A Core Curriculum for Insurance Supervisors

Regulation and Supervision Supporting Inclusive Insurance Markets

Basic-Level Module

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This module on regulation and supervision supporting inclusive insurance markets was developed in 2013 as a cooperative project of the IAIS and the Access to Insurance Initiative (A2ii). The module has been endorsed by the IAIS Committee structure.

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About the Core Curriculum

A financially sound insurance sector contributes to economic growth and well-being by supporting the management of risk, allocation of resources, and mobilization of long-term savings. The Insurance Core Principles (ICPs; IAIS 2012b), developed by the International Association of Insurance Supervisors (IAIS), are key international standards relevant for sound financial systems.

Effective implementation of the ICPs requires skilled and knowledgeable insurance supervisors. Recognizing this need, the World Bank and the IAIS partnered in 2002 to develop a "core curriculum" for insurance supervisors. The Core Curriculum Project, funded and supported by various sources, accelerates the learning process of both new and experienced supervisors. The ICPs provide the structure for the core curriculum, which consists of a set of modules that summarize the most relevant aspects of each topic, focus on the practical application of supervisory concepts, and cross-reference existing literature.

This module on regulation and supervision supporting inclusive insurance markets was developed in 2013 as a cooperative project of the IAIS and the Access to Insurance Initiative (A2ii). Its purpose is to help supervisors to implement effectively the concepts set out in the application paper on the same topic (IAIS 2012a).

The core curriculum is designed to help those studying it to do the following:

- Recognize the risks that arise from insurance operations
- Know the techniques and tools used by private and public sector professionals
- Identify, measure, and manage these risks
- Operate effectively within a supervisory organization
- Understand the ICPs and other IAIS principles, standards, and guidance
- Recommend techniques and tools to help a jurisdiction to observe the ICPs and other IAIS principles, standards, and guidance
- Identify the constraints and identify and prioritize supervisory techniques and tools to manage the existing risks in light of these constraints.

Note to learner

Welcome to the module on regulation and supervision supporting inclusive insurance markets. This is a basic-level module that does not require specific prior knowledge of this topic. However, because it touches on many aspects of insurance regulation and supervision, reference to other modules of the core curriculum would help to provide a more complete understanding of the specific aspects covered in those modules. The module should be useful to either new insurance supervisors or experienced supervisors who have not dealt extensively with the topic or are simply seeking to refresh and update their knowledge.

Start by reviewing the objectives, which will give you an idea of what a person will learn as a result of studying the module, and answer the questions in the pretest to help to gauge your prior knowledge of the topic. Then proceed to study the module either on an independent, self-study basis or in the context of a seminar or workshop. The amount of time required to study the module on a self-study basis will vary, but it is best addressed over a short period of time, broken into sessions on parts, if desired.

To help you to engage with the topic, we have interspersed the module with hands-on activities for you to complete. These are intended to provide a checkpoint from time to time so that you can absorb and understand the material more readily. You are encouraged to complete each of these activities before proceeding with the next section of the module. You will also find questions dealing with the local situation and relating to practices in your jurisdiction. These are intended to help you to apply the material in this module to your local circumstances. If you are working with others on this module, develop the answers through discussion and cooperative work methods. Since these responses will vary by jurisdiction, the answer key in appendix I suggests where you might look for the answers.

As a result of studying the material in this module, you will be able to do the following:

1. Describe the characteristics of an inclusive insurance market and explain why insurance markets should be inclusive

2. Describe common barriers to the achievement of inclusive insurance markets

3. Identify potential barriers to the achievement of an inclusive insurance market in a particular jurisdiction

4. Illustrate, through examples, informal insurance mechanisms that have evolved to meet the needs of customers

5. Describe differences in the products, services, channels for delivery, and insurers that might exist in an inclusive insurance market compared to those in a typical formal insurance market

6. Discuss the challenges that such differences can create for insurance supervisors

7. Explain the importance of having inclusive insurance products and services provided within the supervised market

8. Discuss the roles and responsibilities that an insurance supervisory authority might have in creating and maintaining a more inclusive insurance market

9. Explain the concept of proportionality and illustrate how it might be applied by a supervisory authority to support the inclusiveness of the insurance market

10. Explain why it might be necessary to define "microinsurance" in regulation and discuss the possible implications of an inappropriate definition

11. Discuss the steps a supervisory authority might take to deal with the diverse market participants and authorities that might be involved in an inclusive insurance market

12. Discuss the possible implications of a more inclusive insurance market for the need for supervisory resources

13. Discuss the issues that might arise with respect to the licensing of entities providing insurance in an inclusive insurance market, including the following:
    a. minimum size
    b. mixed entities
    c. pilots
    d. formalization.

