ones through associated institutions. One of the goals of the Foundation is to enable poor communities to make positive changes in their livelihoods, with emphasis on member ownership, control and decision-making.

The DHAN Foundation has taken up ICT for the poor as a theme to experiment, develop and implement socially relevant programmes. It has become a cross-cutting theme to complement its microfinance, microinsurance and agricultural activities.

At the beginning of its interaction with technology, the DHAN Foundation intended to use commercially developed software for its microinsurance programme. However, after completing a pilot phase and considering the implications of many user licences, it decided not to use the software package, in part because the licence cost was equal to total premium income. DHAN therefore developed its own insurance system called social security software (SSS). Initially SSS was used only for the management of its life insurance scheme, but in 2005 a health insurance product was also introduced. Plans include the extension of the system to cover livestock and crop insurance. Staff salaries account for the largest portion of the DHAN IT budget. DHAN has an ICT team who maintain and further develop its in-house ICT systems.

DHAN Foundation's next step will be to develop a web-based system for its microfinance and microinsurance programmes. This system will link to mobile phones to streamline data entry, policy renewal and premium payment. It will also include customer service features such as voice and text messages about how much premium to pay and when to renew. It will have a smart card feature as well to link the scheme with empanelled hospitals and clinics.

Source: Adapted from DHAN Foundation, 2009.

The trend for transaction processing is away from local client-server and towards non-localized platforms, Internet-based solutions that are highly suited to integration with mobile devices. For example, Software as a Service (SaaS) is an Internet-based platform that is not managed by the insurance company, but

by a third party. The current SaaS offerings for microinsurance are still customized for each corporate client, which increases total costs; but as these services mature, solutions will be provided through a set of standard selectable modules. SaaS allows organizations to access business functionality at a cost that is typically less than paying for licensed applications, since its pricing is based on a monthly or annual usage fee. This is in contrast to traditional software, which is typically sold as a perpetual licence with a one-off up-front payment and small on-going support fees.

SaaS provides information to all levels of the microinsurance hierarchy, especially to the bottom of the pyramid. For instance, if it is integrated with mobile phones, customers can obtain real-time information on premium rates and cover levels, check policy status and receive premium reminders. SaaS can also be used to deliver online training to microinsurance agents as well as to provide them with information on new products or updates to existing ones.

ICT has also allowed for the emergence of administrators – organizations to which insurance companies can outsource policy administration to reduce costs. A prominent example of an administrator that is trading off the strength and efficiency of its MIS is MicroEnsure (*see Chapter 23*). MicroEnsure works with a range of client groups (e.g. MFIs, faith-based organizations and mobile phone companies) to facilitate product sales, for which it assumes responsibility for administration. Some of the more specific back-office services offered by MicroEnsure include product design, collection of clients' biographical data, data entry, management reports and claims processing. MicroEnsure also offers other services that do not involve transaction processing, such as training the sales staff of its distribution partners and conducting consumer education campaigns.

Probably the most widely used means of capturing or updating client information is call centre technology. Call centres now have the ability to unlock low-income insurance markets, as many poor households have access to a mobile phone and this medium of communication also enables them to use an interactive sales process. Although a call centre is generally viewed as a client-interfacing technology, it is in fact an integral part of the insurer's back-office systems. While many call centres operate via fixed line telephone, they are increasingly relying on voice over Internet protocol (VOIP) to reduce telecommunications costs. Clients can telephone the call centre directly, often via a toll-free number, or request that the call centre phone them by sending a "please call me" message to the company.

As the microinsurance market matures, there will be a greater need for data standardization. International efforts are under way to standardize data for management reporting across the financial services industry, notably the ACORD initiative for insurance (*see Box 24.6*). The most relevant similar initiatives for microinsurance are those based on the open standard eXtensible Business

Reporting Language (XBRL), a coding language developed to improve the efficiency and quality of data for financial and business reporting. The underlying principle of XBRL is to define the structure of financial information to be communicated between organizations. This is a key benefit in areas where there are many diverse organizations trying to share information in a global microinsurance marketplace. Data and workflow standardization efforts will simplify management reporting and allow a more flexible approach to building data analysis and modelling applications. Standardization will allow different players to exchange data with confidence and improve data quality in a cost-efficient manner, which will lead to better understanding of risk that can have a positive impact on better product development.

Box 24.6

Electronic data transmission standards: The case of the ACORD standards

The Association for Cooperative Operations Research and Development (ACORD) is a global, non-profit standards development organization that serves the insurance industry. ACORD facilitates the development of open consensus electronic data standards and standard forms, working closely with its members. ACORD members include insurance and reinsurance companies, agents and brokers, software providers and industry associations. ACORD works with its members to improve data communication across diverse platforms through the implementation of standards.

Common data standards and services improve data quality and transparency, resulting in greater efficiency and expanded market reach. For instance, ACORD standards make it possible for an insurance broker to obtain a price quote from a range of insurers for a personal motor policy at the same time. All the broker does is fill out a request for a quote and send out an eXtensible Markup Language (XML) message to multiple insurance companies (XML is a set of rules for encoding documents or data in machine readable form). The insurers respond by sending the quote back to the broker in XML formatted language.

In some cases, the ACORD standards facilitate compliance with requirements set by regulators. For example, ACORD is currently working with the South African Insurance Association (SAIA) to develop electronic data transmission standards for brokers and insurers to meet the data sharing requirements set by the South African insurance regulator.

It will become increasingly necessary to develop electronic data standards as microinsurance operations gain scale across the globe. The way data is communicated within and between companies will have to be standardized.

Source: Adapted from www.acord.org.

24.4

Data analysis

Data analysis is particularly relevant for microinsurance because one of the obstacles inhibiting insurers from servicing this market, or from providing fairly priced products, is the lack of data to accurately estimate the frequency and magnitude of insured events (*see Chapter 21*). As more data on the loss experience of low-income households is amassed and analysed, it will be possible for insurers to reduce the cost of uncertainty, which they have taken into account in the premium calculation.

Data mining is also useful for customizing products to market segments. The microinsurance partnership between the Spanish insurance conglomerate, Mapfre, and Codensa, a Colombian utility company, demonstrates how client information can be used in product development. Codensa captures extensive information on its electricity customers, e.g. income and regularity of payment, in a database specifically designed for this purpose. Using data analysis tools, Mapfre has developed products that are specifically tailored to the customers' available income. Codensa and Mapfre believe that this has been one of the drivers of the success of their partnership (Zuluaga, 2010).

Data mining to extract client features and behaviour for product design and pricing permits the development of products much more closely tailored to clients' needs, but it can raise privacy and identity theft issues. However, this can be overcome by requesting clients to "opt in" to an analysis of their data (Zurich, 2011).

Data analysis is particularly relevant for index-based insurance, which relies heavily on the collection and analysis of historical weather data to derive product parameters and determine payout triggers (*see Chapters 4 and 11*). Besides analysing historical data from meteorological services or universities, new technology can be used to monitor weather experience, trigger claims where relevant, and adjust products with additional years of weather data. For example:

- **Weather stations:** Weather stations that measure rainfall, temperature and wind speed can be established by public- or private-sector investors. While they were originally in the public-sector domain, private-sector investors are becoming increasingly involved. To complement India's public weather data service, private weather data providers such as Weather Risk Management Services (WRMS) and National Collateral Management Services Limited (NCMSL) are assisting in collecting weather data for a fee. NCMSL has installed 1 000 automated weather stations that produce real-time data used in the development of weather-index products.

The DHAN Foundation has a project that installs rain gauges at a distance of five kilometres from each other to assist in minimizing the basis risk in weather-index insurance products. The solar-powered rain gauges transmit rainfall data

via GPS to a central database at 15-minute intervals. By September 2011, 150 rain gauges had been installed covering about 6 300 farmers (Prashad, 2011).

- **Satellite imaging:** Satellite images can be used to collect different weather-related data. Satellites are able to capture images of cloud density that can be used for generating rainfall predictions (Prashad, 2011).

Another approach is to use normalized differenced vegetation indexes (NDVI), which are derived from data captured by satellite images permitting the measurement of vegetative “greenness” that correlates with photosynthesis levels on the ground. Such an approach is being tested by the International Livestock Research Institute in Kenya to provide cover to nomadic herders (*see Chapter 12*). A drawback of using this type of technology is that cloud cover can limit satellites’ ability to capture clear ground-level images, thereby disrupting the availability of continuous or regulator historical data (Hazell et al., 2010).

24.5

The promise of mobile phones

The use of mobile phones in the various microinsurance models clearly illustrates the powerful potential of this widespread technology. For instance, in 2011 close to 57 per cent of Africa’s adult population had mobile phones, ranging from a high of 84 per cent in South Africa to a low of 21 per cent in Mali (Gallup, 2011). Mobile phones make product purchases possible, permit premium payment through airtime deductions or via a mobile wallet, and facilitate claims assessment and payment.

Another critical feature for microinsurance is that mobile phones permit immediate communication throughout the value chain, cost-effectively bolstering the confidence of a sceptical market. Mobile technology provides the opportunity to communicate and collect data from clients. Through SMS and voice messages, insurance companies and their distribution partners can confirm to clients whether enrolment has been completed and their policy initiated, communicate information such as the need to have sufficient funds in their bank account available for the next premium payment, and advise whether a claim has been received and is being processed.

Both text messaging and voice communication are immediate forms of communication, permitting real-time responses from the insurers. In the case of the Max Vijay in India (*see Chapter 8*), clients were willing to trust confirmation of payment received via text message as much as a printed cash receipt from the merchant where they made their premium top-up. This helps to avoid fraud and, over time, builds trust in electronic communication as a replacement for paper-based and other communication methods.

Going forward, mobile technology may ultimately become more prominent in supporting the collection, validation and packaging of microinsurance

data. It will provide the benefit of turning data collection into a routine, low-cost and complementary activity that can eventually replace traditional market surveys. A dependence on mobile phones, however, involves certain risks, especially where a client's mobile phone is also their wallet and may provide access to private information. They can be easily damaged, lost or stolen, which could break the link between the insured and insurer; but this risk also provides an opportunity for insurers to offer additional coverage, for the mobile phone itself.

In March 2011, Ghana saw the launch of MiLife, the world's first fully mobile phone-based insurance product (*see Box 24.7*). The advent of this product holds a lot of promise for microinsurance delivery across the developing world.

Box 24.7

Mi Life mobile insurance in Ghana

Mi Life, the first fully mobile payments-based insurance product, was launched in Ghana in March 2011 on a pilot basis. The project is a partnership between MTN Ghana (a mobile network operator), MFS Africa (a mobile financial services technology provider), MicroEnsure, UT Life (a Ghanaian life insurer) and Hollard Insurance. Mi Life covers the lives of two beneficiaries, the policyholder and their nominated next-of-kin. An MTN subscriber who chooses to buy the product can expect to pay anything between US\$0.66 and US\$3 in monthly premiums. The associated cover ranges from US\$330 to US\$1 300 for the two lives.

Technology in policy initiation: With Mi Life, MTN subscribers who also have MTN Mobile Money can register for cover either through MTN's mobile money agents or directly through their phones. After initiating the policy, the subscriber receives an SMS confirmation that the policy has been activated. The SMS also contains a unique pin-code that serves as the customer's policy number. Customers use this pin-code to make amendments to or check the status of the policy using an interactive menu on their mobile phones.

Technology in premium collection: Premiums are automatically deducted monthly from the customer's m-wallet. Customers are reminded, via SMS, to keep their m-wallets topped up just before the payment is due. Once premiums have been deducted, the customer receives an SMS notifying them that cover has been renewed for the following month. Cover only lasts for a month, until the next month's premium is deducted.

Technology in claims payment: Claims can be initiated in one of two ways. In the first option, the customer sends an SMS to a specified number and the call centre immediately calls back with further instructions. With the second option,

the customer can walk into an MTN store where dedicated agents offer assistance. In both cases, supporting documents need to be submitted before claims can be processed. Payment is made into the customer's m-wallet and happens within two weeks of receiving supporting documentation (Gross, 2011a).

The mobile platform presents many advantages over traditional models of selling insurance. For instance, insurers can lower the cost of collecting premiums and paying claims. It is, therefore, not surprising that the monthly premiums for Mi Life are 50 to 90 per cent less than for comparable products in the market. In addition, since mobile phones are ubiquitous in Ghana, mobile money presents a massive and efficient distribution platform.

Using mobile phones to market insurance has many advantages besides lowering costs. For instance, the use of SMS reminders improves the communication flow between the insurance company and the policyholder and improves the persistency of premium payments. Secondly, it empowers customers to manage their policies in a cost-effective and easily accessible manner. The fact that customers can use familiar technology like the mobile phone for insurance purposes might help to fill the "gap" in low-income people's trust of insurance.

The Mi Life pilot in Ghana has allowed the insurer and intermediary, in this case Hollard and MicroEnsure, to learn about the impact and limits of technology in the business model:

- Despite technology's ability to lower client interaction costs, clients still prefer face-to-face interaction when given the choice. Subscribers can register for the policy via their mobile phone or through dedicated agents in MTN stores. The majority of subscribers opt for the latter option. Having someone explain the registration process and the workings of the policy seems to provide a degree of comfort, especially in a country where only 5 per cent of the adult population has some insurance cover (FinMark Trust, 2011).
- The success of products like Mi Life relies on having a mobile payments platform that works well. The platform needs to be improved continuously to ensure that it remains user-friendly and also needs regular maintenance, especially as mobile insurance operations expand. The extent to which this can be done is constrained by the resources that a mobile network operator (MNO) can dedicate to this purpose. As long as voice calling remains the primary revenue generator for most MNOs across the developing world, funds to invest in ancillary services will be limited.

Sources: Leach, 2011; MicroEnsure, 2011.

24.6

Conclusion

Technology promises to increase efficiency and enable providers to attain scale by integrating various operations across the value chain, including the insurer and its distribution partner. It promises to lower administration costs, reach remote clients, collect premiums and pay claims, but can also fulfil other functions such as product development or communications.

