Improving risk management for the poor

The Working Group on Microinsurance, initiated by CGAP and comprising of representatives from donors, multilateral agencies, NGOs, private insurance companies and other interested parties, was established in 2001 to promote the development of insurance services for the poor through increased stakeholder cooperation and information sharing. Currently chaired by the International Labour Organization (ILO), the Working Group is organised into four subgroups: Operations and Donor Guidelines, Demand, Regulation and Dissemination. To share information about microinsurance initiatives, the Working Group issues this quarterly Newsletter. For more information contact Craig Churchill, churchill@ilo.org.

To receive the coming issues of MICROINSURANCE, please contact insurance@microfinance.lu

Microinsurance regulation in developing countries is an emerging field. Specific regulations for microinsurance do not exist, and the existing general regulatory framework is not adequate. Weaknesses are, for example, related to high capital requirements, policy details, agent regulations and the "sole business line" requirement.

It is recognized that regulation can either promote or restrict insurance provision for lower income groups. A well-designed regulatory framework is a major factor for the effective and efficient provision of microinsurance services. In promoting more professional and expansive microinsurance services, regulation can play an important role by encouraging microinsurers' decision to become regulated, and by facilitating this process.

Role of Insurance Regulations

Regulations define the requirements of an insurer, provide consumer protection through the supervision of insurers to safeguard their solvency and thus shield the customer from buying insurance from an unsuitable company. More specifically, insurance regulations:

- protect customers from misleading sellers,
- protect the financial viability of insurers,
- define the general features of insurance,
- define duties and responsibilities,
- define the conditions for the entry and exit of players in the market,
- guarantee a level playing field in the market.

Regulatory Authorities

The insurance regulator is either a separate body for the insurance sector (e.g. in Argentina, India, Sri Lanka), or it is responsible for various areas in the financial system (e.g. banking, pensions and securities - like the Superintendency of Pensions, Insurance and Securities in Bolivia).

The regulator is in charge of all insurances, which should also cover microinsurance. However, most of them have continued to concentrate on regulating (and supervising) commercial insurance companies and not included microinsurance. In addition, microinsurers themselves have rarely approached regulators and applied for a license. We find an exception to this in the Philippines, where a microinsurer approached the regulator and received an exemption from the stipulations of the insurance law.

The role of the regulator in the growth of microinsurance is critical, a fact which is slowly being recognized. Studies indicate that it will only be a matter of time before they take (or will have to take) steps to deal with this situation. In India, however, the coverage of insurances for the poor has been integrated into the insurance law – this is new in the world of insurance. With continued political support, this approach will lead to a wider provision of insurance services to lower income households.
Country Example …

<table>
<thead>
<tr>
<th>... how regulation CAN PROMOTE microinsurance</th>
<th>... how regulations CAN HINDER microinsurance</th>
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| India: The “Obligations of Insurers to Rural or Social Sectors” from 16th October, 2002 stipulate that insurers that started operations after 1999 must sell a fixed percentage of their number of insurances to the social sector and rural areas. | Minimum capital requirements are prohibitively high for the micro segment (Uganda 1 million US$, SA 1.2 million US$, India 21.2 million US$).

Obstacles to partnerships between MFIs and insurers:
- requirements that do not allow MFIs to sell insurances, e.g. making use of an officer in a “universal” way, but requiring specialised staff for insurance;
- requiring an agent to be a private person (not an enterprise or NGO).

High and cumbersome reporting requirements (administrative burden to prudentially regulated insurers). |
| Sri Lanka: Deregulation of the insurance sector allows for new providers, which affects the micro-market positively. |
| Jordan: Government planned to revise the insurance law in 2002 in order to promote microinsurance, e.g. concerning the licensing conditions for insurance agents and the NGO law (realization should be analysed). |
| Philippines: Mutual aid schemes are allowed to operate under lower capital requirements. |

Loopholes in Insurance Regulations

<table>
<thead>
<tr>
<th>Country</th>
<th>Problem</th>
<th>Consequence</th>
</tr>
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<tbody>
<tr>
<td>All countries</td>
<td>If the scheme is available to members only, and NGO complies with MFI regulation, insurance regulation does not apply.</td>
<td>• NGOs, mutuals etc. are not “insurers” as defined by the law.</td>
</tr>
<tr>
<td>South Africa</td>
<td>A MFI cannot register as an insurance company. But the Friendly Societies Act allows NGO/MFIs to sell insurance (up to 675 $). If policy benefits for funeral insurance “are something other than a sum or money” (a benefit in kind, e.g. mortuary, transport, catering services), then the contract is not considered an insurance policy.</td>
<td>• Insurance activities of these institutions are not restricted or supervised and their customers not protected.</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>Mutual health insurers are recognised within the broad category of voluntary non-profit organisations and governed by a separate law.</td>
<td></td>
</tr>
</tbody>
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Sources: “Making Insurance Work for MFIs”, ILO 2003; South African Microinsurance Case Study, Aliber 2001