14. Discuss the typical differences between a mutual, cooperative, or community-based organization and a commercial insurer and the implications of such differences for insurance supervision

15. Explain why the solvency regime applicable to an insurer that underwrites only microinsurance might appropriately differ from the regime applicable to commercial insurers and discuss what such differences might be

16. Discuss how the prudential supervision of insurers that underwrite only microinsurance might differ from the supervision of commercial insurers

17. Explain why the requirements placed on intermediaries might need to change to accommodate the use of alternative channels for delivery and discuss what such changes might be

18. Explain why the requirements on the conduct of business for microinsurance might differ from those applicable to conventional insurance and discuss what such differences might be

19. Discuss the differences between microinsurance and conventional insurance with respect to the risks of fraud, money laundering, and the financing of terrorism.

Pretest

Before studying this module on regulation and supervision supporting inclusive insurance markets, answer the following questions. The questions are designed to help you to gauge your existing knowledge of this topic. An answer key is presented in appendix I at the end of the module.

For each of the following questions, circle the response that is correct or most relevant.

1. An inclusive insurance market means one in which:
    a. Microinsurance is defined in legislation.
    b. All licensed insurers and intermediaries are allowed to offer microinsurance.
    c. All working-age adults have effective access to insurance from formal providers.
    d. Entities of all legal forms are eligible to apply for licenses.
2. Removal of any barriers to the supply of insurance will result in an inclusive insurance market.
    a. True
    b. False.
3. Informal insurance mechanisms:
    a. Do not involve the issuance of written insurance policies
    b. Provide for the sharing of profits among policyholders
    c. Insure persons working in informal employment
    d. Are not subject to insurance supervision.
4. Products sold in an inclusive insurance market are typically similar to those sold in a more conventional insurance market, except that the amounts of insurance are lower and the policy wording is simpler.

a. True

b. False.

5. It is useful to establish inclusiveness as an explicit supervisory objective because this can help the insurance supervisor and other government authorities to reach agreement on their respective responsibilities.

   a. True

   b. False.

6. When seeking to enhance the inclusiveness of an insurance market, which of the following steps should come first?

   a. Defining microinsurance in regulation

   b. Analyzing the current market and policy environment

   c. Promoting the establishment of dedicated microinsurers

   d. Creating a separate microinsurance supervision department within the supervisory authority.

7. If regulatory and supervisory requirements are truly proportionate, even the smallest entity should be eligible to apply for a license.

   a. True

   b. False.

8. The solvency regime applicable to dedicated microinsurers should include all elements applicable to conventional insurers, except that reinsurance requirements are not applicable because amounts of insurance are low.

   a. True

   b. False.

9. In order to keep microinsurance premiums affordable for low-income customers, limits on commission rates should be lower than those applicable to conventional insurance products covering the same classes of insurance.

a. True

b. False.

10. Although microinsurance customers might be more susceptible to fraud by insurers or intermediaries than traditional insurance customers would be, insurers need not be concerned about potential fraud by microinsurance customers, because the small amounts of insurance mean that customers have little to gain by committing fraud.

    a. True

    b. False.

A. Introduction

Importance of financial inclusion

In many jurisdictions, insurers and other financial institutions compete vigorously to provide products and services to high- and middle-income people and large commercial enterprises. Access to financial services helps these customers to improve their financial situations and to manage the risks they face. But not everyone enjoys ready access to financial services. Low-income people and small businesses are often unable to access financial services that are appropriate to their needs. Access can be especially limited if the economy, the financial sector, or the formal labor market of a jurisdiction is not well developed.

Inclusive financial markets enable all adult consumers to readily access products and services that are appropriate to their needs. Governments and other stakeholders have increasingly recognized the importance of financial inclusion. For example, leaders of the G20 group of large economies adopted principles on financial inclusion and established a mechanism to further the development of inclusive financial markets.[1] Such initiatives are driven by the recognition that financial inclusion can help to reduce poverty, enhance social welfare, and promote economic development. These outcomes, in turn, contribute to financial stability.