The spread of mobile phones has had a massive impact on the communication function fulfilled by technology in microinsurance. Insurance companies can communicate instantly with their clients through every step of interaction, from policy initiation to policy adjustment and claims, through text messages as well as voice communication. Furthermore, money transfer in both the premium collection and claims payment processes has been revolutionized by smart card and mobile wallet technology.

It is important, however, to emphasize that technology is no panacea when it comes to microinsurance. The ability of technology to impact positively on microinsurance business is directly dependent on the strength of the business model, the relationship between the risk carrier and its distribution partner (where applicable), and existing internal systems and operations.

In this context, microinsurance can learn valuable lessons from microfinance. For example, some MFIs had been under the impression that technology would assist in solving their problems, but neglected to map and clean up their business processes before installing the systems. This decreases the efficacy of the MIS and its impact on their overall business, and may lead to a view that it has not delivered the benefits it promised. In the absence of strong and efficient back-office systems and processes, interesting or “sexy” customer interfacing technology is unlikely to be successful.

While technology can make the life of a microinsurer easier, it also poses a variety of challenges. Once the investment in certain technology has been made, it is difficult to overturn the decision. It is thus important for the microinsurer or its distribution partner to take a forward-looking perspective when making the investment; otherwise, there will be a risk of technology becoming a business constraint.

Furthermore, while technology has the potential to lower costs throughout the value chain, in certain cases it can actually end up increasing costs, as in the example of insurance premiums paid through mobile phone airtime. In making the technology purchase decision, it is therefore important to seek a balance between the improvement in customer service and overall efficiency on the one hand, and the cost of purchase on the other (Fuller, 2011).

Technological innovation has the potential to revolutionize the delivery of microinsurance. In achieving this goal, it is important to bear in mind that the selected technology does not necessarily have to be complex, but should merely be able to respond flexibly to the needs of the microinsurer, its distribution partner and clients. This will require intelligent diagnosis of areas where technology can best make a contribution, followed by focused implementation.

25 Access to insurance and financial-sector regulation

Arup Chatterjee

The author appreciates the insightful input and guidance provided by numerous reviewers, including Hennie Bester (Cenfri), Rodney Lester (consultant), Dirk Reinhard (Munich Re Foundation), Craig Thorburn (World Bank), Martina Wiedmaier-Pfister (consultant to GIZ) and Henry Yan (Access to Insurance Initiative).

The G-20's call for the promotion of regulatory and policy approaches to enhance financial access, financial literacy and consumer protection in 2010 represented a paradigm shift for the international financial community. It is increasingly acknowledged that any measure to stimulate economic growth and stabilize the financial system must be coupled with greater efforts to tackle the structural problems of extreme poverty and inequality, particularly in developing countries (Matsuura, 2009). The recognition and importance given to financial-sector development and inclusive growth has encouraged the G-20 to task international standard setting bodies with considering how they can further contribute to financial inclusion (G-20 Communiqué, 2010). This heightened visibility of financial inclusion on the global agenda has lent significant backing to national policy and regulatory initiatives in many countries.

The issue before policymakers and regulators is to develop a framework that will enable the financial system to deliver affordable services efficiently to the excluded population without compromising systemic stability. The focus should be on enhancing the scale, quality and sustainability of diverse and relevant financial services for the poor, while offering a high degree of consumer protection through prudential supervision and the right incentives.

This chapter draws on international research and discussions on financial inclusion to explore how sound policies and regulations can pave the way for the development of efficient, sustainable and stable insurance markets for the poor. It further explains why a well-regulated insurance market could offer protection against risk and contribute to poverty reduction beyond the combined impact of public safety nets and existing informal mutual support systems. To present this argument, the chapter answers six questions:

1. Why does financial inclusion include insurance?
2. Is there a trade-off between the prudential role and the developmental role?
3. What have been the various regulatory interventions to facilitate access to insurance?

4. What has been the approach towards the treatment of informal providers and mutuals, cooperatives and community-based organizations in providing insurance?
5. What is the approach to alternative distribution channels and entities providing innovative and low-cost solutions for financial inclusion?
6. What are the important consumer protection issues to be considered when expanding access to insurance?

25.1

Financial inclusion and insurance

While there appears to be consensus on the importance of financial inclusion, the same consensus does not exist around its definition. Financial inclusion should improve the range, quality and availability of services to those currently excluded by the financial system. However, financial inclusion is often perceived as synonymous with giving people access to banking in rural areas. One tends to forget that large segments of the urban population are also excluded from the formal financial system, and access means more than the ability to obtain loans – financial services are needed to smooth consumption across time, diversify risks and secure livelihoods.

Indeed, the evolution from microcredit to financial inclusion has three implications. First, the target market is broader than just micro- and small enterprises; it includes all low-income persons. Second, the demand from low-income households for financial services includes a number of products, such as savings, loans, remittances and insurance. Lastly, a range of organizations, including non-governmental organizations (NGOs), financial cooperatives, commercial and state-owned banks and non-bank financial institutions, could provide efficient and affordable access while generating sufficient revenues to make their distribution networks sustainable.

The International Association of Insurance Supervisors (IAIS) defines micro-insurance as any form of protection against risks that is designed for and accessed by low-income people, provided by different categories of carriers but operating on basic principles of insurance and funded by premiums (IAIS, 2007). This definition leaves the door open to a range of institutional arrangements that should ideally be in the purview of the insurance regulatory authority. Since consumer protection for the low-income segment of the population is particularly critical, an insurance supervisor that can oversee all insurance activities is an important ingredient for maintaining trust in the insurance system (McCord et al., 2008).

Exposure to risk results in households' consumption being highly volatile over time, perpetuating the cycle of poverty (Elbers et al., 2007; Dercon et al., 2009). But how can policymakers address this issue? In 2008, the Committee on

Financial Inclusion in India observed that microcredit without microinsurance is bad financial behaviour. From a policy perspective, financial inclusion must include access to payments, credit, savings and insurance to achieve effective and sustainable results. Adopting an integrated approach is critical to accelerating the delivery of financial services to marginalized and low-income groups through a variety of strong and dynamic institutions, in both the public and the private sector.

25.2 Prudential role and developmental role – is there a trade-off?

Insurance supervisors traditionally perform important social and economic functions and contribute to long-term stability with two objectives:

- 1) **Prudential:** To ensure that the liabilities under insurance contracts can be fulfilled at all times; and
- 2) **Market conduct:** To ensure that the interests of the insured are adequately safeguarded.

Significant importance is attached to prudential supervision (financial soundness) to ensure that insurers remain solvent so that they can honour their contractual agreements over time. In particular, insurers must establish adequate technical provisions, invest their assets safely and profitably, and observe the principles of good business practice.

Recently, a third objective has emerged: the development role of insurance supervisors to increase the availability and affordability of insurance. This new role ranges from developing the necessary institutions and market infrastructure for a modern financial system to strengthening the foundation of the economy. The intention is to expand the insurance market through innovations in distribution and product structure, and the use of new technologies, to reach unserved segments of the population. This new dimension imposes onerous responsibilities on regulators to motivate political and economic agents to participate in a functioning market, and then to supervise that market.

Adding a developmental role to the traditional mandates raises the question of whether there is a trade-off between outreach and sustainability, between the financial inclusion agenda and the regulator's traditional mandate. And, if so, how can it be managed? On the surface, there appears to be an inherent conflict between the two. For example, regulations that are intended to promote stability, such as capital and solvency requirements, can result in high compliance costs that could push smaller and more innovative insurers with a development agenda out of the market.

Prudential supervision is concerned with the effective monitoring and mitigation of risk. Yet development focuses on facilitating business innovation and enterprise, which often entails taking risks. This conflict is healthy if it provides incentives for discussion about the future; it can also be debilitating if interest groups become entrenched in irreconcilable positions. Regulation involves using sets of rules, standards and codes of practice that are generally tried and tested techniques, while development through innovation may require new rules and standards. Schumpeter (1942) used the term “creative destruction” to describe the development process. In creating new knowledge, rules and standards, old ones must be dispensed with or adapted. Herein often lies the conflict between development and regulatory processes.

However, in a deeper sense, regulation and development are not incompatible. In fact, they are complementary. A well-regulated and supervised financial-services sector is not an end in itself. A regulator promotes financial soundness because it is a vital component of economic growth and development. Financial institutions enter the market in large part because the regulatory regime offers a well-regulated, stable and sound financial system. Thus, supervision and development work hand in hand to promote a sound and progressive financial-services sector.

To understand the development role of the insurance regulator, a broader view of the insurance business and its role in economic development is also needed. Effective coordination between the supervisory and development roles is vital, so that rules or regulations can be business-friendly without undermining the basic tenets of good supervision. As illustrated in Box 25.1, the delicate balance between the supervisory and developmental roles is best achieved within one organization with a shared purpose rather than through separate agencies with possibly conflicting goals.

There are several synergies between financial stability and financial inclusion as it pertains to insurance. Zingales (2009) notes that regulation plays a key role in bolstering trust in insurance and is an important factor in the development of a nascent industry. From a prudential perspective, proper access to insurance is not possible if entities that accept insurance premiums are not well regulated. Furthermore, for an insurance industry to experience healthy growth, it needs to have a strong and stable foundation. Huge volumes of small policies can form such a foundation because they do not represent a concentration of risk, and they should have a stable claims experience due to the law of large numbers.

*Box 25.1***Taking active steps to develop a microinsurance market in India**

When India's insurance regulatory body was established in 1999, it was named the Insurance Regulatory and Development Authority (IRDA), reflecting the strong developmental role that the Government envisaged for the regulator to support the orderly growth of the insurance market. This approach resulted in a large and dynamic microinsurance industry through insurance legislation compelling companies to sell insurance to the "rural and social" sectors, which is roughly equivalent to microinsurance.

As described in Chapter 20, the growth of microinsurance in India, and the proliferation of innovation in distribution, product design and product range, has been heavily influenced by the IRDA's development role. Although some insurers perceive the mandates as a cost of doing business, the regulation did send important signals to induce the industry to discover the low-income segment.

However, approaches need to be evaluated carefully to ensure that insurance providers have a genuine business interest and that the Government's policy creates a sound and sustainable market. Critics of the rural and social sector mandates often do not realize that many insurers have regularly exceeded their targets. To assess whether such an approach would be effective in other countries, it is important to consider whether the insurance products are viable and whether they are providing value for money, by analysing the surrender and lapse rates and utilization levels.

Source: Author.

To balance this potential trade-off, policymakers have an important role in creating the right incentives and competitive environment for financial institutions to respond to the opportunities in financial inclusion. If insurers and intermediaries are to take advantage of this prospect, they must achieve economies of scale. This requires markets to grow to an optimal size, which is not possible without capital. Investors and lenders are comfortable providing more funds only if such entities are well regulated. In other words, a sound regulatory and policy framework for insurance also plays a key role in encouraging investment.

As summarized in the introduction to this volume, access to insurance has positive effects on the economy in that it narrows development imbalances, complements social safety nets, reduces high precautionary saving, stimulates domestic demand, increases infrastructure spending and enhances public-sector and corporate governance – all leading to higher overall economic efficiency. With the right reforms, the insurance sector can be an important vehicle for

encouraging enterprise to enhance social well-being. Innovation should continue to be encouraged while ensuring that the complexities are understood, the risks are mitigated and there is reward for those willing to take risks (Mukherjee, 2011).

25.3

Regulatory interventions through enabling policy frameworks

A framework for financial inclusion needs to comply with international standards. The insurance industry follows the IAIS's Insurance Core Principles (ICPs) and the accompanying standards and guidance.¹ The ICPs generally provide sufficient flexibility to be adapted to national circumstances. However, the relationship between international standards and financial inclusion is often not well understood and there is scope for better elaboration and guidance.

To achieve this, in 2005 the IAIS and the Microinsurance Network created a joint working group to provide a platform for policymakers, regulators and development practitioners to share experiences. The active involvement of these players has contributed to the development of a growing body of knowledge in the regulatory, supervisory and policy aspects of microinsurance, including the development of guidance to apply the ICPs in support of financial inclusion.

Also emerging from the labours of this joint working group is the Access to Insurance Initiative (*see Box 1.4*). Launched by IAIS and development partners in 2009, the Initiative facilitates financial inclusion by promoting the effective and proportionate regulation and supervision of insurance markets. Since its inception, the Initiative has carried out a systematic analysis of the microinsurance sector in several countries to provide information in support of constructive policy recommendations. The evidence available so far has helped in outlining the key levers of a prudential regulatory framework that supports the sustainable expansion of microinsurance, as summarized in Figure 25.1 and discussed in detail throughout the rest of this chapter. These levers are also consistent with the G-20 Principles for Innovative Financial Inclusion (*see Table 25.1*) – a reflection of how an enabling policy and regulatory environment can spur innovation for financial inclusion while ensuring financial stability and protecting consumers.

¹ For details on the Insurance Core Principles and related standards and guidance, see www.iaisweb.org.

Table 25.1

G-20 Principles for Innovative Financial Inclusion: Country examples from the insurance sector

1. Leadership: Cultivate a broad-based government commitment to financial inclusion to help alleviate poverty.

China

- All work done by the Government is aimed at enabling the people to “lead a better-off and dignified life”, and making society more impartial and harmonious.
- The China Insurance Regulatory Commission (CIRC) is currently facilitating the market development of microinsurance by encouraging insurers to undertake pilot projects in rural areas.

India

- Innovation in terms of distribution and product range has been heavily influenced by the development role of the IRDA (see Box 25.1).
- “Obligations of Insurers to the Rural and Social Sectors” requires all insurers to satisfy specific targets.

2. Diversity: Implement policies that promote competition and provide market-based incentives for sustainable access to a broad range of affordable financial services provided by a diversity of service providers.

India

- IRDA has relaxed agent regulations for microinsurance products, promoted links between regulated insurers and NGOs and self-help groups, and permitted the sale of composite insurance products.
- Self-help groups are allowed to collect proposal forms, collect and remit premiums, carry out policy administration services and assist in the claims settlement process, and are therefore remunerated at a higher level than conventional insurance agents.