Today, many microinsurance providers are operating in legal loopholes, outside the insurance laws. (See table above). The risks and problems associated with this situation are considerable. Neither the interests nor the funds of consumers receive adequate protection; and institutional risks (e.g. mismanagement) are high. Even though this situation facilitates innovation and service provision, it is not a sustainable solution for the provision of microinsurance on a massive scale.

The Future Challenges

A number of questions emerge when analysing the implications of the current (inadequate) regulatory framework on microinsurance:
- How adequate are the regulations in terms of safeguarding the interests of microinsurance clients?
- Which types of institutions are favoured or hindered by the present regulatory framework?
- How can the cost of regulation and supervision be minimised, while at the same time ensuring quality services?
- What can the regulatory framework contribute in order to motivate informal insurers to legally provide microinsurance services?
- How could a tried system of regulation and supervision for microinsurance be developed?

The expected development of microinsurance comes along with a number of challenges in the field of regulation and supervision, which can be summed up in five activity fields: (1) development of a framework for the regulation and supervision of microinsurance; (2) sensitisation and concertation; (3) analysis of lessons from microfinance; (4) empirical analysis of regulatory environments and (5) networking.

Regulatory Fields to be Improved

Regulation, or the non-existence of (adequate) regulation, can affect the provision of microinsurance in manifold ways. These regulations can (unintentionally) restrict the provision of insurance to low-income markets (for example, by favouring large companies). This is especially true for regulations on capital requirements, the requirements for agents, the role of the insurer, policy details, the semi-formal schemes, reinsurance and the varying requirements and definitions.1

For example, minimum capital requirements are usually too high, compared to the small amounts of the policies, and for locally organised small microinsurance institutions, and the requirements for agents are either too low (anybody without prior formation can act as agent), or too restrictive.

1 Adapted from Warren Brown, Craig Churchill, 2000
Microinsurance Regulation in India

Unlike most regulators, the Indian government has been very involved with microinsurance, both as promoter and as regulator of this industry. The driving agent behind this has been the Insurance Regulatory and Development Authority of India (IRDA), which has consulted widely with the public on regulatory issues. The impact of their interventions has been significant. Nonetheless, it is too early to say, if this impact has been overall positive or negative.

This paper discusses the two main documents, published by IRDA: “Obligations of Insurers to Rural Social Sector” and “Concept Paper on Need for Regulations on Micro-Insurance in India”, and highlights some of the first lessons for the field of microinsurance regulation.

Obligations of Insurers to Rural Social Sectors

This document has been published in 2002 and quintessentially outlines a quota system. It compels insurers to sell a percentage of their insurance policies to de facto low-income clients. It was imposed directly on those new insurers who entered the Indian insurance after the market was liberalised. The old public insurance monopolies have no specified quotas, but had to ensure that the amount of business done with the specified sectors was “not to be less than what has been recorded by them for the accounting year ended 31st March, 2002”; a figure that would be revised from time to time by the regulator.

The social sector target is aimed at rural clients. With the great majority of poverty in India located in rural areas, the effect of such a stipulation is to ensure that poor clients are reached.

The quota rises each year reaching a maximum of 16% after 5 years of the total number of life policies sold for life insurance and 5% of premium income for other types of insurance. The former is likely to be easier to reach than the latter, considering how many insurance policies covering huts need to be sold to attain 5% of the premium of $ 100.000 houses in Bangalore. This condition has generated massive pressure on insurers as without selling microinsurance they cannot sell their more profitable products. To date the IRDA has fined a number of insurers for failing to meet their targets.

The regulation has also been the motor for important innovation in the sector. To date much of the innovation in microinsurance worldwide has derived either from donors, academics or MFIs working on the issue. In India, in their drive to meet their microinsurance sales targets, regulated insurers are developing innovative new products and delivery channels, and allocate considerable resources to this task.

However, it would certainly be socially unfortunate if the regulation resulted in a mass of poorly serviced products sold at a loss, to enable insurers to concentrate on their more profitable products, and this danger clearly exists.

Concept Paper on Need for Regulations on Micro-Insurance in India

This central regulatory document, which is not yet official, was published by the IRDA in August, 2004, and reflects the intentions of the regulator. There is much that is commendable, but there are two significant concerns: The implicit restriction to the partner-agent model, and the lack of product flexibility.