G20 Principles for Innovative Financial Inclusion[2]

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

2. **Diversity.** Implement policy approaches that promote competition and provide market-based incentives for the delivery of sustainable financial access and the use of a broad range of affordable services (savings, credit, payments and transfers, insurance) as well as a diversity of service providers

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

4. **Protection.** Encourage a comprehensive approach to consumer protection that recognizes the roles of government

[1] The Global Partnership for Financial Inclusion (GPFI) is an inclusive platform that enables all G20 countries, interested non-G20 countries, and relevant stakeholders to conduct work on financial inclusion, including implementation of the Financial Inclusion Action Plan, endorsed at the G20 Summit in South Korea. See www.gpfi.org.
[2] See the appendix of the application paper (IAIS 2012a) for comments on the applicability of each of the principles to microinsurance.

5. **Empowerment.** Develop financial literacy and financial capability

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

7. **Knowledge.** Use improved data to make evidence-based policy and to measure progress; consider adopting an incremental "test and learn" approach acceptable to both regulator and service provider.

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

9. **Framework.** Consider the following in the regulatory framework, reflecting international standards, national circumstances, and support for a competitive landscape: an appropriate, flexible, risk-based anti-money laundering and combating the financing of terrorism (AML/CFT) regime; conditions for the use of agents as a customer interface; and a clear regulatory regime for electronically stored value.

What can achieving these high-level government objectives mean to consumers? Access to a small loan can enable farmers to purchase the fertilizer they need to produce a profitable crop. Access to life insurance, health insurance, and crop insurance can protect farmers and family members, as well as lenders, from the financial risks of adverse events. This protection can increase the likelihood that a loan will be available. It can also make farmers more willing to invest scarce capital in their farm rather than maintain savings as a protection against risk. Beyond its financial benefits, health insurance can enhance personal well-being by providing access to earlier and more effective health care.

In the long term, inclusive financial markets must be sustainable to be successful. This means that the providers of financial products and services should operate in a manner that enables them not only to reach a large number of customers with useful and affordable products and services, but also to meet their financial commitments to customers and to do so fairly. Inclusiveness should not come at the cost of compromising the protection of customers, particularly those with limited knowledge of or experience with such products and services. Regulation and supervision exist largely to protect customers, which is why the IAIS calls for insurance to be provided through regulated markets.

Some traditional financial institutions, including insurers, have recognized opportunities to expand their markets, increase their revenues, and generate profits by developing products and services that are accessible to a wider range of customers. Others have yet to conclude that the potential benefits of moving in this direction outweigh the potential costs and risks. There can be many barriers to the development of sustainable, inclusive insurance markets. Removing these barriers can be a challenging task.

Barriers to inclusive insurance markets

Inclusive insurance markets offer the potential of significant benefits for individual customers, society as a whole, and the insurance sector. So how can the attainment of an inclusive insurance market be impeded? Some things can be barriers to the supply of insurance products and services, while others can be barriers to the demand for insurance products and services. Still others, such as inappropriate insurance regulation and supervision, can adversely affect both supply and demand. The barriers can vary significantly among jurisdictions, but those that have been commonly encountered are highlighted here.

On the supply side, many insurers and intermediaries have traditionally focused on the needs of high- and middle-income people and medium and large commercial enterprises. They understand the needs of these customers, have developed products and services that meet such needs, and have created mechanisms to deliver these products to their customers. If they are successful in doing so, the business might be sufficiently profitable and demonstrate enough potential for growth to satisfy their owners, board, and senior management. Accordingly, they might simply lack a strong business incentive to broaden their markets—in some cases, even to encompass middle-income customers.

Some insurers might be willing to broaden their reach, but lack sufficient information or expertise to do so. Shortcomings might exist in appreciating the potential size of the market and in understanding the needs of the underserved. Moreover, the ability to design products to satisfy those needs may be lacking, as may the data required to quantify insurance risks.

Operational factors can also be barriers. Distribution, underwriting, administration, and claims-handling practices suitable when dealing with large insurance policies might be unduly burdensome or uneconomic if applied to small policies. For example, an agent might be unable to make a living prospecting for and selling to individuals one by one, even if commission rates are high, because the premiums per policy are much smaller than in the traditional market. Underserved consumers might be geographically distant from existing offices and lack bank accounts from which premium payments can be deducted automatically.

On the demand side, low income is perhaps the most obvious barrier to an inclusive insurance market. Low-income individuals and very small businesses may simply be unable to afford conventional insurance products. Furthermore, they might have seasonal or irregular patterns of earnings and expenses, which would make it difficult for them to pay insurance premiums annually in advance.

