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Regulatory Feasibility in Microinsurance

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Regulation is instrumental in development of microinsurance in any country. While microinsurance in countries like India and the Philippines has developed as a consequence of regulatory interventions, the absence of sector specific regulations has restricted development of microinsurance market in some high potential countries such as Indonesia and Mongolia. Many other developing economies such as Bangladesh, Nepal, Pakistan and Uganda, having realised the need, are now developing their first ever microinsurance regulation. However, if these regulations are not focussed on effective market development, they will fail to stimulate growth of their respective microinsurance sectors, as witnessed in the case of Cambodia and Vietnam.[1] So what aspects of a microinsurance regulation create an efficient and effective microinsurance market? In this Note we discuss a framework to analyse the feasibility and effectiveness of microinsurance regulation.

There are broadly three pillars of such comprehensive regulatory feasibility assessment.

1. Readiness of Regulator

For an effective microinsurance market, it is a pre-requisite to have an efficient regulatory structure that is ready for such developments. Such readiness is a function of the following aspects:

- ***Regulatory capacity***: For effective implementation of microinsurance regulation it is necessary to have a regulator capable of managing multiple and diverse types of entities. Though it is difficult to assess such capacity, the number of offices and staff of the regulator as well as the number of organisations currently regulated can indicate the bandwidth of the proposed microinsurance regulator. An independent insurance regulator which effectively supervises more than 100 insurers (e.g. the Philippines), for example, may have better regulatory capacity than a small division of insurance regulation in one of the ministries of the country, regulating less than 10 insurers (e.g. Cambodia).
- ***Regulatory arbitrage***: In some countries, different functions of insurance/microinsurance (e.g. investment, risk underwriting and distribution) are regulated by different regulatory authorities. For example, in Bangladesh, two separate entities, the Microcredit Regulatory Authority (MRA) and the Insurance Development and Regulatory Authority (IDRA) claim microinsurance to be under their respective regulatory control, potentially causing regulatory conflict. Similarly in the Indian insurance industry where, in 2010, the conflict between the Securities Exchange Board of India (SEBI) and the Insurance Regulatory and Development Authority (IRDA) led to deceleration in the industry. The existence of one regulator for, and/or close coordination amongst regulators of, different functions of microinsurance enables the sector to avoid such controversies and possible regulatory confusion.
- ***Implementation and market conduct***: For a mature and effective microinsurance sector, it is essential that regulations and supervisory guidelines are actually implemented in a manner that insurance and financial market fundamentals (e.g. client protection, process sanctity, fund management etc.), are followed by the players transparently and in accordance with the best practices in the world. While the very existence of guidelines for market conduct, underwriting, investment and solvency are indications of regulatory efficiency, the implementation level is confirmed by audits, grievance redressal mechanisms and the trend of regulatory revisions in the country, along with the regulator's history of punitive action against non-compliant entities.
- ***Flexibility***: Though regulators in nascent insurance markets often prescribe strict product specifications for microinsurance (e.g. Nepal), such initiatives are limited in their effectiveness. An innovative, client friendly and diverse microinsurance sector can emerge only if the regulator promotes a flexible product and distribution regime. The openness of regulator towards composite products (e.g. Cambodia); fast product licensing (e.g. the Philippines); semi-formal intermediaries (e.g. Pakistan); the bancassurance model (e.g. India) are some indicators of such flexibility.

2. Clarity in Regulation

Clear definition of products to be offered, practices to be carried out under microinsurance and its distinction in terms of different types of institutions, solvency, investment and market conduct are seeds for the development of a confident microinsurance market. This includes clarity on the following areas:

- ***Social security and microinsurance policy:*** Clarity on intention, quantum and areas of social security indicate whether such social security/insurance schemes will affect the growth of microinsurance sector positively or negatively. While fully subsidised universal health schemes wipe out the possibility of market based

[1] In both of these countries, microinsurance market remained underdeveloped in spite of specific microinsurance regulation

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health microinsurance development (e.g. RSBY of India), some governments want private microinsurance as part of their social security measures (e.g. CBHIs of Laos, VHI of Vietnam).