Limitations of a Single Model in Microinsurance Delivery

The approach taken by the IRDA in its Concept Paper is, however, to restrict microinsurance to the partner-agent model. The case for supporting and promoting the partner-agent model is very strong in India, in particular when coupled with a quota system compelling insurers to sell to the poor. From the point of view of the regulator, it does not have to deal with thousands of institutions that do not specialise in insurance, which often know little about it and cannot produce the reports it requires. From the client’s perspective the partner-agent model gives the client the security that a regulated large insurer is holding their premiums. From the intermediary’s perspective, they offer their clients an extra product, receive agent’s commission for selling the product and do not need to carry significant risk. The IRDA has recognised the benefits of the partner-agent model and as such is at the cutting edge of microinsurance regulation worldwide.

Apart from the fact that not everyone wants to buy policies of regulated insurers, and communities often prefer to pool their funds to form their own insurance schemes, the focus on the partner-agent model does not seem an adequate response given the scale and number of other microinsurance delivery mechanisms in India. It may be prudent to recognise and regulate the existence of these institutions and provide thresholds for conversion to a partner-agent model. Many countries allow small insurance schemes, that do not present significant systemic risk, to operate under a simplified set of regulations, for example the British “Friendly Societies Act”. Another general issue not addressed by the Concept Paper, is the issue of capital adequacy requirements. The IRDA takes an extreme position on the capital required to do microinsurance, and they don’t provide a precise mathematical formula for deriving a figure for capital requirements. In India, an insurer that wishes only to sell low cost microinsurance policies would need to have the same capital as an insurer selling other forms of life insurance. For example, in 2003, an insurer in India required approximately $ 21.7m to undertake life insurance compared to just $ 3.7m in Sweden, $ 2m in New York State, $ 1m in Uganda, $ 1.2m is South Africa and only $ 0.258m in nearby Sri Lanka.

Product Flexibility

Essentially the concept paper creates a framework for NGOs and MFIs to sell microinsurance. While there is nothing inherently limiting in this arrangement some of the clauses in the Concept Paper severely curtail the capacity of MFIs and NGOs to get products out that best meet their own needs and those of their clients.

In defining what a microinsurance product is, it creates two seemingly arbitrary products, a life microinsurance product and...
a general microinsurance product with a specified minimum amount of cover, term of cover, age of entry and age of exit. Unless the product sold by the insurer meets these criteria, their product will not be classified as a “microinsurance product” and therefore will not be able to avoi of some of the exemptions. Some of these conditions are out of sync with existing microinsurance products in India. For example the Concept Paper sets a minimum amount of cover of Rs. 10,000. In client surveys undertaken by partner organisations of Friends of Women’s World Banking, many NGOs found that their clients were not able to pay such an amount of cover. They preferred less cover for a lower price. The “Minimum Amount of Cover” requirement would exclude a large segment of the poor from the insurance market.

In recent informal discussions with the IRDA, it has indicated that in the final regulations, a microinsurance product will be defined solely by the maximum amount of cover. An issue that remains is how a microinsurance product will be registered with the IRDA. At present an insurer wishing to introduce a new product on the market in India needs to go through a “File and Use Procedure”, divided into life and general products. Insurers have told me that obtaining the relevant information and completing the required forms can take several weeks. While this may be justified for complex insurance products with significant sums assured, with microinsurance and its low sums assured, such a long and complicated procedure does not seem necessary.

At present in India many MFIs have met the needs of their clients by partnering with a variety of insurers. For example, Grama Vidiyal an MFI in Tamil Nadu provides life insurance through Allianz Bajaj and AMP Sanmar. The concept paper does not permit this. In Section 7a of the concept paper states the microinsurance agent “shall work either for one life insurer or for one general insurer or for one life insurer and one general insurer”.

Section 7e sets caps on how much commission can be charged. These caps may affect the products that MFIs and NGOs are prepared to offer and will create barriers to sell to the poorest segments of the population. The cap set on commissions for servicing life policies is set at 20% while the cap set on servicing health insurance, which is much more expensive to service, is set at 7.5%.

There are many other issues with these papers, which cannot be discussed in the frame of this article.

Possible Lessons for the Regulation of Microinsurance

The Indian case has some reasonably unique features, for example, many insurers may be willing to take a loss on their microinsurance business to tap into the huge regular Indian insurance market. Insurers may not be willing to do so in other developing countries where the regular insurance market may not be as large or lucrative. However, as microinsurance grows globally, regulators elsewhere are likely to look at India with its large microinsurance sector for ideas on regulation. It would be useful if these ideas were evaluated.