Income aside, social and demographic factors can also be barriers. Those who have not been participating in the insurance market might have no knowledge of what insurance is or how it can be used to manage the risks they face. In some cases, they may be illiterate, which means that traditional approaches to imparting such knowledge, as well as to selling insurance and documenting its terms and conditions, will likely be unsuitable. There may be no tradition of using insurance within the culture, with people relying on the support of their families, communities, or government to help them to cope with adversity. Some avoid conventional insurance for religious reasons, believing that it involves sales with a lack of knowledge, speculation, and usury.

Trust is essential to the insurance business, which requires payment up-front in exchange for possible benefits later. Unfortunately, some consumers might be reluctant to use insurance because of lack of trust. Perhaps they had previous, unsatisfactory dealings with insurers or intermediaries. Or perhaps they simply distrust large, formal institutions.

Because of these barriers, some consumers have insurance needs that are not being met through the formal insurance market. Sometimes this means that their insurance needs are simply not being met. However, in many jurisdictions, informal insurance mechanisms have evolved to fill the gaps. Informal insurance mechanisms are not subject to insurance regulation, either because they have been exempted from regulation or because they are operating illegally. Such mechanisms, which are discussed further in section B, might put customers and the financial system at higher risk than policymakers would consider acceptable.

Inappropriate insurance regulation and supervision might be barriers to supply by, for example, impeding the development of new products that would better meet the needs of customers, restricting the use of nontraditional channels for delivery, or imposing disproportionate financial or operational requirements on small insurers that offer only simple products. They might be barriers to demand by, for example, requiring complex product disclosures or imposing identification requirements that are difficult or costly to satisfy.

Challenges in removing the barriers

A wide variety of factors might be barriers to the development of a more inclusive insurance market. Although it is unlikely that all of these factors will be relevant in a particular jurisdiction, it is equally unlikely that only a single barrier will need to be removed. The presence of diverse barriers means that diverse actions will probably be required to remove them. Many of these actions will probably be outside the direct responsibility and control of the insurance supervisor—or indeed those of any single party. Cooperative and well-coordinated efforts are essential, but may be even more difficult to achieve than when dealing with conventional insurance markets.

One reason for such difficulty is that the removal of barriers often requires innovation, for example, in the design of products and the manner in which they are delivered to customers. But successful innovation requires competence, imagination, and a good understanding of the needs of customers. Innovation can be costly, even if it is successful, while unsuccessful innovation can pose significant risks to customers, insurers, and the achievement of supervisory objectives. Legislation might need to be changed to allow for innovation, particularly if it prescribes requirements in detail and provides little scope for supervisory discretion. In many jurisdictions, the process of accomplishing changes to legislation can be long and difficult, even if the key stakeholders have agreed on the need for change.

Identifying appropriate changes to the regulatory framework and supervisory practices can be difficult. Regulation and supervision should be proportionate in nature, so as not to interfere with the operation of the insurance market any more than is necessary to meet supervisory objectives. However, when seeking proportionality, there is a risk that regulation and supervision might fall short of adequately protecting customers. Achieving a reasonable balance is challenging enough when dealing with a well-established and stable conventional insurance market. It will be even more challenging when dealing with an innovative, rapidly evolving one.

The wider range of stakeholders often involved in a more inclusive insurance market contributes to this challenge. In addition to commercial insurers, mutuals, cooperatives, and community-based organizations (MCCOs), other financial institutions and nonfinancial entities might be involved in underwriting insurance risk. They and others, such as microfinance institutions, retailers, and telecommunications companies, might serve as channels for delivery, in addition to or instead of traditional insurance intermediaries. For example, microfinance institutions play a dominant role in the delivery of credit life insurance, which is the leading microinsurance product in many jurisdictions. A wider range of government agencies, such as those dealing with agricultural cooperatives, might have an interest in these entities or the customers that they serve. Nongovernmental organizations can also be active in promoting financial inclusion or services, such as health care, that might benefit from more inclusive insurance markets. Each of these stakeholders will have its own interests and objectives, some of which might align with those of the insurance supervisor and others of which might not. But even if stakeholders share common objectives, their views on the best ways to achieve these objectives might be quite different.

Those who seek to create more inclusive insurance markets should have a good understanding of the stakeholders involved, the roles they might play, and their interests and objectives. Such understanding facilitates the development of a proportionate approach to regulation and supervision, which enables innovation and has the support of key stakeholders, without compromising the achievement of supervisory objectives. Accomplishing this is much easier said than done.

How this module can help

The application paper on which this module is based provides important information on how the ICPs can be implemented in a manner supportive of a more inclusive insurance market (IAIS 2012a). It is recommended that you read it before continuing with your study of this module, if you have not done so already, and use it as a reference during your study. The module expands on the information in the application paper. It elaborates on the meaning of guidance, emphasizes key considerations, and suggests alternative approaches to dealing with issues.