Peru

- Microinsurance regulation broadens the type of organization that could be agents, e.g. microfinance institutions, trade unions and others (see Box 25.3).

3. Innovation: Promote technological and institutional innovation as a means to expand financial system access and usage, including by addressing infrastructure weaknesses

India

- Allowed innovative technology solutions by FINO (see Box 25.6) including biometric-enabled smart cards and a portable point-of-sale terminals.

Kenya

- “Kilimo Salama” utilizes mobile phone technologies and the expertise of farmers and rural business persons to provide reliable, low-cost cover for excess or lack of rain (see Box 24.3).
- Uses a low-cost, mobile phone payment and data system and automated solar-powered weather stations to offer farmers affordable, “pay as you plant” insurance to protect their investment in high-yielding seeds.

4. Protection: Encourage a comprehensive approach to consumer protection that recognizes the roles of government, providers and consumers.

South Africa

- Legislation prescribes minimum standards in respect of business practice, policies and policyholder protection.
- A dedicated Consumer Education Department that has various initiatives in place to educate consumers.
- Media releases to warn against unregistered operators.
- Insurance industry associations have established ombudsman schemes.

India

- Policyholder protection regulation, which takes care of all aspects of policyholder protection in the insurance value chain.
- Insurance ombudsmen in 12 cities to take care of consumer grievances.

5. Empowerment: Develop financial literacy and financial capability.

Ghana

- The National Insurance Commission supports literacy work including a focus on the low-income segment.

India

- IRDA has a comprehensive advertising strategy to promote consumer awareness on insurance in print and electronic media in 13 regional languages.

6. Cooperation: Create an institutional environment with clear lines of accountability and coordination within government; and also encourage partnerships and direct consultation across government, business and other stakeholders.

Philippines

- Insurance Commission has issued a separate set of rules, together with the Securities and Exchange Commission (SEC) and the Cooperative Development Authority (CDA), to stop “informal insurance” or “insurance-like schemes” offered by different organizations (see Box 25.5).

Brazil

- SUSEP has set up an interdisciplinary Microinsurance Commission comprising of government entities, insurance industry and academia (see Box 25.2).

7. Knowledge: Utilize improved data to make evidence-based policy, measure progress and consider an incremental “test and learn” approach acceptable to both regulator and service provider.

IAIS’s global approach

- Since 2006, the IAIS, in cooperation with the Microinsurance Network, has been active in facilitating learning between policymakers from over 40 countries and prepare guidelines for developing microinsurance that are consistent with international standards.

8. *Proportionality: Build a policy and regulatory framework that is proportionate to the risks and benefits involved in such innovative products and services and is based on an understanding of the gaps and barriers in existing regulation.*

Philippines

- The Insurance Commission has adapted its regulation of mutual benefit associations (MBAs), creating a new tier of “Microinsurance (MI) MBAs”.
- Simple products, stipulated requirements to comply with performance standards, and defined eligibility criteria for microinsurance based on the benchmark of the minimum daily wage for non-agricultural labourers.

West Africa (UEMOA)

- The UEMOA legislation has developed a multinational framework that allows mutual social health organizations to underwrite health insurance using simplified accounting requirements.

9. *Framework: Consider the following for the regulatory framework: reflect international standards and national circumstances, and foster a competitive landscape; introduce an appropriate, flexible, risk-based regime to combat money laundering and the financing of terrorism (AML/CFT); lay down conditions for the use of agents as a customer interface; create a clear regulatory regime for electronically stored value; market-based incentives to achieve the long-term goal of broad interoperability and interconnection.*

India

- Regarding “know your customer” (KYC) requirements, norms have been relaxed by the exemption of microinsurance clients from the requirement to submit a recent photograph and proof of residence for life insurance policies held by a single individual up to a total annual premium of INR10 000 (US\$220).

Figure 25.1

Regulatory and supervisory levers to enhance access to insurance

Policy guidelines

- Take active steps to develop a microinsurance market
- Adopt a policy on microinsurance as a part of the broader goal of financial inclusion

Prudential guidelines

- Define a microinsurance product category
- Tailor regulation to the risk character of the microinsurance product category
- Allow microinsurance underwriting by multiple entities
- Provide a path for formalization of informal and unregulated insurance providers

Market conduct guidelines

- Create a flexible regime for distribution of microinsurance
- Facilitate the active selling of microinsurance

Supervision and enforcement

- Monitor market developments and respond with appropriate regulatory adjustments
- Use market capacity to support supervision in low-risk areas

Source: Bester et al., 2009.

Take active steps to develop a microinsurance market

By working with market participants and other cross-sector regulators, insurance supervisors can facilitate the competitive provision of insurance to low-income households and small firms in an efficient and effective manner. This requires research to identify the obstacles inhibiting market development, including supply and demand issues, as well as possible regulatory challenges, and then dialogue among key stakeholders to identify possible solutions.²

² For more details how to conduct such a review, see the Access to Insurance Initiative’s Toolkit No. 2 (Bester et al., 2010).

*Box 25.2***Developing a national microinsurance strategy: The Brazilian experience**

In April 2008, Superintendência de Seguros Privados (SUSEP), the Brazilian insurance authority, constituted a Microinsurance Consultative Commission with representatives from the public sector (SUSEP, Ministry of Finance, Central Bank and Ministry of Social Security) and private sector (Insurers Federation, Brokers Federation and the National School of Insurance). The objective was to develop and implement a suitable regulatory framework for the development of microinsurance. The participation of other government bodies in the process broadened the awareness of those responsible for defining policies that affect the insurance sector. A Working Group on Microinsurance was also constituted within SUSEP comprising technicians from different departments (e.g. actuary, statistics, on-site and off-site supervision) to support the Commission.

The Commission produced reports on the definition of “microinsurance” and “low-income population” in Brazil, identification of regulatory barriers, identification of stakeholders and their roles, and microinsurance products and parameters. The Commission’s proposals were presented and discussed at two workshops with stakeholders in September and December 2009 before finalization.

In parallel, a Microinsurance Bill was also introduced in the Brazilian Congress in April 2008. In line with the Commission’s proposals, SUSEP recommended changes to the Bill, which were duly incorporated. If passed, the Bill will create categories for “microinsurance brokers” and “microinsurance correspondents”, and grant a specific licence to sell microinsurance. The Bill also proposes to create a special tax regime for microinsurance operations and for employers who contract insurance for their employees, which will dramatically reduce the tax burden on microinsurance.

Following the appointment of the new Insurance Superintendent in 2011, most of the provisions of the draft Microinsurance Bill, with the exception of the tax provisions, have been incorporated in a draft Resolution of the National Council of Private Insurance (Conselho Nacional de Seguros Privados).

Source: Adapted from Simões, 2010.

Adopt a policy on microinsurance

For most developing countries, the reform agenda – to develop an institutional and legal basis to underpin the expansion of microinsurance – needs to be outlined as an integral part of financial sector policy. A range of approaches can be chosen to address regulatory, market infrastructure and competitive barriers to expanding insurance markets, including a proactive approach by the government to inclusion issues, openness to innovation, fostering broad-based alliances, stimulating private-sector interest, offering supportive services such as financial edu-

cation and payment system infrastructure, gathering and providing data on the frequency and severity of losses, and paying careful attention to proportionality.

All of these approaches can contribute to the development of a relevant public policy on inclusive insurance, as undertaken by several countries in recent years. For example, as described in Box 25.2, Brazil has made a public commitment to microinsurance. Through stakeholder dialogue, the authorities have demonstrated leadership in pursuit of microinsurance policies to establish and promote fair competition and initiate market development. In doing so, they have attempted to improve their understanding of the existing and potential market for insurance.

Define a microinsurance product category with lower risk

In most microinsurance markets: (1) products tend to entail lower risk than conventional insurance products, as well as lower benefits, with few exclusions; (2) policy terms tend to be short, often one year or less; (3) the risk events covered are relatively predictable and the financial impact of each event relatively small; and (4) the terms of the policy tend to be simple, so they are easy for the market to understand and avoid complex underwriting processes. Microinsurance is often sold on a group basis and does not require individual underwriting. Regulatory burdens that inhibit the growth of microinsurance, but cannot be reduced across the board, can normally be addressed by defining a product category based on these characteristics, which will systematically lower risk, reducing prudential and marketing conduct regulations.

The rationale for defining a product category for microinsurance is to allow differential treatment. As described in Chapter 1, definitions can be related to various factors including the product, the target group and even the provider or distribution channel, and they can be either qualitative or quantitative (*see Table 25.2*). Qualitative definitions are usually appropriate for broader financial sector policy statements. A quantitative definition of the cover, based on premium amount or sum assured, for example, may be necessary to delineate a microinsurance business line. When defining the product category, the scope should be as wide as possible in terms of perils covered as well as maximum benefit levels. However, quantitative definitions can be problematic for insurers and supervisors to administer. If it cannot be avoided, a quantitative definition needs to align the resulting business profiles with the expected proportionate regulation and supervision.

It is also important to consider how the definition will affect insurance providers, as illustrated by the experience in Peru (*see Box 25.3*). The product definition should encourage insurance penetration into the low-income market while maintaining operational integration with the insurance industry. It also needs to provide an easy mechanism to adjust benefit levels in tune with inflation and market changes.

Regulatory definitions of microinsurance products

	India	Philippines	Peru (3/2007–9/2009)	South Africa (proposed)	Brazil (proposed)
Target group	IRDA defines the rural sector as: – a population of less than 5 000; – population of less than 400 per square kilometre; and – more than 25 per cent of the male working population engaged in agricultural pursuits RSBY defines its target population as: – BPL workers in the unorganized sector and their families	The disadvantaged who need risk protection and relief against distress of misfortune	1.1 million people, with access to basic financial services, who do not live in extreme poverty but are nevertheless poor	The low-income population, otherwise known as the mass market	The population with per capita monthly income of up to two minimum wages in the formal or informal sectors of the economy
Product definition	Life: – Maximum sum assured US\$1 230 – Minimum sum assured US\$123 – Age: >18, <60 – Term: >5, <15 years term life Non-life: – Maximum sum assured US\$740 – Minimum sum assured US\$12	Life: – Maximum annual premium: Five per cent daily minimum wage for non-agricultural workers in Manila, currently US\$25.5	Cover life and asset insurance: – Maximum premium US\$3.30 – Maximum sum assured US\$3 300 – Maximum grace period of 30 days Distinguishes between group and individual	Asset insurance: – Maximum summed assured US\$12 500 Other micro insurance: – Maximum sum assured US\$6 250 – Cover is limited to risk only	Specific parameters to be set proposed legislation: – Need for simplicity – Targeting of microinsurance market – Product parameters
Provider definition	No concessions Composite life and non-life micro-insurance products allowed, but separate insurers must underwrite the risk Progressive rural and social sector obligations for providers (<i>see Box 20.1</i>)	Capital requirements: – Commercial insurers: US\$24m – Cooperative insurers: Insurance Commission may reduce this requirement by up to half – Existing MBAs: US\$305 000 – New MBAs: US\$3m – Microinsurance MBAs: US\$122 000 to be phased up over time	No concessions	Lower capital requirements for a dedicated microinsurance company: – Subject to a minimum capital requirement of US\$375 000 – Minimum of US\$187 500 will apply to those institutions to be phased up to US\$375 000 over three years	– Specialized microinsurance firms – Existing insurance can create separate microinsurance divisions
Distribution channel	Distribution through qualifying microinsurance agents, must be non-profit, e.g. NGOs Commission cap of 10 to 20 per cent, depending on premium payment	Microinsurance agent or broker category created Subject to a special training programme and qualifying exam	Opening up of distribution channel beyond traditional insurer-agent model	– Uncapped commissions – Reduced minimum skills level in favour of training requirements – No advice required – Simplified and clear language disclosure requirements	Microinsurance correspondents and broker category created

Source: Adapted from Hougaard et al., 2011

*Box 25.3***The evolving definition of microinsurance in Peru**

Superintendencia de Banca, Seguros y AFP (SBS) in Peru introduced its first specific regulation on microinsurance in 2007 to promote the provision of affordable insurance to the low-income population.

In terms of product attributes, the regulation was applicable to products that did not exceed US\$3 300 cover limit or US\$3.30 monthly premium. The focus was on simplicity and the insurance needs of the target market. Deductibles and co-payments and any prior assessment of the insured values at the time of underwriting were prohibited. A list of acceptable claims documents was also to be specified in a simplified policy document. To assess compliance with these criteria, all microinsurance products were to be filed and reviewed by the insurance regulator before being marketed to the public.

In the event of a claim, the policyholder was required to notify the agent or the sales clerk, who in turn acted as the interface between the policyholder and insurance company. The insurer had the option to pay the claim through the agent or directly to the policyholder. If the claim was rejected, the policyholder had the option to make a complaint through the agent, and the insurer was required to resolve complaints within 15 days.

To reduce costs, marketing through alternative distribution channels (e.g. sales clerks, MFIs, savings and credit cooperatives, and social organizations) was allowed in a partner-agent relationship. These channels had access to the low-income population and were capable of collecting premiums and quickly handling claims. They were also responsible for explaining the insurance benefits and costs to their clients. Innovative techniques for offering more tangible insurance benefits (e.g. tickets or certificates, regular visits and reports to customers, and payment in goods and services) were also introduced. The insurers were ultimately responsible for the management of risks and regulatory compliance.

When implementing the regulation, the SBS did not see the volume of activity that it expected, and soon realized that regulatory caps on prices and benefits acted as obstacles to developing microinsurance products. Therefore, in consultation with the industry, in 2009 a new regulation removing limits on cover or premiums was introduced to provide a further boost to the market. Microinsurance is now expected to respond to the protection needs of specific groups. Exclusions can be introduced, if necessary, but are to be kept at a minimum and should be commensurate with the cover. Minimum information requirements for the simplified contracts and documents that insurance companies or intermediaries need to provide to the policyholders as proof of cover have also been set out.