- ***Institutions for microinsurance:*** Globally, diverse semi-formal institutions, such as mutuals, health providers, and church groups, underwrite microinsurance products, either with, or despite lack of, regulatory legitimacy. In the absence of clear guidelines on institutions, many such unregulated entities can mushroom. These are often ultimately orphaned or unable to scale-up due to fear of being banned by the regulator in future. The risk of violation of client protection principles is also high if such unregulated entities continue to provide microinsurance in the absence of regulatory supervision. While some countries are pro-active in inviting such microinsurance specific institutions (e.g. Cambodia, the Philippines), most regulators prefer only commercial insurers to underwrite microinsurance, while adopting a "benign neglect" towards the semi-formal microinsurers (e.g. India).

- ***Product and pricing:*** Since microinsurance is new for many insurers, they feel more confident to enter the sector when the regulator clarifies the scope and boundaries around product features (e.g. India) and pricing range (e.g. the Philippines). In addition, pricing guidelines help overcome the practice of pricing without actuarial analysis, which is worryingly common in microinsurance. Apart from ensuring efficient and client friendly products, such practices help to avoid unfair competition through price undercutting (e.g. Uganda) and mis-selling around product features and benefits.

- ***Intermediary and distribution***: Since the maturity of any insurance market depends highly on the quality of solicitation (by individual and corporate agents) and service provided (by loss assessors, third party administrators etc.), clear guidelines necessary on roles and responsibilities of all entities allowed as either distributor or intermediary are essential. Moreover, the regulator's approach towards new and alternative distribution (e.g. banking agents in India and throughout much of Africa) affect the potential for growth of the sector in the country.

3. Promotion of Microinsurance

Microinsurance, is largely alien to commercial insurers, and thus develops only if the regulator and government actively promote microinsurance through regulatory and other measures. The regulator's intention can be assessed from the following:

- ***Ensure ready market of microinsurance***: Regulators and governments often encourage insurers to start microinsurance through market scoping studies (e.g. Pakistan) and/or by providing a captive client base to them by allowing government infrastructure to be used for microinsurance. In many countries microinsurance has, in fact, initiated only after the government has created a demonstration effect through pilot programmes on microinsurance (e.g. China, Mongolia); or provided the necessary infrastructure for microinsurance to grow (e.g. a specific reinsurance fund in Nepal).

- ***Incentivise microinsurance***: Commercial insurers, if incentivised to enter microinsurance, bring efficiency to the sector through their expertise in the insurance business. On the other hand, it is also important to bring semi-formal microinsurers under regulation in order to optimise client protection, pricing and market conduct. Regulators often incentivise the entities through collateral benefits (e.g. China), mandatory participation (e.g. India, Bangladesh), or reduced capital requirement (e.g. the Philippines), to promote the growth of the microinsurance sector.

- ***Build awareness***: Microinsurance in any country is positively reinforced if the regulator and/or the government actively promote microinsurance through publications, press statements or conferences. Creation of an exclusive microinsurance website (e.g. the Philippines), microinsurance workshops organised by the regulator (e.g. Armenia, Indonesia, Pacific islands), inclusion of microinsurance in the national finance plan (e.g. Laos, Cambodia, Vietnam) are some examples of promotional measures taken by regulators.

- ***Political interference and subsidy***: While inconsistent policies restrict the growth of market-based microinsurance, a positive political intent can promote microinsurance in a country despite absence of clear regulation or existent infrastructure. Similarly, subsidised government schemes (especially if they cover full premium cost) are a deterrent for market based microinsurance (e.g. Azerbaijan) unless they are used efficiently in combination with clients' premium (e.g. 50% premium subsidy in Nepal).

Conclusion

In most countries, microinsurance develops as a sub-segment of social security programmes, conventional insurance or microfinance activities. Microinsurance development is, therefore, affected not only by microinsurance specific regulations, but by regulations and trends impacting these sectors of the country as well. Regulatory assessments, therefore, are able to capture true potential for the sector only if they include all the regulatory aspects affecting the overall business environment of microinsurance in the country.

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