You are encouraged to focus on the fundamentals and ask yourself questions as you consider the situation in your jurisdiction and alternatives for dealing with the challenges. For example,

- What roles are played by various parties?
- What risks are created by the activities of a particular party?
- Why does a regulatory requirement exist?

The module seeks to enhance your understanding of what it takes to achieve a more inclusive insurance market and your ability to apply this understanding in the context of your own jurisdiction. Section B considers the market and policy environment, while section C focuses on the role of the insurance supervisor in creating a favorable environment. Sections D and E examine prudential and market conduct issues that might be faced when seeking to create more inclusive insurance markets. If you are successful in learning and applying this material, the ultimate outcome can be not only an insurance market that offers more access but also one that is fairer, safer, and more stable.

Exercises

Answer the following questions considering, where indicated, the situation in your jurisdiction. If you are working with others on this module, develop the answers through discussion and cooperative work methods.

1. Financial inclusion can help to reduce poverty, enhance social welfare, promote economic development, and contribute to financial stability. Briefly explain how the access of a small seller of household goods to property insurance might contribute to the achievement of these objectives.

2. Provide at least three examples each of potential barriers to the supply of insurance and potential barriers to the demand for insurance. Do any of these exist in your jurisdiction?

3. The development of a more inclusive insurance market often requires innovation. Briefly explain why innovation might be difficult to achieve.

Commonly used terms

Before delving into the topic, it is important to define some commonly used terms. The following definitions are taken or adapted from various IAIS and other documents.

Apex organizations. Entities that are formed to provide services to groups of MCCOs or to facilitate groupings of MCCOs or both. They can be owned or operated by the group of MCCOs that they provide services to or be more independent in legal terms (IAIS and MIN 2010).

Customer. A policyholder or prospective policyholder with whom an insurer or insurance intermediary interacts. It includes, where relevant, other beneficiaries and claimants with a legitimate interest in the policy (IAIS Glossary).

Effective access. Convenient and responsible service delivery, at a cost affordable to the customer and sustainable for the provider, with the result that financially excluded customers use formal financial services rather than existing informal options (CGAP 2011).

Financial inclusion. A state in which all working-age adults have effective access to credit, savings, payments, and insurance from formal providers (CGAP 2011).

Jurisdiction. A territory with local insurance laws that relate to the incorporation or operation of insurance companies. This territory, as a rule, is the territory of the nation and, at the same time, the territory of the insurance supervisor's competence. In certain cases, this may be a territory inside a nation with a federal structure—for example, the states making up the United States.

Microinsurance. Insurance that is accessed by low-income populations, provided by a variety of different entities, but run in accordance with generally accepted insurance practices (which include the ICPs). This means that the risk insured under a microinsurance policy is managed based on insurance principles and is funded by premiums. Premiums can be privately or publicly funded or a combination of both. The microinsurance activity itself should therefore fall within the purview of the relevant domestic insurance supervisor (IAIS 2012a).

Mutuals, cooperatives, and other community-based organizations (MCCOs). Organizations that are characterized by member ownership, democracy, solidarity, creation to serve a defined group and purpose, and entitlement to profit. With respect to insurance activities, some MCCOs might act as risk carriers, but others might have more limited roles, for example, providing administrative or distribution services only (IAIS and MIN 2010).

Underserved. Those who have less than sufficient access to insurance services. They may be partly or wholly “excluded” (IAIS 2012a).

B. Market and policy environment

Section A pointed out that the particular combination of barriers to an inclusive insurance market can differ from one jurisdiction to another. An essential step toward removing the barriers that exist in a particular jurisdiction is to identify them. This applies not only with respect to barriers created by inappropriate insurance regulation and supervision but also, more generally, to any barriers affecting the supply of or the demand for insurance. Although barriers are sometimes obvious, often they are not. Accordingly, some jurisdictions have conducted comprehensive analyses of aspects of the market and policy environment that can affect access to insurance. Such analyses typically document the current situation with respect to demand, supply, and the policy environment. They identify barriers and perhaps even the reasons the barriers have arisen. A comprehensive toolkit is available to assist authorities in undertaking diagnostic analyses (see Bester, Hougaard, and Chamberlain 2010b). Even in jurisdictions that have not yet undertaken comprehensive analyses, more focused studies might have been performed, for example, by a nongovernmental organization regarding the availability of health care insurance. The information provided by such studies can serve as input to a more comprehensive analysis.