Faced with a number of means of expanding microinsurance in India, the IRDA has focused exclusively on the partner-agent model. While there is a strong case for favouring this model, it is unclear why it has excluded other means of expanding microinsurance, e.g. by creating a framework for small insurance schemes. Expanding access to microinsurance is likely to require a multi-pronged approach in which the partner-agent model should play a role, but not exclusively.

Whatever the shortcomings of the “Concept Paper on Need for Regulations on Micro-Insurance in India” are, the creation of a regulatory framework is a substantial advance for the regulation of microinsurance and the consultative manner in which the regulation came about.

This contribution has been prepared by Jim Rotti, Chief Technical Adviser ILO India based on the following paper: “Concept Paper on Need for Developing Micro-Insurance in India”, August 2004.

More info: http://www.irdaindia.org/

Case Study

The Centre for Agricultural Research and Development (CARD) - Philippines

CARD has benefited in its ability to offer microinsurance products through a microinsurance friendly legal structure based on the Mutual Benefit Association (MBA) legislation.4

Risk-sharing and other forms of risk management through solidarity mechanisms have been part of community life in the Philippines for centuries. One of the scheme types that remain prevalent is the practice of damayan. The damayan has become the basis of risk-pooling schemes for life insurance and is common among co-operatives and associations. In this self-insurance scheme, group members agree to shift the risk from one individual to the group, which manages and owns the risks collectively. They have been institutionalized and labeled as “life insurance” by MFIs, along with the installation of some policies to make the custom of damayan binding and compulsory. This active risk pooling tradition has helped the insurance regulators to see the benefit of such local, self-managed insurance.

The Philippine Insurance Commission is the government agency that regulates and supervises the insurance industry in accordance with the Insurance Code. With the objective to promote the coverage by insurance, the insurance code provides specific procedures for MBAs and Trusts for Charitable Uses. Mutual Benefit Associations are registered first with the Securities and Exchange Commission (SEC) to become legal entities, and then are licensed and accredited by the Insurance Commission. They report their operations and activities to the Insurance Commission. Cooperatives are under the regulatory supervision of the Cooperatives Development Authority (CDA).


«Microinsurance, Improving risk management for the poor» is edited by ADA with the support of the Luxembourg Development Cooperation
The Philippine government has proclaimed its continued support of the insurance industry because they expect insurance to boost national savings and the further development of the capital markets. In 1997, the Insurance Commission launched the government’s 20/20 vision. This aimed to increase to 20% the number of Filipinos with insurance, in whatever form, by the end of the year 2000. In 1999, the government recognized the failings of the state health insurance programs, and completely restructured them with the objective that “the State shall adopt an affordable, adaptable health system covering all Filipinos” within ten years. Their commitment to expanding insurance creates a positive environment for microinsurance.

For the year ended 31 December 2002, fourteen mutual benefit associations submitted their annual statements to the insurance commission. Their combined assets were P8.49 billion (USD 155 million). Almost half or 44.6% of the aggregate assets came from the Armed Forces of the Philippines (AFP) Mutual Benefit Associations, followed by Philippine Public School Teachers Association with 18.7%. CARD MBA had about 0.8% of the total.

Member Benefit Associations (MBA) have the legal right to become full insurance companies given that they meet the minimum capital requirement. The benefit of this conversion is the ability to sell a broad range of products to the wider low-income market that is not interested in fulfilling the requirements of membership, or in transacting savings or credit products with an MFI. Additionally, it would give an institution like CARD MBA the opportunity to sell insurance directly to members of other MFIs.

However, the transformation from a non-profit (and therefore tax-exempt) mutual benefit association to a for-profit insurance company results implies severe tax burden. CARD MBA found that they would pay between 12.5% and 25.0% in premiums of taxes if they concluded their planned transformation. This would necessitate a reflective an increase in premiums to their members. They expected that this new premium adjustment, simply to pay taxes, would not be acceptable to their members, even if they were able to offer additional products to a broader market. This tax burden caused CARD MBA to abandon its transformation.

Generally, the MBA laws have been helpful in developing and securing large membership based microinsurance organizations. The entry requirements are relatively easy, yet stringent enough that the Insurance Commission has been able to keep out those that might act intentionally fraudulently. However, restricting to membership based microinsurance can create problems of concentration, and may keep a microinsurer from efficiently using the infrastructure they have built to serve their own members.


