Munich Re Foundation
From Knowledge to Action

CGAP WORKING GROUP ON MICROINSURANCE

बीमा विनियामक और विकास प्राधिकरण
INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY

## Summary

## Microinsurance Conference 2007

### 13–15 November 2007, Mumbai, India

**Parallel Session 11** – Regulation, supervision and policy
**Challenges for regulators and supervisors**

**Mr. Arup Chatterjee,** IAIS, Switzerland
**Ms. Martina Wiedmaier-Pfister,** GTZ, Germany
Faciliator: **Dr. Brigitte Klein,** GTZ, Germany
*Challenges for Regulators and Supervisors*

One plenary session and two working groups were conducted on Regulation, Supervision and Policy Issues of Microinsurance. This final session aimed at synthesizing what had been discussed and, based on input statements and discussions - providing a summary for the future.

The session was guided along the following issues:

1. Policy environment
2. Rule-based versus principle-based approach to regulation and supervision
3. Mainstreaming microinsurance
4. Operational concerns in the regulation of microinsurance

### 1. Policy environment*

**Clear mandate**: It is important that policymakers provide a clear mandate to the regulator/supervisor to develop an enabling regulatory framework for the microinsurance sector. This is the case e.g. in India (IRDA's insurance sector development mandate), South Africa (Financial Access Charter), Brazil (National Microfinance Policy). In Brazil, the policy gave SUSEP the mandate to enter into dialogue with the industry and to come up with a model regulation. In Colombia the microinsurance market is private sector led. The Colombian government has launched a programme called "Banca de las Opportunidades" which apart from savings and loans also covers microinsurance. This policy - though not explicitly focusing on microinsurance - has nevertheless given a clear signal to the industry by not defining any regulations on the distribution and also on the prudential side and by encouraging innovations in products and delivery mechanisms. Though a full-fledged policy may not always be necessary, a clear signal from the government is important in order to help the insurance supervisor to get engaged in consensus building. From the government side, it can be normally expected that the ministry in charge of the financial sector shall be the one responsible for coordinating efforts

Supported by:

gtz

Federal Ministry for Economic Cooperation and Development

THE WORLD BANK

related to microinsurance with other departments e.g. social security, health, rural development, and agriculture etc.

**Conductive regulations**: In India, only three types of MFIs (NGOs, SHGs and MFis which are societies and cooperative societies) can act as agent. Including other MFIs and financial service providers such as Rural Banks and Cooperatives can enlarge the scope of delivery mechanisms considerably.

**Coherence and coordination among ministres**: In India, the Ministry of Finance spearheads the plan to introduce a Financial Access Policy. As many government agencies (at national and state level) are involved in insurance or social protection issues, there are many ad-hoc and isolated initiatives, and conflicting issues. A Financial Access Policy can provide the needed coherence and coordination.

**No distortions**: Government should avoid subsidising and implementing insurance schemes that distort market-led initiatives for insurance provision. In order to ensure better targeting of subsidies governments can avoid coming up with solutions for certain low income populations who can afford to pay health insurance premium and instead focus at the poorest of the poor. In this sense, the insurance scheme mentioned by the Minister of Finance in his inaugural speech, which aims at reaching out to 10 million of the poorest people in India and where premiums are finance by the government, may not be considered to be microinsurance in a commercial sense, but rather an instrument to provide basic social security to the poorest who cannot afford to pay premiums.

**Fiscal incentives:** Fiscal incentives like abolishing financial services tax (FST) can spur microinsurance up-take by the poor. Colombia still has a FST of 16 % on premiums, India 12.5 % on premiums and on commissions. In Brazil, FST was abolished for all life insurance which – according to the statements made by the Brazilian supervisors present - spurred sales also of life microinsurance products.