The functions which intermediaries can perform have been expanded and they are now permitted to collect premiums, attend to claims and pay benefits on behalf of insurance companies, but they have now also been made accountable

for any deficiency in these operations. Reporting has been simplified and providers now only need to furnish the SBS with a quarterly report detailing the number of policyholders, premium volume and claims. In addition, a “file and use” product approval process is now used and if SBS has no objection the insurer can market the product. The impact of these changes has been significant, as they have facilitated access to insurance for low-income women, farmers and entrepreneurs through NGOs, MFIs and banks.

Sources: Adapted from Gomez, 2007; Burns and Caceres, 2010; Villegas, 2010.

Despite efforts to keep microinsurance products simple, the promotion of financial inclusion has also introduced more complex products, such as index-based insurance (*see Chapters 4 and 11*) to manage risks in rural areas, where farmers are vulnerable to weather risks or other natural events. The complexities of contract design and basis risk are significant constraints for such products. In many countries, the laws and regulations necessary to accommodate index-based products are simply not in place. Such regulation will need to be consistent with international standards to improve insurers’ chances of gaining access to reinsurance and other alternative risk transfer instruments.

Proportionality – Tailor regulation to the risk character of the product

Under a proportional regulatory framework, requirements vary with the benefits and risks associated with the insurer or the intermediary, providing regulators with the flexibility to tailor prudential and market conduct regulations to the characteristics of the market. Regulators should consider developing rules proportionate to the risks incurred for microinsurance that reflect the limited business risk and enable smaller players that cannot comply with one-size-fits-all regimes to participate. Proportionality in regulation can be accomplished, for example, by correlating requirements with the differing levels and types of risk involved.

When revising regulation, policymakers should consider the extent to which current regulations inhibit the underwriting and/or distribution of insurance products for low-income markets. High compliance costs could prevent the entry of new providers, squeeze out those attempting to introduce new business models, products and services, or force customers to use informal providers. A balance needs to be struck between reducing the compliance burden and maintaining sufficient standards to protect clients.

Allow microinsurance underwriting by a number of entities – A tiered approach

In countries where the legislation allows, regulators generally opt to provide regulatory exemptions for a microinsurance line of business. Existing insurers (or

new insurers able to comply with the existing entry requirements) can then offer microinsurance products because of the reduced requirements. This would typically include an adjustment to market conduct regulations, for example by exempting microinsurance product lines from commission caps or allowing alternative distribution channels to be used for sales. This approach, however, generally restricts the universe of providers to companies that are already licensed.

Regulators in some countries have preferred to go for a more extensive intervention by creating a second tier of insurance licence regulatory requirements tailored to microinsurance. Tailored capital, solvency and investment requirements can be stipulated to facilitate the entry of dedicated insurance providers that wish to participate in this niche market (*see Box 25.4*). The supervisor may prescribe less costly risk management and underwriting systems that are within the capacity of smaller operators. Moreover, since life and non-life microinsurance business is often underwritten on a short-term basis, and since single channel distribution reduces cost and promotes positive insurance discovery, a few countries are considering the removal of the demarcation between life and non-life for microinsurance.

Box 25.4

Proposed framework for dedicated microinsurance companies in South Africa

The South African Government plans to introduce a dedicated legislative framework to foster the provision of low-cost, simple and standard insurance. Detailed policy proposals for a microinsurance regulatory regime were mapped out in a paper released by the Treasury in July 2011, with the goal of broadening access to insurance for low-income earners.

Microinsurers would have their own dedicated licence and be subject to lower capital requirements and less onerous regulations. The compliance regime for microinsurance licences will be lighter than for other insurance products because of the lower risks. For a policy to qualify as microinsurance, the benefits payable must be capped at R50 000 (US\$6 200) per individual risk per year for life products and R100 000 (US\$12 400) for asset products; the term of the contract cannot exceed 12 months; and the product is limited to risk only, excluding savings.

Unregistered insurance businesses such as burial societies, funeral parlours and those involved in “assistance business” would be expected to become formalized, while formal insurers could take out a dedicated licence to enter microinsurance. The new regime is expected to combat the abuse of consumers, particularly by funeral parlours.

Source: Adapted from National Treasury, 2011.

Allow microinsurance underwriting by a number of entities – Cell captives

Cell captives are another institutional arrangement that could facilitate the provision of insurance to low-income markets (Aliber, 2003). Cell captives are formed when a client company (e.g. an MFI or other aggregator) either buys shares in an insurance company that have been set aside for this specific purpose, or pays a fee to rent a captive cell. These arrangements allow the client company to rely on the insurer for its expertise and its insurance licence, while the client participates in the underwriting profits and losses. Such an approach would be relevant for large group schemes or if a provider wants to offer niche products that are not available in the market.

Despite these advantages, a cell captive still requires technical expertise, and would only be viable if the client had a large number of policyholders. In the absence of specific cell captive regulation, it can create risks and uncertainties in the market. It is therefore essential to build a better understanding of the realities of the cell captive market and how it is regulated in order to consider the role that it may play in a microinsurance regulatory framework.

25.4

Treatment of MCCOs and informal providers

Low-income households are most vulnerable to risks and it is therefore assumed that they have an unmet demand for insurance. Clearly, they need cover given the limited social protection available to them (*see Chapter 2*) and their exclusion from most formal types of insurance. However, this need does not automatically translate into demand. Institutional rigidities also suppress low-income households' demand for insurance, even for people who could afford to pay the premiums. Consequently, this target group sometimes creates its own risk management tools, which may include informal, mutual risk-pooling mechanisms.

Allow microinsurance underwriting by a number of entities: Role of MCCOs

According to an IAIS Issues Paper (IAIS, 2010), mutuals, cooperatives and community-based organizations (MCCOs) include a diverse range of organizations. These can include institutions that are not: a) registered under any specific law or regulation; b) recognized under a specific law even if the law does not specifically cover insurance; or c) recognized under the insurance law itself. They may be described as mutuals, mutual benefit organizations, cooperatives, friendly societies, burial societies, fraternal societies, community-based organizations or self-insuring schemes. Where this is part of the social structure of the country, member-based mutual-type institutions tend to fare better than traditional insurers in offering microinsurance due to high levels of trust amongst members.

*Box 25.5***Formalizing informal insurance in the Philippines**

In the Philippines, many informal organizations were offering insurance without a licence even though the Insurance Code clearly stipulated that they had to have a certificate of authority from the Insurance Commission (IC). Similarly, the Cooperative Code also required cooperatives undertaking such activities to obtain an IC certificate. There are also entities, including non-profit organizations registered with the Securities and Exchange Commission (SEC), which were extending insurance without authorization.

In January 2010, a Joint IC-CDA-SEC Memorandum Circular No.1 issued by the Insurance Commission, the Cooperative Development Authority (CDA) and the Securities and Exchange Commission, announced termination of “informal insurance” or “insurance-like schemes” within a year. Organizations that offered such schemes were given the option either to become a distribution channel for a commercial insurers or within two years to incorporate themselves into a life or non-life insurer, a cooperative or a mutual benefit association (MBA) licensed by the IC. Entities failing to put their activities on a formal footing will risk revocation of their primary franchise or the filing of criminal charges against the individuals concerned.

Joint IC-CDA-SEC Memorandum Circular No.2, issued in June 2010, stipulated the rules on the use of funds collected under informal microinsurance schemes to protect contributors. According to the circular, funds collected by entities with informal microinsurance schemes that will formalize their activities – either by partnering with licensed companies or setting up their own companies – were to be used to pay the premiums for insurance or insurance-like products. The funds could also be used to pay fees to mutual benefit associations (MBAs) – set up especially by NGOs to provide microinsurance to members – where the contributors become members. For cooperatives, the funds were to be used for members’ share capital contributions to a single-purpose or multi-purpose cooperative that would provide for their insurance needs. Any excess funds were required to be placed in members’ savings accounts in these cooperatives.

The potential role of MCCOs as insurance providers may be restricted if they are not recognized in the legal framework. Alternatively, they may evolve into underground or informal insurers. Efforts to reform the framework to include these organizations would seem to be an important factor in ensuring that all policyholders are afforded the benefits of prudential supervision and consumer protection.

A major weakness of member-based institutions can be attributed to weak corporate governance and inadequate risk management. Corporate governance regulation normally forms part of the institutional regulations, such as a company’s act or cooperatives’ act. All institutions underwriting microinsurance should be sub-

ject to corporate governance, accounting and public disclosure standards that are adequate to ensure compliance with the applicable insurance regulations.

Provide a path for formalization

When a significant informal insurance market has developed, many complex questions arise as to how it can be integrated into the formal sector. Besides informal insurance provided by MCCOs, some countries also have numerous unlicensed insurers, such as funeral parlours, hospitals and MFIs, which provide cover in response to a real need for risk management in low-income communities. Informal providers can meet a social and economic need, but may be the source of consumer abuse and operations may fail due to inadequate risk management. Formalizing these operations is in the public interest. However, the limited resources available to insurance supervisors usually make this objective difficult to achieve. In these circumstances, it is necessary to define a clear path whereby informal providers can gradually and realistically meet regulatory requirements, as illustrated in Box 25.5.

Supervisors will have to approach their involvement with informal schemes as a facilitator to support their transition to the formal sector. This would include the application of the principles of proportionality and materiality to ascertain the extent of informal insurance provision and the obstacles to the formalization of informal providers. For example, where informal schemes do not guarantee benefits, there is no need to bring them under insurance supervision. A process of formalization should be complemented by awareness campaigns, amnesties or grace periods, capacity-building support to train owners and managers, and opportunities for consolidation among informal schemes and/or partnerships between informal operators and formal underwriters.

One practical way forward is a tiered minimum capital and solvency structure, whereby previously informal insurers are also allowed to underwrite microinsurance on a selective basis as they graduate to the minimum capital requirements of a full insurer over time at a prescribed rate. In addition, good coordination for the formalizing of informal providers with other government agencies, for example law enforcement and revenue authorities, is required to ensure compliance with the formal framework.

25.5

Recognizing alternative distribution channels

The market opportunity represented by the uninsured has motivated a diverse assortment of financial and non-financial institutions to increase the availability of insurance services at the bottom of the pyramid in a competitive manner (*see Chapter 22*). Serving this market requires the management of high volumes of small transactions, and therefore companies with robust technology platforms such as telecommunications are well positioned to play a key role – if the regulatory framework permits.

Table 25.3

Alternative distribution channels and regulatory issues

	<i>Alternative distribution channels</i>	<i>Regulatory checks</i>
Tele- and mobile marketing	<p>Telemarketing is a direct marketing channel for selling, promoting or soliciting a product or service over the telephone, sometimes through pre-recorded messages.</p> <p>Mobile advertising campaigns are used for both life and non-life insurance products. Generally, via a text message, the customer is provided with the option to purchase insurance cover over the phone or send a text message to request more information and special offers.</p> <p>Example: Innovative Filipino entrepreneurs have persuaded telecom companies to bundle sales of mobile phones with life insurance that is easy to understand and has low monthly premiums.</p>	<ul style="list-style-type: none"> – Telemarketing that includes a pre-recorded message must contain a quick and easy method for the recipient to opt out of receiving future calls. – The content for tele- and mobile marketing should accomplish the following: <ul style="list-style-type: none"> · identify the seller · state that the purpose of the call/SMS is to sell insurance · describe the nature of the product offered for sale · state that if a prize promotion is offered, no purchase or payment need be made. – Due to lack of face-to-face interaction, this channel should be restricted to simple products with small premiums.
Virtual marketing	<p>Activities such as an electronic kiosk and the Internet are emerging as alternative distribution channels. In a typical kiosk sale, a customer enters basic information (such as name, gender, type of policy, and amount to be insured) and the system generates a quote. The customer has the option to approve the terms and make a payment.</p> <p>Examples: Insurance solutions offered through kiosks include accident insurance counters in railway and bus stations; kiosks in shopping malls offering multiple products; banks selling insurance through ATMs.</p>	<p>E-kiosks, ATMs:</p> <ul style="list-style-type: none"> – Security issues related to identity theft and credit card fraud need to be addressed. <p>M-advertising:</p> <ul style="list-style-type: none"> – Only permission-based advertising should be regarded as an appropriate approach. – Privacy risks have to be considered and appropriate data protection and privacy safeguards must be guaranteed. – A combination of a legal framework, privacy-enhancing technologies and consumer education may be important components of consumer protection. <p>Internet:</p> <ul style="list-style-type: none"> – The sale, purchase and delivery of insurance over the Internet should be conducted in a secure environment. – Supervisors should require companies to have sufficient controls in place (including security, confidentiality, control of personal data, back-up and record-keeping systems) to transact business in a proper manner. – Supervisors should look closely at any outsourcing arrangements to ensure that appropriate contracts are in place and that risks are addressed effectively.
Bank-assurance	<p>This channel offers insurers a ready-made customer base of bank customers, brand awareness and established credibility</p>	<ul style="list-style-type: none"> – Risks in structuring insurance distribution through banks should be clearly identified, as insurers ultimately do not control the access to the customer. – Protocols for sharing confidential information and disclosure of commission should be transparent. – Regulators in some countries allow partnerships with a number of banks. This not only broadens distribution but also eliminates the risk to insurers of losing an entire channel. – The issue of training staff to sell insurance and their registration or not as insurance intermediaries must be addressed.
Retailers	<p>The distribution of insurance through supermarkets and retail chains is expected to become an emerging channel due to its ability to reach a vast customer base.</p> <p>Example: Future Generali in India has introduced <i>mallassurance</i> to sell cover in shopping malls, modelled on its successful operation in the Philippines. This channel offers convenience, reach, and personal advice. Financial advisers are available for consultation and finalizing the contract.</p>	<ul style="list-style-type: none"> – Retailers do not currently provide financial advice in connection with life insurance, and their marketing material is purely factual, although some do offer help in finding an independent financial adviser. – The risk of mis-selling is a concern. – Providers of life insurance in supermarkets need to find methods to prevent sales of unsuited products. – Training staff to sell insurance and their registration as insurance intermediaries must be addressed.