More Info on Microinsurance Regulation

**Other Publications**

- **A Cautionary Note for Microfinance Institutions and Donors Considering Developing Microinsurance Products,** MPB and DAI, (Brown/Green/Lindquist), 2000, [http://www.usaidmicro.org/pdfs/mbp/a_cautionary_note_for_microfinance_institutions.pdf](http://www.usaidmicro.org/pdfs/mbp/a_cautionary_note_for_microfinance_institutions.pdf)
- **Microinsurance: The Risks, Perils and Opportunities – a Guide through the Questions to address before Developing a Product,** SED Journal (W. Brown), 2001, [http://www.itdgpublishing.org.uk/content/sed12_1.htm](http://www.itdgpublishing.org.uk/content/sed12_1.htm)

**Terms and Definitions**

Regulation: Rules on the whole, set by the authorities and employable by the insurers, which deal with minimal capital requirement and required expert knowledge. Protect the consumer by ensuring the supervision of insurers and, in particular, their policies with regards to pricing, customer forms and sales practises.


**Websites**

- International Association of Insurance Supervisors (IAIS): [www.IAISweb.org](http://www.IAISweb.org)
- Insurance Information Institute (III): [www.iii.org](http://www.iii.org)
**Takaful - Islamic Insurance**

Takaful is an Arabic word meaning “guaranteeing each other” or joint guarantee, and is a form of insurance deemed permissible for Muslims under Shariah Law. Its basic philosophy is similar to that of cooperatives, with added restrictions on investments and more flexibility on capital formation.

The principles of Takaful insurance are as follows:
- Policyholders cooperate among themselves for their common good.
- Every policyholder pays his/her subscription to help those that need assistance.
- Losses are divided and liabilities spread according to the community pooling system.
- Uncertainty is eliminated in respect of subscription and compensation.
- It does not derive advantage at the cost of others.

Theoretically, Takaful is perceived as cooperative insurance, where members contribute a certain sum of money to a common pool. The objective is not profit, but mutual support.

The commercialisation of takaful has produced several models, each reflecting different experiences, environments and school of thoughts.

There is a lot of scepticism among the Muslim community about its permissibility, but also from the provider’s side, a lot needs to be done with regards to distribution channels. The fact that there are only a few players and a small capital basis makes the provision of access difficult for the moment.

The first microtakaful scheme was established in 1997 by the Agricultural Mutual Fund in Lebanon, which provides health insurance coverage for costs not covered by the government social security fund.


Source: “Takaful and Poverty Alleviation”, ICMIF, UK, October 2004

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**Latest Publications**


A **Microinsurance Sector Study: Sri Lanka** assessing the microinsurance demand in Sri Lanka has been published by GTZ. (Wiedmaier, M. & Wohlner, P.E., 2004). Main findings are that there is a demand for microinsurance and that a favourable framework for its implementation exists, but that only a few small private insurers are interested and have the potential to cater for the microinsurance needs of the low-income segment. Download at [http://www.microfinancegateway.com/files/20540_Microinsurance_Sri_Lanka.pdf](http://www.microfinancegateway.com/files/20540_Microinsurance_Sri_Lanka.pdf)

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**News from the Working Group**

The **Regulation Group** has prepared three extensive **case studies on microinsurance regulation and supervision** in order to gain deeper insight into how the lack of an adequate regulatory framework hinders access to microinsurance services in developing countries.

These studies aim to:
1. Provide an overview on the general situation of regulation and supervision in microinsurance in selected countries
2. Identify strength and weaknesses, best practices and lessons learnt, and
3. Derive conclusions and recommendations for sound and prudential regulation and supervision in microinsurance.

The main findings will be summarized in a synthesis report. On this basis, recommendations for the next steps for the development of a model regulatory framework will be made. The implementation of the case studies will start in January 2005.

Contact: Svenja.Paulino@gtz.de

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**Events**

**ILO** organised as part of its Strategies and Tools against Social Exclusion and Poverty (ILO-STEP) Programme a training course on **Contracting Health Services by Micro-Insurances**, in Senegal. 


**AAC/MIS XII.** Annual Conference on **Best Practices in Cooperative and Mutual Insurance in the Americas** took place last November in Asunción, Paraguay.

Info: [http://www.aacmis.org/Meetings/annualconf.htm](http://www.aacmis.org/Meetings/annualconf.htm)

**Provention Consortium** organised last October a conference on **The Potential of Insurance for Disaster Risk Management in Developing Countries** in Switzerland.

Info: [http://www.proventionconsortium.org/projects/insurance.htm](http://www.proventionconsortium.org/projects/insurance.htm)