**Pros and cons of quotas and industry targets**: In India, the rural and social sector obligations issued by IRDA have clearly motivated the industry to provide microinsurance. In South Africa, the government has motivated the industry to subscribe to voluntary industry targets. Both countries are leading the expert discussion in microinsurance policy issues including regulation, and their industry players shows first results. However, the groups left it open whether or not a prescriptive approach is recommendable in general. This aspects still needs a thorough evaluation. Quota should not be misunderstood as indicator.

**Summary of discussion:** Better clarity on the relative importance of policy interventions on these issues can motivate insurers to engage themselves in providing microinsurance. In some countries, the industry became engaged without much involvement of the government. In other countries, the government is seen as a proactive driver of the process. In any case, the industry alone cannot go too far without the government also facilitating microinsurance. “Policy matters.” Policies make government mechanisms work. The mandate should not only focus on stability but also have a visible impact on market inclusion.
The two ways of developing microinsurance are complementary and go together like two sides of a coin: the policy side and the industry side. The government can facilitate consensus building and thereby allow different stakeholders to play their specific roles more effectively and efficiently.
Proposals for amending the insurance law by lowering MCR for entities intending to serve the low income segment should include all legal forms of insurers.
There should be due understanding and awareness of the specific form and role of member-based insurance schemes when implementing microinsurance regulation.

## 2. Rule-based versus principle-based approach

The advantages of both approaches, and related examples, were presented and discussed as follows.

| **Rule-based approach** | **Principle-based approach** |
|---|---|
| More traditional approach<br>Detailed rules and regulations which try to regulate all aspects | New approach which tries to determine key principles<br>More flexibility and responsibility for industry, regulator and customers |
| Relies less on supervisors capacity | High capacity and involvement of supervisor required |
| Disadvantages:<br>- Regulators and supervisors following this approach spend a lot of time crafting perfect rules (which sometimes the industry finds ways to circumvent); they can slowly tighten it to give the | This approach is more difficult to follow as it can also create uncertainty in markets which are not mature; and operational issues (e.g. examination, reporting) are difficult to define |

| | |
|---|---|
| rules more flexibility<br>- Laws have become too many and too cumbersome, too static | |
| Emerging markets still prefer a rule-based approach because of poor consumer education and low budgets; but when they review their laws they should consider whether they can follow a principle based approach. | Developed countries often follow a principle-based approach. Principle-based works best in mature and developed markets with a high level of consumer awareness. |

Though there is movement towards the more modern "principle-based approach", both approaches have advantages and disadvantages – and consequences e.g. that the principle-base approach requires a lot of capacity building for supervisors, and there is no clear recommendations which approach to follow  as this depends on the situation of the individual jurisdiction.

## 3. Mainstreaming microinsurance

Definition (to be agreed-upon):

a) "Integrating the un- and underserved into the formal insurance system"

b) "Integration of insurance services for the low-income segment into the formal insurance sector"

There are several options for mainstreaming microinsurance.

### 3.1 Integrating (small)  informal players into the formal insurance system

a) The integration of informal (e.g. funeral societies) or semi-formal players (e.g. NGOs, Cooperatives) is a big issue in many countries with many related questions. During the conference, two cases were presented where a lower tier was created (Philippines Mutual Benefit Associations) or will be created (South Africas Microinsurance license). In West Africa, a standardized regulation was drafted to bring Health Mutuals operating successfully under the regulatory ambit, although not necessarily the insurance supervisor. In India, cooperatives are trying to dialogue with the government and regulator to introduce a lower tier as presently insurance cooperatives have the same minimum capital requirements (MCR) like commercial insurers (25 million US$).