	<i>Alternative distribution channels</i>	<i>Regulatory checks</i>
Direct response TV	DRTV is used to create immediate consumer response to a company's products and to provide a convenient channel for potential customers to obtain more information on insurance plans, as well as to buy the plans through telephone orders. Example: CIGNA's growth strategy for the near future in Asia-Pacific includes expanding the DRTV distribution channel.	<ul style="list-style-type: none"> – Regulations should specify that the product being marketed is simple and its benefits can be reliably and easily demonstrated on TV. – The product should have proven retail or direct sales. – The premium, benefits and other charges and fees are transparent.

Create a flexible regime for distribution

Microinsurance is in the process of building on alternative distribution channels and new technology (*see Chapter 24*) to significantly expand outreach without investing in bricks-and-mortar branches. Without clear regulatory frameworks, however, reputable technology and solutions providers are unlikely to commit the resources to launch and sustain deployments (Porteous, 2006). The channel-mix described in Table 25.3 highlights possible innovations that need to be considered when designing the regulatory environment. Regulations need to permit the use of alternative channels while providing adequate safeguards for consumers' interests, without which large-scale adoption is unlikely (Porteous et al., 2008).

New technologies such as mobile telephones, point-of-sale networks and the Internet are increasingly being used for client communication, data collection, premium collection, and even for the payment of claims. Technology can also play a critical role in building a financial identity for the previously unserved by transforming their transaction history into an asset that they can use to access financial services. Examples of innovative technologies to reach the underserved segments are provided in Chapter 24 and Box 25.6.

Box 25.6

Creating a flexible regime for distribution: Technology and financial inclusion

Financial Information Network and Operations (FINO), an Indian technology solutions company, provides sourcing and servicing solutions for more than 50 banks, MFIs, insurance companies and government agencies. FINO operates through 12 400 transaction points to reach millions of underserved people. One of FINO's key solutions is a biometric-enabled smart card and a portable point-of-sale terminal, combined with back-end software. For example, the smart card forms the basis for ICICI Bank's micro-savings product.

The general insurance company ICICI Lombard uses FINO's biometric cards to lower the costs of enrolment and claims processing in its health microinsurance scheme. In partnership with Manipal Group of hospitals (*see Chapter 18*), smart cards have been piloted in locations equipped with laptops for online enrolment. The card will also be used for premium collection. Through this tech-

nology, customers transact using a personalized e-passbook, which facilitates biometric authentication.

As a key enabler and facilitator of financial inclusion, FINO has unlocked a US\$ one billion potential microinsurance market for health insurance companies, triggering a sea change in their delivery system by providing them with the geographical coverage, a scalable technology platform and the required processing capabilities. FINO facilitated the standardization of the delivery platform, back-end database management system and data maintenance format, effectively solving the problems faced by earlier government schemes that were plagued by design and implementation problems.

Source: Adapted from www.fino.co.in.

Infrastructure weaknesses, such as interbank and wholesale payment systems, can inhibit the introduction of microinsurance innovations. Porteous (2006) notes that additional barriers, including the fast-evolving fields of m-payments, m-banking and microinsurance, typically cross the distinct regulatory domains of banking, insurance, telecommunications, payment systems and anti-money-laundering. The overlap raises the risk of coordination failure between regulators with potential legislation or supervisory inconsistencies or contradictions that can constrain the growth of innovative services and create unforeseen problems.

The growth of mobile financial services has raised basic policy questions for supervisors such as how to distinguish a “payment” (mobile or not) from a “deposit”, and what differentiates the business of providing payments from deposit taking. It is noticeable that most developing countries do not allow e-contracts, and therefore a human interface for paper-based proof of sales is still required, significantly raising costs and minimizing the benefit of the mobile phone. Furthermore, there is a need to simplify disclosure requirements to ensure that clients understand them as well as to respect the confines of the limited space available on a mobile phone. Additionally, with growing concerns over privacy and the advent of consumer protection rules, it could be more difficult for service providers to market to clients. Intelligent ways of obtaining a client’s permission would therefore be needed.

To pave the way for new financial service models, regulators need to find the right balance between openness to innovation and sufficient certainty regarding the legal framework that protects users and clearly assigns liability. It is important for regulators, supervisors and policymakers to understand the risks and practical concerns around the emergence of alternative distribution channels, new technologies, flexible payment mechanisms and innovations in product design.

Not all innovation is detrimental to financial stability, and regulations can encourage players to do things in a better way. To promote financial stability,

supervisors must initiate steps to improve their understanding of the complexities that underpin new financial products and distribution systems, including the underlying assumptions, their functioning, the best practices and the supervision issues. A comprehensive vision for market development based on dialogue and policy coordination between policymakers, supervisors and industry players is the key to identifying the risks associated with new products and delivery channels, and producing proportionate responses.

Facilitate active selling of microinsurance

One-on-one sales processes provide clients with access to good information, but are expensive and can easily make low-premium products unsustainable. Some countries have set a maximum commission payable to agents and brokers for services rendered in the intermediation of insurance policies. A capped commission on a small premium will lead to a miniscule actual payout to the intermediary and will not increase their incentive to sell insurance. To avoid regulations limiting the cost of intermediation, supervisors could instead make it mandatory for providers to disclose commission levels.

The objective is to avoid market conduct regulation that can make the sales process too costly. In many environments, the traditional agent/broker model that relies on dedicated sales professionals will be too expensive for microinsurance. Regulators therefore need to stipulate the minimum levels of market conduct regulation for microinsurance without compromising on consumer protection.

25.6

Access to insurance and consumer protection

Consumer protection regulation is a cornerstone of any financial regulatory architecture and aims to monitor insurers' dealings with their customers. Besides investment in consumer education and raising awareness, consumer protection involves putting in place supervision mechanisms to promote market transparency, restrict specific behaviour, and enforce compliance with rules (*see Chapter 26*). This typically involves the monitoring of advertising, marketing, pricing and underwriting, policy cancellation and non-renewal, and the settlement of claims.

The primary motivation for consumer protection regulation in insurance is the idea that consumers are imperfectly informed about a product's characteristics.³ Asymmetrical information gives rise to the potential for insurers or their agents to misrepresent or manipulate information. Failure to properly under-

³ For example, premium depends upon individual/group risk characteristics, which may include previous loss experience, demographics, and financial history or lifestyle choices. Cover features include investment strategies and calculation of returns, the definition of insured events or cover amounts for specific events.

stand different aspects of insurance benefits can lead to improper choice of contracts. A related concern is that insurers, recognizing consumers' limitations, may be tempted to design products or disclosure in ways that take advantage of customers (Hansen and Kysar, 1999).

The mantra "treating customers fairly" (TCF) is reflected in the statutes of most financial market regulations and should be a key strand of the consumer protection agenda for microinsurance. TCF is aimed at helping customers understand the features, benefits, risks and costs of financial products. It is designed to minimize the sale of unsuitable products by encouraging best practice before, during and after a sale. The Financial Services Authority (FSA) in the United Kingdom has outlined six TCF outcomes that it intends to achieve (*see Box 25.7*), which are relevant to other jurisdictions as well.

Policymakers and regulators should consider establishing consumer protection regulation that requires transparency in pricing and services; identifies the parties ultimately responsible for upholding the protection (including protection against fraud relating to funds entrusted to the service provider or its agent); identifies the supervisory authority; and ensures that effective means of dispute resolution and redress are in place. The key difficulty in designing these regulations is in achieving the appropriate balance of costs and benefits.

Box 25.7

The six TCF consumer outcomes

The UK Financial Services Authority (FSA) has outlined six core consumer outcomes that it wishes to see as a result of the TCF initiative. These are:

- Outcome 1 – Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.
- Outcome 2 – Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.
- Outcome 3 – Consumers are provided with clear information and kept appropriately informed before, during and after the point of sale.
- Outcome 4 – Where consumers receive advice, the advice is suitable and takes account of their circumstances.
- Outcome 5 – Consumers are provided with products that perform as firms have led them to expect, and the associated service is of an acceptable standard and as they have been led to expect.
- Outcome 6 – Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

Source: FSA UK, 2007.

The remit of consumer protection varies significantly across countries. Microinsurance pioneers such as Colombia, India and Mexico provide relevant examples. They have mitigated the risk posed by the use of agents by placing liability on financial service providers for agents' violations of regulation applicable to outsourced services.

When crafting regulation for microinsurance, the following aspects should be noted:

- The bar for consumer protection should not be set so high that responsible providers are dissuaded from entering the market. It would make sense to involve financial services providers in the monitoring process, since they have an incentive to build trust and long-term relationships with their clients.
- Although the information-based rationale for consumer protection in insurance markets suggests disclosure regulation as the preferred regulatory tool, in practice product regulation may lead to better outcomes. Insurance product regulation is intended to foster market transparency by ensuring that contracts are clear and do not contain hidden clauses that may be used to mislead consumers (Grace and Scott, 2009).
- A particular microinsurance challenge is to overcome the lack of consumer understanding of their rights (such as recourse mechanisms) and responsibilities (such as paying on time). The target group often lacks knowledge of basic insurance concepts and products. One way to overcome this problem is by standardizing products with simple terms and conditions (*see Box. 25.8*).
- Regulatory enforcement that imposes penalties for misleading, unclear or unfair product features may provide insurers with incentives to create simple and transparent contracts, while allowing product innovation and consumer choice.

Box 25.8

Microinsurance standards and products: Philippines

In January 2011, an inter-agency committee in the Philippines approved a set of standards for the marketing and selling of microinsurance products as well as a draft for a standard product structure. The standards, known as “SEGURO” – for Solvency/Stability, Efficiency, Governance, Understanding of the product, Risk-based capital and Outreach – will help ensure that microinsurers can meet their claims obligations and are solvent.

A three-in-one microinsurance product has also been approved, which would pay beneficiaries a set amount in the event of a death, a destroyed house, or if a business is damaged by weather or natural catastrophes. Standardizing microinsurance will help to broaden its reach and ensure that the people it is designed to help actually understand it. It will also level the playing field and allow insurers to compete effectively.

Source: Adapted from Artemis, 5 January 2011.

The most common consumer complaints involve claims settlements, notably about claim rejections, delays or disputes over the amount of payments. Ideally, the underwriter/intermediary must provide an easy and acceptable consumer recourse option. However, at the very least the customer must be able to lodge a complaint or enquiry via the point of sale. In most countries, insurance supervisors have no authority to require an insurer to settle a claim, relying on conciliation, mediation and explanation in their dispute resolution (Schwarcz, 2010). In some countries, an ombudsman, usually separate from the regulator, is empowered to adjudicate consumer disputes with insurance companies. Besides resolving problems, a complaint resolution mechanism may also provide insurers with an incentive to create better internal systems and standards.

Another avenue for improving consumers' decisions and their use of insurance is to promote better understanding of insurance among consumers (*see Chapter 14*). Enhancing the financial capability of the poor is a necessary complement to consumer protection. It enables microinsurance clients to: understand the information that insurers are required to disclose; make use of the available recourse mechanisms; understand basic financial concepts; appreciate how insurance can meet the needs currently filled via informal financial arrangements; help make informed choices to suit their circumstances; and demand products that improve their financial well-being. All major stakeholders in the financial markets – providers, consumers and government – need to work together to create a fair financial framework that protects customers.

Lastly, consumer protection regulation requires mechanisms to determine whether insurers and intermediaries are complying with requirements, and to uncover practices that regulators view as unfair. Monitoring for traditional insurance includes a market conduct examination of individual insurers, which would be too onerous for microinsurance, and therefore supervisors need to rely on market analysis. Market analysis includes the use of data on industry trends, regulatory data submitted by insurers and intermediaries, consumer complaints, and other information. Specific areas of examination include determining that insurers are consistent with advertising materials, that policies sold and rates charged are consistent with regulations, that claims are paid within a reasonable period and that consumer complaints are addressed.

25.7

Conclusion

Access to insurance is an important component of financial inclusion policy and a key weapon in the fight against poverty. While developing a robust regulatory framework that promotes financial stability, policymakers, regulators and supervisors are realizing that the financial sector plays an important role in meeting the needs of small businesses and low-income households. They are becoming

cognizant of the potential impact that access to insurance can have on economic growth and the eradication of poverty.

Policies for improving access should have clear and measurable objectives and their effectiveness should be monitored through transparent public reporting. In particular, the effectiveness of regulation in facilitating and expanding access should be assessed. Whilst appropriate and reliable data are a useful support to designing an appropriate policy, the absence of data does the opposite, which can diminish consumer confidence and deter potential consumers from buying insurance. In addition, a lack of effective supervision can discourage foreign and domestic investors from supplying capital, retard insurance market efficiency and dampen industry development.

Achieving the appropriate balance between safety and soundness on one hand, and facilitating growth and development on the other, is particularly difficult in cases where innovative approaches, new services and untested business models figure prominently. Unanticipated risks can emerge down the road while perceived risks can generate overly cautious regulatory approaches. Since a deeper knowledge of the actual risks will emerge as markets mature, regulations need to evolve over time and allow for incremental adjustments to help achieve regulatory balance.

Regulatory initiatives emanating from the IAIS are attempting to address the challenges of compliance with global insurance standards in specific circumstances. Based on country studies facilitated by the Access to Insurance Initiative, and in close dialogue with insurance supervisors, work is under way to understand how proportionality principles can be used in crafting a regulatory and supervisory framework, which in turn can create the right incentives to promote access in different economic and socio-cultural settings.

Designing and implementing such a framework will require concomitant steps to strengthen the capacity of policymakers, regulators and supervisors so that they can make greater use of regulatory judgment to identify opportunities and problems early. It will also require a new supervisory approach, moving away from the one-size-fits-all strategy. In doing so, they would need to dialogue with stakeholders and examine the structure of their domestic insurance industry and current and prospective microinsurance delivery channels.