However, this move towards a favoured treatment only for cooperatives only has been questioned by IRDA.  It was pointed out that argument for a lower capital regime for reaching out to the low income segment is valid for all forms of insurers and not only for cooperatives. Therefore proposals for amending the insurance law by lowering MCR for entities intending to serve the low income segment should include all legal forms of insurers.

b) Supervisors in general are reluctant to introduce a new tier of insurers as they fear an increase in regulatory burden of regulating and supervising thereby resulting in increased regulatory cost; and, also lack of regulatory capacity and therefore want to keep the number of entities to supervise limited. The existing insurers may also resist as they fear the new competition may be distorted owing to regulatory arbitrage due to a possibility of a different treatment.

c) The regulatory cost for the new insurers may also deter formalisation as it may make provision of their services more expensive and thereby drive clients away (e.g. the requirement of clients ID card).

**Summary of discussion:** The creation of a new tier depends on the country situation. If there is a large number of informal players (such as in South Africa) there is hardly an alternative to such options in order to avoid damage, regardless the capacity of the supervisor. The push from the microfinance industry points in the same direction as happened in the Philippines — CARD MBA and a number of MFIs which run insurance portfolios in the MFIs have motivated the supervisor to create a new tier. Supervisors may want to rely on the risk based-capital approach as in the Philippines (where MI-MBAS can gradually build their capital base as the volume of operations grows).

### 3.2 Motivating (large) insurance companies to provide large-scale microinsurance

Motivating traditional insurers is a major issue and there are various ways to do this such as:

a) improve regulations for delivery channels (In Uganda banks and Micro-deposit taking institution, (Microfinance Deposit-taking Institutions/MDIs cannot be an insurance intermediary and sell bank assurance products);

b) do away with regulations which are either conflicting in nature or are difficult- to-implement e.g. payment systems, rules for specific Financial Institutions (in India Rural Banks cannot collect premiums or claims and pass them through their books); allow the application of other regulations more flexible (in Colombia AML create problems; in South Africa a “Easy Bank Account” for low-income population has showed good results.

c) initiate and maintain a dialogue with the insurance industry like in Brazil, South Africa and India to continuously share information on developments amongst all stakeholders, or to convey their views on regulatory adaptations;

d) support public campaigns for consumer education which can help in creating an insurance culture among the poor (in Philippines the Ministry of Finance and the Central Bank, including the Insurance Commission promote such a programme which includes radio and has named January as the microinsurance month; in India IRDA promoted a literacy campaign in 14 languages (a live radio and television phone-in programme was well received). In China, financial literacy issues have been made compulsory in school text books.

The informal insurance market should be given room for development and evolution outside of the licensed framework and be integrated at the right moment without imposing a model.

### 3.3 Green-fielding (building institutions from scratch)

Is this an option? We have not discussed this in the past. During this conference, the issue emerged related to India, as SEWA is interested in creating its own insurance company or insurance cooperative (see new above discussion on a new tier).

The same may be true for countries with a very weak insurance system such as former socialist of post-conflict countries (Angola, Sierra Leone, Laos). See e.g. the lessons from microfinance where there are many social investment funds.

## 4. Operational concerns in the regulation of microinsurance

- In Uganda some insurers provide life-insurance product (which tend to have a higher risk profile and therefore, often require a different kind of license) under a non-life license. The supervisor has not found a solution yet to this situation.

- In South Africa, commission caps do not apply to funeral insurance. Commission caps apply to all other insurance products, therefore the industry has introduced tick-box products. Market conduct regulation in South Africa is very restrictive which makes selling micoinsurance difficult. As a consequence, many insurers have shifted away from advice-based to non-advice based selling based on standardized tick-box insurance products. The industry also uses cheap channels (e.g. retailers). However, here, consumer recourse is more difficult. There is the option to better organise consumer recourse when entry requirements are lower.

- General discussion on commission caps: While the general argument is in favour of keeping commissions capped so that premium levels are kept down, an additional argument was to do away with the commission caps to allow microinsurance to spread and promote competition in order to achieve a critical mass. This will help in realising commission levels which are realistic to sustain in the business.

- Need for statistics. In the absence of data there are no performance parameters to evaluate the relative success of different microinsurance initiatives. Therefore there is need to establish common standards for collecting, collating and analysing data so that experience can be shared.