26 **Protecting consumers while promoting microinsurance**

Rodney Lester and Katharine McKee

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Ultimately, microinsurance markets will not develop unless they demonstrably meet the particular needs of the economically active poor.¹ Recent empirical research from China, India and Kenya also suggests that trust and the perceived credibility of the product and the institution(s) involved in building long-term demand are important (for example Dercon et al., 2011, Cai et al., 2009; Cole et al., 2010). The existence of appropriate consumer protection measures can both help build trust in microinsurance products and providers, and encourage sound market development.

While a considerable amount of work has been done to develop a relatively standardized regulatory framework for consumer protection in mainstream retail insurance markets,² the microinsurance market may have specific characteristics that suggest a need for a more tailored approach. Typical consumers might be less able to assess how well a specific insurance policy fits their needs, or they might be more vulnerable to pressure sales or mis-selling. For example, recent empirical work in India finds that “consumers demonstrating lower levels of sophistication are more likely to be offered the wrong product” (Anagol, 2011).

At the same time, the low-income insurance market is still well below its potential size in many developing countries, and many regulatory authorities now have explicit mandates for financial inclusion as well as prudential supervision. Given the potential benefits of insurance cover for low-income consumers that are currently underserved, policymakers will want to avoid unintentionally “protecting consumers out of the market” by adopting rules that make serving these new markets unviable. In addition, rapid innovation in products, channels and business models is necessary to bring down costs, meet consumer needs better

¹ The primary focus of this chapter is on the interaction between the individual economically active poor consumer and the insurance market, rather than cover for the indigent or other social insurance provided by government to a defined population.

² International Association of Insurance Supervisors (IAIS) has set up a sub-committee to consider this topic, although it is has been addressed at a high level by the IAIS Assessment Methodology since 2000. Both the Organization for Economic Co-operation and Development (OECD) and Financial Stability Board (FSB) have also set up consultative committees under a post-financial-crisis mandate from the G-20, and the World Bank has issued a set of good practices (based on work in Eastern Europe) for public comment

and ensure provider profitability. Thus, policymakers should aim for market conduct³ regulation that is proportionate, well balanced, and tailored to the specific risks that arise, so that it does not unnecessarily stall the development of microinsurance markets.

As with the market itself, regulation of microinsurance is nascent in most countries: there is little precedent for policymakers to draw upon in designing a proportionate consumer protection framework. One policy choice, for example, is whether to add market conduct rules for microinsurance to the existing insurance regulation framework or to develop a tailored regime for the sector. To date the “early movers” include India, Peru and the Philippines, each of which has passed and implemented specific microinsurance rules (*see Chapter 25*). Brazil, Cambodia and South Africa have indicated that they will be making changes in the legal and regulatory framework soon. The Securities and Exchange Commission of Pakistan (SECP), which oversees insurance and other financial services in that country, has announced that it is drawing up a microinsurance framework. Policy development and pilots are also underway in a number of other countries, including China, Mongolia, Nepal and Nigeria.

In practice, the microinsurance consumer protection framework in its early stages will need to draw selectively upon policy approaches in mainstream insurance markets, and then be modified on the basis of evidence of actual experience in microinsurance markets. This chapter adopts such an approach and is organized under four broad headings:

- 1) **Market characteristics and risks:** The chapter describes particular aspects of current microinsurance markets that affect consumer risks and should be considered in policy decisions on whether and when to introduce consumer protection regulation.
- 2) **Consumer protection goals and measures:** The chapter assesses options for achieving three common consumer protection goals: 1) transparency; 2) fair treatment (with a focus on product design, distribution arrangements and the claims payment process); and 3) effective recourse. This includes attention to prioritization and sequencing of new consumer protection rules, as well as the benefits and drawbacks of separate microinsurance regulation and supervisory bodies from a market conduct standpoint.
- 3) **Special consumer protection regimes specific to microinsurance:** When jurisdictions are creating specialized regulations and supervisory requirements for microinsurance, it creates particular sets of consumer protection issues that need to be considered.

³ Market conduct regulation sets rules specific to the insurer’s activities, practices and product features. Consumer protection comprises a broader set of tools that may also include mechanisms to protect consumers that are extraneous to the insurer (e.g. independent ombudsman schemes).

- 4) **Complementary non-legislated and non-regulatory measures:** The chapter also briefly explores the role that approaches – such as codes of conduct or initiatives to improve consumer awareness and financial literacy can play in improving the effectiveness of consumer protection regulatory regimes and the healthy development of microinsurance markets.

The chapter concludes with a summary of emerging good practices that could be useful for policymakers seeking to craft a proportionate regulation and supervision regime that promotes market development while protecting lower-income and less experienced consumers.

26.1

Microinsurance market characteristics relevant for consumer protection

Emerging microinsurance markets have some specific features that policymakers should take into account in designing and implementing a proportionate consumer protection regime.

Clientele: Typical microinsurance customers – the economically active poor – have limited and fluctuating discretionary income, lack assets, and are unfamiliar with or mistrustful of formal providers and products. Furthermore, their levels of financial literacy tend to be low. Thus, even where low-income consumers have been involved in rather sophisticated family- or community-based risk-sharing arrangements, their initial purchase of formal insurance (a contract-based rather than a relationship-based transaction) requires learning a new set of rules. These client characteristics raise the policy question of how to ensure an adequate standard of care for customers who could be particularly vulnerable to consumer protection problems.

Products: A significant proportion of microinsurance policies are currently being generated through credit-related transactions with microfinance institutions (MFIs) and other providers of small loans to low-income borrowers. Credit life insurance (or “loan repayment” insurance) is a short-term policy designed to pay off the outstanding loan balance should the borrower die or become permanently disabled (*see Chapter 9*). As described elsewhere in this volume, other increasingly common products include life insurance (*Chapter 8*), personal accident, restricted forms of health insurance (*Chapter 5*), and index-based agricultural insurance (*Chapter 11*). Rapid innovation is leading to the development of new covers such as pharmaceutical, property, and livestock insurance (*Chapter 12*). Each product raises distinct consumer protection concerns.

To reduce transaction costs, products are often kept simple and standard, and are delivered to groups with limited or no underwriting of individual risks (*see Chapter 21*). Experimentation is under way to find cost-effective ways to tailor products to consumers’ liquidity constraints and price elasticity (i.e. typically

very small weekly or monthly instalments and possibly premium subsidies and payment grace periods). Products are often presented through a trusted intermediary and incorporate specialized client outreach and education efforts. Each of these aspects of product design and delivery may call for adaptations of conventional approaches to consumer protection rules and supervision.

As noted, the drive towards simplicity and low cost may also mean that products are bundled and that there is a commensurate level of non-disclosure (i.e. passive selling). Consumer protection mechanisms need to ensure that policyholders are fully aware of what they have purchased and of their rights; the chapter addresses various approaches to achieving this.

Providers and business models: While microinsurance markets are underdeveloped relative to their potential, they exhibit a wide range of business models and underlying marketing mixes.⁴ These innovations offer the promise of making risk management services more widely available. However, they can also raise consumer protection concerns.

One key concern involves distribution arrangements. The search for cost-effective ways to reach lower-income, less educated and more remote consumers has led to distribution systems that include a range of players carrying out different functions depending on their skills, technology, resources and influence. The role of aggregators is prominent. The common “partner-agent model” typically involves a conventional insurance company teaming up with an MFI. Other major aggregators to date have been agricultural banks, non-governmental organizations (NGOs), postal systems, and various forms of mutual or cooperative institutions, sometimes in combination. The aggregator may have its own captive insurer, place some or all risk with one or more commercial insurers, or even carry the risk on its own balance sheet.

Recent innovations that could improve the value proposition of microinsurance include the use of pre-paid cards and non-traditional distribution networks such as pharmacies (Venezuela), mobile phone operators (Ghana), utilities (Colombia), or retailers that service the low-income populations in the Philippines and South Africa (*see Chapter 22*). Another innovation that could help poorer people manage risks involves bundling. For example, when a borrower takes a loan for an asset such as livestock, asset insurance may be offered on attractive terms. In other cases, the purchase of agriculture supplies, such as seed and fertilizer, triggers the automatic purchase of crop insurance.

⁴ Business model refers to the broad approach adopted, e.g. partner-agent, direct sales. Marketing mix is more granular and defines the detailed combination of pricing, product, distribution and promotion to be adopted.

Each of these features of the rapidly evolving microinsurance market – client segments, products and product mixes, distribution systems, technology and business models – may raise consumer protection questions, with answers somewhat different from those appropriate for conventional markets.

Market conduct concerns tend to focus on challenges faced by consumers specific to prevalent product features and practices at key points in the value chain. Policymaking and rules-writing will benefit from consumer research into the actual nature, incidence and consequences of consumer protection problems experienced by microinsurance policyholders (*see Box 26.1*).

Box 26.1

What can go wrong? Kenya consumer research findings

What consumer protection issues arise for microinsurance policyholders? A recent consumer protection diagnostic study in Kenya drew upon focus group discussions and a national survey of mass-market consumers, including insurance users. While penetration rates are very low and many respondents did not have formal, private insurance, the research revealed that those who did were often dissatisfied. Many complaints centred on salespeople not explaining products clearly and the lack of understandable documents. As one man explained, “It is like they have used anyone to sell insurance and they don’t know the products so you sign for a product then when the policy comes you find that it is totally different.”

Thirteen per cent of insurance users said the details were not explained in writing and 11 per cent said they did not understand such details as the policy cost, what was and was not covered, and how much they would receive in the event of a claim. Respondents also described problems with claims processing and disputes; 26 per cent of policyholders in the survey who had made a claim reported that it was not processed quickly.

Insurance policymakers in developing countries typically face significant capacity constraints. Research of this type can help them focus consumer protection regulation and supervision on the most important concerns and test whether proposed rules and other measures are likely to work as intended.

Source: Adapted from Flaming et al., 2011.

One risk that can undermine consumer protection is microinsurance policies that are overly complex, or with prices and key terms that are difficult to understand or are even deceptive. The relatively common practice of “bundling” or “tying,” often in combination with compulsion (as can be the case with credit life insurance), can raise consumer protection con-

cerns.⁵ The consumer may have no choice but to purchase the policy or may not be able to choose the provider. Yet bundled or tied products can also extend access and yield benefits such as cost reductions as a result of marketing synergies, the larger risk pool, avoidance of anti-selection, and simplified administration. From a regulatory standpoint, it might be appropriate to permit bundling and compulsory purchase, as long as safeguards are in place to ensure adequate disclosure and value for money. Rather than prohibiting practices such as tying, “no advice” sales or narrow cover, proportionate regulation would thus aim to balance protection of consumers with the economic realities of providers trying to reach these new markets.

Additional consumer protection challenges can arise at the sales, premium collection and claims stages of the value chain. Aggressive sales techniques are a common complaint, including but not limited to door-to-door sales models. Intermediaries such as agents or brokers can play a critical role in reaching and servicing new microinsurance policyholders (*see Chapter 23*). Yet they do not always receive adequate training or supervision from the insurer, and indeed, it can be unclear whom the intermediaries are working for and what incentive they have to serve the policyholder well once the policy has been issued. Sometimes the person who sold the policy disappears altogether (Collins et al., 2009), with no guarantee that the premiums were ever forwarded, that collections will continue and that the policy will be honoured.

Claims handling and the lack of effective complaints and recourse mechanisms can also undermine new consumers’ trust in formal microinsurance. Sometimes the claims process is neither timely nor fair, as when claims are rejected on the basis of exclusions that were not made clear at the time of sale. Sometimes there is no formal process for lodging and resolving complaints. When it does exist, it is sometimes cumbersome or the complaint is unlikely to be resolved in the policyholder’s favour.

In summary, policymakers must balance the goals of financial inclusion, innovation and consumer protection in setting market conduct rules for microinsurance. In doing so, regulation may need to accommodate a more flexible approach to permissible product design, packaging and distribution, while requiring high standards of disclosure and service provision combined with strong recourse mechanisms.

⁵ Bundling occurs when several distinct products are sold at the same time in a linked transaction. The concept of adhesion may apply in these situations whereby a single contract is deemed to exist. Tying occurs when the organization selling the primary product (e.g. credit) also sells complementary but separate products in a non-competitive manner. Bundling may be voluntary (as in the option to take out supplementary funeral insurance) or compulsory (e.g. where insurance is sold as part of a credit product).

26.2 Towards a consumer protection framework for microinsurance

This section explores in greater depth the options for workable regulation to improve transparency, fair treatment and recourse in microinsurance markets.

26.2.1 Transparency

Disclosure of key prices, terms and conditions to policyholders is the foundation of transparency and a bedrock principle of consumer protection, whether in developed or less developed markets.

The wording, language and format of disclosures need to be in a form that consumers with limited formal financial experience and literacy can readily comprehend. It is becoming more common in developed markets to require that a “Key Facts” document, following a prescribed format and summarizing the most critical information pertaining to the policy, be attached to the contract. This approach could also be valuable in early-stage microinsurance markets, with the basic parameters of the insurance contract (i.e. type of contract, term, sum insured, premium and premium frequency, renewal conditions, how to make a claim) being set out in large print and simple terms on the front page. Indeed, although they reduce flexibility and the potential to tailor policies to the specific risk profile of individual clients, for the most part simplicity and standardization themselves contribute to protecting less experienced consumers. For example, one page could be sufficient to describe and satisfy the contractual requirements of a simplified product with standard terms. Other forms of communication – such as the interactive games developed for health product options and prices (*see Chapter 14*) – could also prove effective with these client segments in addition.

Consumers also need to receive disclosures at the right points in the process. At a minimum, they should receive complete pre-sale information on the significant product features, their own rights and responsibilities, and the obligations of the provider, including aggregator, agent and others as relevant. At the point of purchase, they should also receive a written copy of the contract or policy, although there may be cases where verbal disclosure would offer sufficient transparency for simple products. China has recently gone further by introducing requirements for certain product/distribution combinations, with new policyholders acknowledging in writing that they understand the contract provisions; the insurer must then contact the policyholder soon after purchase to verify this.

As illustrated by the Kenya example, supervisors can benefit from up-front consumer research (either directly commissioned or carried out by independent third parties) to identify common areas of confusion and potential deceptiveness, and test proposed wordings and formats with low-income consumers. Insurers or

their partners also could be required to explain how they intend to use such studies in developing products.

Disclosure has its limitations, however, due to factors such as inherent product complexity and consumer behavioural biases.

26.2.2 Fair treatment

The fair treatment component of consumer protection can be considered separately for three aspects of insurance operations: product design, distribution and claims handling.

Product design

Many consumer protection problems can be avoided by ensuring that microinsurance products are appropriate for the intended clientele. The key tests are relevance of product benefits and services, the fairness of contract provisions, and value for money. Does the product address key risks for the policyholders? Are contract clauses reasonable and straightforward? Is the policy's cost proportionate to the benefits received if the insured event occurs? Are the obligations to make payments and the mechanisms for securing benefits aligned with the client's circumstances? And is it affordable for the targeted client segment?

Common approaches to overcoming the information and power asymmetry between providers and consumers in mainstream markets include both product regulation and an affirmative requirement for distributors to consider the specific circumstances of the individual in selling specific policies.⁶ Many developed countries are concerned about how bundling can introduce or reinforce asymmetry; to improve suitability and reduce mis-selling, some have attempted to promote choice in tied selling situations by requiring that customers have an opportunity to compare products offered by alternative insurers. However, such measures may be neither effective nor practical in the microinsurance markets of developing countries.

⁶ For more complex products, generally long-term contracts involving life-cycle planning such as universal life and pension contracts, developed-country regulation increasingly has restricted the category of intermediary that may be involved in such transactions to relatively highly-qualified and fully-registered financial planners, many of whom now operate on a fee basis. Rules may also require that sufficient documentation is retained to prove that the intermediary obtained adequate information on the client's needs to select the appropriate products and contract characteristics.

Instead of banning product-bundling or regulating advice, other approaches could be employed to improve the suitability of microinsurance sold to the economically active poor. Sometimes the legal definition of microinsurance specifies mandatory or prohibited product characteristics that reduce product risk and complexity. For example, specific rules might be put in place that make clear the expectation that contract wordings need to be far simpler and have fewer exclusions than are acceptable in a more developed legal environment. Examples of exclusions include non-coverage of certain conditions or pre-conditions (e.g. HIV/AIDS).⁷ The obligations on the policyholder to disclose changes of risk will need to be less onerous as well. Consumer input can be useful in determining product design.

For basic life and accident policies, it should be possible to develop standard wordings, with variations being possible subject to regulatory clearance. The ultimate contract will ideally be in certificate form and contain no more than a single page and a schedule. By contrast, for policies covering more complex risks, such as agricultural and health, insurers may need greater latitude for design and pricing to make such products attractive to consumers and commercially viable. If they are granted this leeway, these products could be subject to enhanced regulatory disclosure requirements, including an explicit statement of underlying assumptions and how they were arrived at.⁸ In addition, as most developing-country supervisors have limited technical resources available to them, it might be appropriate to require that the pricing be carried out by a suitably qualified individual, who could be an actuary employed by the insurer or individuals working with a third-party distributor. This could help to ensure that the intermediary, underwriter and any facilitator have the capacity needed to take on such a product.

Sometimes regulation addresses price, either directly (e.g. by prohibiting or limiting certain fees and commissions) or indirectly (e.g. by requiring prior approval of new microinsurance products and including analysis of value for money in the assessment process). Insurers, their association or the insurance supervisor could also be required to publish performance indicators that identify pricing, expense or commission levels beyond the established ranges.⁹ In either case, care must be taken to support pricing that makes it viable for responsible providers to serve new markets.

⁷ After Madison Insurance (Zambia) removed an HIV/AIDS exclusion from its health insurance policy, profitability was maintained due to lower claims adjustment costs and increased portfolio size.

⁸ This is akin to a write and file system where prior supervisory approval is not required to launch a product.

⁹ In India, for the past five years insurers have provided extensive reporting to the Insurance Regulatory and Development Authority (IRDA). IRDA publishes 41 tables of data on all aspects of insurers' operations including claims ratios and claims ageing by class of business, and complaints processing ("grievance disposal") performance.

Performance metrics can be used more broadly as “fairness” or value-for-money monitors. The Microinsurance Network has published a set of recommended performance indicators (Wipf and Garand, 2010), and has proposed social performance indicators (Simanowitz and Sandmark, 2011), several of which are relevant to the consumer protection agenda (*Box 26.2*).

Box 26.2

Social performance indicators especially relevant to consumer protection

Indicator 1 – Incurred claims ratio

Indicator 2 – Claims rejection ratio

Indicator 3 – Renewal ratio

Indicator 4 – Promptness of claim settlement

Indicator 9 – Complaints ratio

Indicator 10 – Transparent sales ratio

Source: Simanowitz and Sandmark, 2010.

The key performance indicator that is especially relevant to value for money is the loss (or claims) ratio. This helps to determine whether the marketing mix of the microinsurance provider makes sense from both an underwriter’s and a consumer’s viewpoint. Cases where loss ratios are planned to be very low to cover excessive expense levels are not desirable in the longer run.¹⁰ Regulation might specify maximum expense loadings, possibly scaling down over time. Whilst the provision of financial services to the poor is typically relatively expensive, appropriate benchmarks could be developed. For example, is it reasonable for the expense ratios of an established life insurer to exceed 30 per cent? Similarly, a consistent net claims ratio of significantly less than 50 per cent for basic products should be a red flag for mature non-life insurers. A high lapse rate might also indicate poor value for money or unfair practices and contract terms. Consultation among regulators, industry and consumer representatives could contribute to development of such benchmarks.

¹⁰ Non-insurance services bundled into an insurance product should be costed before carrying out such an analysis.

Distribution

A globalized and linked insurance supervisory community is adopting increasingly standardized approaches to the regulation and supervision of intermediaries. Special situations that arise in the mainstream markets (e.g. bancassurance, distribution of high-volume mandatory insurance through retailers, direct distribution, tied selling of warranty insurance) tend to be covered by separate laws or regulations. Special microinsurance regulations issued to have usually place significant emphasis on intermediaries. Mainstream approaches to regulating distribution and intermediaries are unlikely to be universally appropriate for microinsurance given the smaller monetary values, the need to minimize costs, the need to capitalize on consumers' trust of the intermediary, and the still evolving set of marketing mixes. It is likely that regulators will want to leave the door open to considering a range of potential intermediaries and the laws governing those intermediaries should allow them to be treated as insurance agents.

Currently, a central topic in insurance consumer protection discussions is the role and remuneration of agents, brokers and financial advisors.¹¹ While aggregators are prevalent, some regulators also allow for tied (i.e., exclusive) agents to sell and service microinsurance. In some cases, these agents are approved under the main insurance law. In other cases (e.g. India, the Philippines), the law provides for microinsurance agents with lower formal qualifications requirements; they may nevertheless have a wider range of responsibilities than conventional agents, including premium collection.¹² Many fail after a period.¹³

This is another difficult trade-off in the access-protection balancing act. Agent failure can severely damage confidence, as policyholders typically lose all premiums paid up to the time the agent ceases to operate due to heavy early-termination penalties (Collins et al., 2009). The likelihood of failure may be higher if microinsurance commission levels are restricted, as is sometimes the case as part of the consumer protection regime (see Anagol (2011) for the distorting effect of commissions). To address this problem, any entity offering microinsurance through tied agents should demonstrate as part of its licensing that it has systems that will ensure that another agent will immediately take over a collection/servicing book if an agent withdraws, or alternatively have means to develop a direct link with the policyholder, including the use of SMS and call centres. This would also need to be monitored by the supervisor, for example, through a simple statutory return and on-site inspections.¹³ In addition, insurers

¹¹ A number of countries including Australia, Denmark, Finland, The Netherlands and the United Kingdom and either have, or are planning to banned some or all commissions for independent financial advisors and brokers.

¹² A strong analogy can be drawn with the old-style industrial insurance "collectors".

¹³ As a rule of thumb, in mainstream markets approximately 15 per cent of initial agency recruits survive to their fourth year as full-time operators.

using tied agents should be responsible under law for any mis-selling or malfeasance on the part of its agents.

Where intermediaries jointly brand a product with an insurer, there could be two options. Either the intermediary could be required to stand behind the product, or regulation could require that the ultimate insurer meet a minimum prudential standard and retain responsibility for the actions of its intermediary.

To compensate for these applications of regulatory proportionality, all microinsurance intermediaries should be formally licensed or registered by the supervisor. Furthermore, relevant staff of an intermediary specializing in microinsurance should be subject to simplified agent training and certification. The supervisor should also have the power to transfer a portfolio of insurance policies to another intermediary and/or insurer if necessary, so as to ensure that the policyholders continue to benefit from cover.

In all cases, where the intermediary handles premiums and claims management, it should be able to demonstrate that policyholder moneys are de facto held separately from its own funds, that adequate systems are in place (computerized or paper-based) to identify and ensure the policyholder's rights, and that the underwriter's records are updated regularly (at least weekly).

Claims management

Claims payment systems can be critical to build trust and enhance the success of a microinsurance arrangement, due to the powerful demonstration effect of good or poor performance. Findings from the Kenya consumer research suggest that it is important for regulators to monitor this issue and intervene if substantial problems are evident, for example, by setting standards on timeliness and fairness of claims processes. Surveys carried out in India indicate that a settlement period of up to four weeks may be acceptable for the economically active poor, although given their low and variable incomes, sooner would certainly be better. In the Philippines, the Microinsurance Framework sets a 10-day limit. A number of microinsurance initiatives involving broker facilitators or other aggregators such as self-help groups permit the payment of valid claims immediately, without prior assessment by the underwriter or its adjusters. For example, a large microinsurance pilot in the Vizianagaram District of Andhra Pradesh uses a call centre and direct electronic transfer to ATMs to speed up the claims process. Weather-insurance products have also been designed in part to facilitate more timely claims settlement.

As a standard practice, any well-run microinsurer or its value chain associates should be recording and analysing its claims performance regardless of supervisory requirements. The supervisor or consumer protection authority should monitor claims performance, both for purposes of consumer welfare and in its development and prudential roles. To this end, microinsurers or their associated intermediaries should be required to report on a periodic basis on the number of

claims received by contract type and the average time taken to settle after the claim is notified. In practice, a strong insurance association could carry out much of the microinsurance data-gathering and analysis on behalf of the relevant consumer protection authority as part of a self-regulatory exercise.

26.2.3 Complaints handling and recourse

The ability to seek redress is also an important element of any consumer protection regime. It is only now being developed in an organized and formal manner in many industrial and transition countries and is effectively non-existent in most developing countries.

Internal dispute resolution

The first line of policyholder recourse when they have a concern or dispute should be with the company. This ensures that there is an opportunity for the insurer to resolve the matter efficiently through an in-house mechanism. Where aggregators or other distributors are involved, it must be clear to the consumer, and disclosed prominently in plain language at the point of sale, how and with whom to file a complaint. Good practice holds that a suitably senior officer should be appointed to deal with policyholder inquiries and complaints. Microinsurance policyholders are likely to be better served by simpler complaints processes that permit the filing of complaints through multiple channels (e.g. in person where the policy was purchased, via mobile phone). This is a requirement in a number of industrial countries, and is incorporated into Peru's special microinsurance regulation. As noted, supervisors can set standards for internal dispute resolution, such as rules on disclosure of recourse options, timeliness and process, and require insurers to report on the nature and frequency of complaints and the resolution success rate.

Third-party recourse

Some countries have third-party recourse options to deal with cases where the consumer is not satisfied with the outcome of the internal dispute resolution process. Countries are increasingly appointing independent Ombudsmen to deal with all forms of complaint in the financial sector.¹⁴ Alternatively, this function could be located in a sufficiently broad industry association, a lead supervisor's office or an appropriate consumer protection body. Under this latter approach, the insurance industry would need to agree to abide by the decisions of this office (typically up to a capped claim amount), which could be determined by a suitably qualified committee.

¹⁴ The International Network of Financial Ombudsman Schemes has more than 30 members, a number of which are from developing or transition markets: <http://www.networkfso.org/Links.html>.

Free look periods

Recourse options can be reinforced by regulation requiring “free look” periods for longer-term or more complex products (particularly if they contain exclusions) where, once a policy is purchased, consumers have a defined period in which to change their mind, cancel the policy for any reason whatsoever and receive an equitable refund. This approach is gaining ground,¹⁵ and in some countries the free look is being built into the policy wording, which also helps to advance the fairness objective.

26.3 Designing and implementing special consumer protection regimes for microinsurance

The previous section discussed typical consumer protection issues in microinsurance and regulatory options to address them, including some reference to how these differ from those in more conventional insurance markets. The mandate, authority and structure of the insurance authority or other entity responsible for designing and implementing such rules is likely to vary from country to country. This has implications for implementation of a consumer protection regime for microinsurance. Where policymakers decide to create an alternative regulatory regime for microinsurance, a number of legal and practical issues need to be considered.

26.3.1 Consumer protection implications of microinsurance definitions and regulation

Once the policy decision for adapted or specialized rules has been taken, there are a number of options for embodying this in law and regulation and achieving the appropriate access/protection balance in market conduct rules. One is to explicitly exempt microinsurance from certain requirements of the mainstream law and regulations. Another is to promulgate a special law or regulation, as in India and Peru. The special treatment of microinsurance may then be framed as broad principles or specific rules. Though a principles-based approach allows for maximum flexibility, in practice a rules-based approach is probably preferable while the microinsurance sector is in its development stage. Specific rules are likely to be applied more effectively by developing country supervisors facing capacity constraints, particularly where their actions may be challenged by politically connected special interests or the judicial system is still developing.

¹⁵ The requirement in South Africa is 30 days and this appears to be workable.

Peru's special regulation (Resolution 14283-2009) addresses consumer protection concerns by specifying qualitative product characteristics, recourse mechanisms and reporting requirements. However, the consumer protection rules cover only registered insurers.

India and the Philippines have issued tailored regulations. In the case of India, the Insurance Regulatory and Development Authority (IRDA) issued the "MicroInsurance regulations" in 2009 entirely concerned with insurance market conduct rather than prudential matters, which rely on the main insurance law. As in Peru, it covered only registered insurers. In the Philippines, the rules introduced in early 2010 are part of a national effort to strengthen supervision and market conduct of a range of microinsurance institutions, including formally licensed insurers, mutual benefit associations and cooperatives. Informal insurance schemes have been given the choice of working through a licensed insurer or converting to one of three approved structures (*see Box 25.5*). In both India and the Philippines, microinsurance agents have to be licensed through the insurance supervisor.

In India, a code of conduct also applies to all agents, including microinsurance agents, and insurers are required to ensure that it is observed. The code has the force of law (being included in the agency regulations) and any breaches result in termination of the agency licence. As long as a code's market conduct requirements are reasonable and a capable institution is in a position to oversee the agents, this "delegated self-regulation" approach to codes of conduct is more likely to succeed than purely voluntary codes in the case of microinsurance. Purely voluntary codes tend to be found more often in industrialized countries (e.g. Canada), where strong supervisors and industry associations are in a position to apply moral suasion; it should be noted, however, that they do not always work perfectly, even in those settings.

26.3.2 Regulatory scope, coverage and arbitrage

A related policy issue is whether consumer protection regulation effectively covers all formal entities that provide risk products to the economically active poor. If special regulation is developed under the powers of the insurance law only, the coverage is likely to be limited and there will be scope for regulatory arbitrage between licensed and unlicensed entities. For this reason, it is desirable for microinsurance consumer protection regulation to be supported by law that applies to all relevant institutions under a single supervisor, as in the Philippines and Australia.¹⁶ As a rule, if an institution is considered to be important enough

¹⁶ In Australia, for historical reasons, a separate law exists for Friendly Societies, but they were brought under the same Federal supervisors as insurance companies when the Australian Prudential Regulatory Authority (APRA) was established.

to be subject to prudential supervision, then it should also be subject to consumer protection rules that ensure a level playing field with other providers of generically similar financial services. Informal insurance arrangements that cover a large number of members and do not come under the consumer protection law rules could be subject to registration or some other form of lighter supervision, or forced to work through licensed entities.

One complication is that the actual beneficiary is sometimes not the individual paying the premium. Typically, when an MFI is the aggregator, the product sold is credit insurance (personal accident, life or life plus disability) for the amount of the loan only. The MFI will often take a commission and the consumer may not know that the cost has been added to the interest rate.¹⁷ It could be argued that, in this case, the appropriate regulator is the banking authority rather than the insurance supervisor. However, the banking regulator may be more concerned with the financial soundness of the lender and in particular its ability to maintain its fee- and commission-based income stream, which creates a potential conflict position regarding consumer welfare. Or banking authorities may limit interest rates to protect consumers, thereby inadvertently encouraging operators to increase prices for tied insurance products. Furthermore, many credit life products pay a sum to the family of the borrower in addition to paying off the outstanding loan, which clearly comes under the insurance heading. For these reasons, credit life is included in the definition of microinsurance for the purposes of this chapter.

Any policy decision to introduce tailored regulation (and an attendant supervisory approach) for microinsurance raises the possibility of mainstream insurance contracts being sold under this alternative regime, which is almost certain to have a lighter regulatory burden and to allow formulations that would not be possible under the IAIS insurance core principles (ICPs). Regulators will want to take steps to avoid creating opportunities for regulatory arbitrage around market conduct, where insurance providers could define themselves as “microinsurers” or products as “microinsurance” in order to take advantage of lighter regulation.¹⁸ This is important on both stability and efficiency grounds, as well as for consumer protection.

A number of countries that have introduced specific microinsurance legislation, including Peru and the Philippines, appear to have charted a sensible path between limiting the scope for arbitrage while allowing for innovative approaches. In some other countries, the rules may be constraining flexibility and limiting the development of microinsurance, for example, by requiring high minimum capital for all underwriters,¹⁹ or imposing developed-country standards on the provision

¹⁷ Typically, the insurance component costs are of the order of 1.5 per cent or more of the loan amount and loss ratios of less than 20 per cent are not uncommon.

¹⁸ This consideration has been one reason for the delay in the launch of the Cambodian microinsurance sector – the proposed legislation will impose lighter capital requirements than for mainstream insurers.

¹⁹ Crecana, a viable insurer for the low-income group, had to cease operations in Bolivia for this reason.

of advice, including comprehensive “fact finds”.²⁰ Some markets have found ways to work around such limitations, but it would be preferable for the regulation to recognize the differing needs of different market segments (*see Box 26.3*).

Box 26.3

South African rules on advice

In South Africa, the Financial Advisory and Intermediary Services Act (FAIS Act) requires the intermediary to provide enough information to enable the consumer to make an informed decision. Where advice is provided, there are specific and relatively onerous rules as to how this is to be done and by whom. In particular, the intermediary must be a registered financial adviser, carry out a financial needs analysis of the prospective buyer, and ensure that the consumer understands the advice given.

This requirement could have limited the development of low-cost microinsurance. In practice, insurers have been able to develop a “tick a box” no-advice category of tied agency (e.g. for simple, standard products sold through retail stores), employing an interpretation of a provision of the Act that was intended for a different purpose. Ideally, such adaptive strategies would not be required.

Source: Adapted from Bester et al., 2006.

It is noteworthy that the India and Philippines laws explicitly provide for a defined category of tied microinsurance agent that is subject to less onerous requirements than a normal broker or tied agent. Microinsurance agents are typically required to have specified experience in dealing with the economically active poor and to have received a minimum amount of training, and in the case of aggregators, to be not-for-profit organizations. They may be expected to carry out a wider range of functions than a mainstream agent, and be remunerated accordingly. However, they may be exempted from the need to pass examinations and have extensive formal educational qualifications. This seems a practical solution.

26.4 Non-legislative and non-regulatory consumer protection

26.4.1 Complementary role of industry codes of conduct and standards

Poor market conduct by insurers and intermediaries can result in overly intrusive and expensive consumer protection regulation. Such a regime can be problem-

²⁰ A “fact find” is a questionnaire that demonstrates that the intermediary has made sufficient enquiries to be able to recommend an appropriate product and sum insured/premium level (i.e. a financial needs analysis).

atic and even counterproductive from a market development and financial inclusion perspective, and result in a lower level of consumer welfare, e.g. if consumers' informal options are inferior to those available in the market. This argues for careful balancing of regulatory responses with the actual risks observed in the market and perhaps a more incremental and "learning-by-doing" approach to the design of a regime. It also suggests that there can be a role for well-designed responses that address the root causes of consumer protection problems by other than purely regulatory means.

Enlightened supervisors and industry associations in a number of countries have recognized this by putting in place industry codes of conduct designed to rein in short-term profit-maximizing business strategies and ensure that consumers receive appropriate products and fair treatment, so they can develop trust in formal products and providers. To this end, the microfinance industry has carried out various initiatives to develop codes and standards for responsible behaviour, including the Smart Campaign, which is organized around seven client protection principles that roughly correspond to the principles proposed in this chapter.²¹ The Campaign is now developing more detailed guidance for different microfinance services including microinsurance. The Microinsurance Network has also formed a consumer protection task force to perform more in-depth work of this type.

One key challenge with self-regulatory approaches is whether rewards and sanctions will be sufficient to motivate operators to achieve high levels of compliance. In the microfinance sector, the Campaign works on the premise that the combination of the development core values of most players in the sector, moral suasion and reinforcement by funders such as social investors will produce acceptable levels of behaviour and continuing improvement. Experience from other self-regulatory initiatives suggests that commitment and supervision on the part of the relevant regulatory authorities can also be a powerful success factor.

26.4.2 Complementary role of consumer awareness and education initiatives

While low levels of formal education and familiarity with formal finance can also be a barrier to effective implementation of consumer protection in the microinsurance sector, the economically active poor are very aware of risk. Events such as the temporary sickness of a wage earner or loss of a cow can be

²¹ See description of the principles and tools for providers, associations and other stakeholders at www.smartcampaign.org. The Campaign benefited from efforts by MFIs and networks to develop codes of conduct and work such as that carried out by the SEEP Network, which earlier articulated the goal of ensuring service provision that is ethical, dignified, transparent and equitable (see SEEP, 2010).

catastrophic for a poor family. However, it can be difficult to grasp the value of a product that can meet their needs, but which is entirely unfamiliar and possibly somewhat counterintuitive. While consumer characteristics do not prevent their understanding the contract or their rights once they have been explained, doing so well takes some careful thought and the mis-selling and malfeasance risks may be greater.

Taken together, these factors reinforce the need for consumer awareness and basic financial education measures to complement a consumer protection regime. Such measures are facilitated by regulatory requirements such as plain-language disclosure and accessible recourse mechanisms. Furthermore, an educated market is much easier to develop.²² Thus, while trust in the intermediary is a main driver of the purchase decision, there is early evidence that some basic financial education can raise consumers' awareness of their risk management options and their contractual and general legal rights once they have entered into an insurance contract.

In the course of testing its Consumer Protection Curriculum in various low-income markets, the Global Financial Education Program (GFEP) noted that the economically active poor often do not realize that they have general legal rights outside the insurance contract wording. Furthermore, GFEP found that only 16 per cent of the poor consumers they worked with trusted insurers prior to participating in the pilot tests of their Risk Management and Insurance Curriculum; after the training, 71 per cent were prepared to concede that some insurers were acceptable (GFEP).

The consumer awareness-raising and education process is likely to require a joint effort by supervisors, industry and other resources such as education ministries or specialized NGOs. While face-to-face involvement to build financial capability would have certain advantages (assuming the potential policyholders can afford the time), the GFEP data and authors' own experience suggests that other channels and popular media such as radio or television soap operas might offer broad outreach potential for insurance awareness and education in most developing countries. Secondary schools may also offer a fruitful channel for long-term knowledge and behaviour change, and have been a method of introducing the insurance concept for many years in developed countries. Not to be forgotten is the fact that the need for consumer education and financial capability is greatly reduced when products are suitable, delivered in a fair and transparent manner and subject to recourse when problems arise.

²² Three Nobel prize-winners (Akerlof, Spence and Stiglitz) have demonstrated that well-informed markets develop more quickly and along a healthier track.

26.5 Emerging good practices

A number of emerging good practices have been identified that might form the core of a proportionate consumer protection regime for microinsurance. Before they could form the basis of any normative regulatory recommendations, however, they would need to be tested on the ground and tailored to context. The practices are categorized under the three broad consumer-protection goals of transparency, fair treatment and effective recourse.

1) *Transparency:*

- Require that the client knows who the ultimate insurer is, e.g. when the insurer's name is clearly stated in the sales documents, the policy and any “Key Facts” documents.
- Require adequate and comprehensible disclosure of the price of the policy, what it does (and does not) provide, the premium payment obligations, when and how a claim can be made under the contract, and for how much, including any exclusions or limitations on cover arising out of explicit or implied warranties.
- Require adequate and comprehensible disclosure of claims procedures and how to access recourse mechanisms if things do not go as expected.
- Given the profile of microinsurance consumers, such disclosures will need to be as simple, comprehensible and accessible as possible to those with lower levels of income, experience and formal education. Standardization of disclosure formats and wordings can help facilitate consumer understanding and comparison of the different products available.

2) *Fair treatment:*

- Require mechanisms to be in place that will mitigate the impact of high-pressure sales practices by ensuring that potential consumers have time to consider the suitability and value for money of the product(s) on offer. Examples of such mechanisms include post-sale call-back by the insurer (using electronic means where possible) and free look periods (*see section 26.3*).
- Give attention to the effect of overly obtuse wording, especially if it limits the delivery of insurance services when customers might otherwise expect that they would be delivered, and consider encouraging operators to offer relatively simple products (e.g. those with standard wordings or restrictions on arcane exclusions and warranties).
- Allow product bundling when it affords benefits (e.g. cost savings or convenience) to customers as well as the provider, subject to suitability and disclosure requirements being met.²³

²³ While bundling may occur at point of sale, the different products may still be effectively provided by different institutions.

- Require that all intermediaries be formally licensed or registered,²⁴ and that they comply with appropriate and proportionate regulation adapted from mainstream markets.
- Make insurers responsible for the actions of their tied agents in delivering and servicing the product(s).
- Ensure client moneys are secured and properly recorded.
- Monitor claims settlement performance through such measures as loss ratios and time between claim notification and payment.

3) *Recourse:*

- Require insurers or affiliation groups that intermediate for them²⁵ (i.e. aggregators) to establish internal complaints-handling procedures that are timely and easily accessed by microinsurance consumers. For example, complaints procedures that are timely, free and convenient, and can be accessed in person and without onerous paperwork. To the extent feasible, the supervisor should oversee the effectiveness of internal dispute resolution systems and have insurers or affiliation groups report data on the outcomes of complaints and dispute resolution.
- If economic considerations permit, appoint an independent consumer representative such as an ombudsman. Alternatively, ensure that consumers have access to a consumer protection unit within the relevant supervisor's office or an independent industry body.
- Require "free look periods" (post-sale periods during which the new policyholder may terminate the contract and receive an equitable refund) for long-term or complex products – particularly if they contain significant exclusions or warranty wordings.²⁶

Research shows that the policy environment can have a major impact on insurance sector development at all levels. Regulators can draw upon these emerging good practices selectively, according to product type, consumer context, level of market development and supervisory capacity. If applied appropriately, these good practices should significantly contribute to financial inclusion through the development of value-adding and sustainable microinsurance markets.

²⁴ Subject to supervision by the regulator, this could be done through approved insurers for individual tied agents.

²⁵ For example, MFIs or self-help groups.

²⁶ If included in policy wordings, this could also be categorized under fair treatment.