Policymakers and other stakeholders can use the information provided by a comprehensive analysis of the market and policy environment as they develop goals for inclusiveness, strategies for achieving their goals, and action plans for implementing their strategies. In doing so, they can also benefit from knowledge of what has been done—both successfully and unsuccessfully—in other jurisdictions faced with similar challenges. A significant amount of information has been published and is freely available on the Internet (see, for example, Churchill and Matul 2012, Iravantchi and Wenner 2012, and Smith et al. 2010), including a comprehensive toolkit for microinsurance market development (see Bester, Hougaard, and Chamberlain 2010a).

This section briefly discusses some aspects of the market and policy environment that are particularly relevant to insurance regulation and supervision.

Demand for insurance

Market analysis should quantify the size of the underserved market, identify the characteristics of the underserved, and examine their protection needs and preferences. Protection needs and preferences can vary based on factors such as income, past experience with insurance, level of literacy, occupation, community, culture, and location.

Insurance supervisors typically have more influence on the supply of insurance than on the demand for it. However, a supervisor might take the following steps to remove barriers to demand:

- Participating in the development of financial literacy programs that teach people what insurance is and how it can be used

- Communicating widely and in an understandable manner with customers about the role of the supervisor and the benefits of dealing with supervised insurers and intermediaries

- Making it easy for customers to get answers to their questions about insurance and to have their complaints resolved

- Dealing promptly and effectively with supervisory concerns, in order to reduce the likelihood that customers will have unfavorable experiences with insurance when they do make use of it.

A significant amount of useful information is available to assist supervisors and others in the development and implementation of programs to educate people on insurance matters (see Dror et al. 2011).

Products and services

Market analysis should identify the insurance products and services that are currently available and the types of customers who are using them. The identification process should extend beyond the offerings of licensed insurers to include insurance or insurance-like arrangements offered by others, which might include government agencies. The existence of informal insurance probably indicates a need to broaden the range of entities subject to supervision. At the same time, it can also provide insights on some of the types of products and services that are needed to satisfy the demands of customers.

As noted in the application paper, relative to more conventional insurance, products oriented toward enhanced inclusion may include the following basic features:

- Relatively low premiums

- Defined and limited cover

- Short policy terms to limit risk

- Few, if any, exclusions

- Preference for group underwriting

- Simple and rapid claims processing, while still controlling for fraud.

It may be useful to consider the extent to which products that are currently available exhibit such features and, if so, the market success and claims experience of them. Perhaps even more useful, from the standpoint of an insurance supervisor, may be to consider whether any regulatory barriers exist to the incorporation of such features in insurance products or to innovations in the way products are offered and administered.

Channels for delivery

Market analysis should identify the channels currently being used to deliver insurance and their relative importance in reaching various types of customers. This will probably be more easily accomplished when considering the activities of licensed insurers and intermediaries than when considering informal insurance. However, even in the formal market, statistical information regarding channels for delivery is sometimes difficult to come by.

Access to insurance can be improved by using channels for delivery that overcome geographic barriers, reach customers cost-effectively, leverage infrastructure, and overcome issues of mistrust. Many innovations have occurred in the use of alternative channels for delivery in attempts to achieve one or more of these objectives. Some attempts have been successful in achieving their objectives, while others have fallen short. Success has been partly a matter of the suitability of a channel to the situation in the jurisdiction and partly a matter of how well it was implemented.

Ideally, the policy environment should allow for innovation in the use of alternative channels for delivery, while adequately protecting customers against the particular risks inherent in each. Such innovations might relate not only to how insurance is sold to customers but also to how subsequent services are delivered.

Insurers

Market analysis should identify the entities that are underwriting insurance risk in the jurisdiction. Licensed insurers are easily identified; other entities might not be if, for example, they are small and operate in a limited geographic area or are engaged primarily in activities other than insurance.

Many aspects of insurance regulation and supervision focus on insurers, so it essential that the regulatory and supervisory frameworks be capable of dealing appropriately with any type and size of entity allowed to underwrite insurance risk. It is impossible to design appropriate frameworks without knowing who is currently operating. It might be useful to consider the following dimensions:

- Legal form (corporation, mutual, cooperative, association, no legal identity)
- Ownership (widely held shares, closely held shares, member owned)
- Nature of the insurance business (mix of microinsurance and larger risks, classes of insurance)
- Scale of the insurance business (size, geographic scope)
- Importance of insurance to the overall business (mix of insurance, financial services, and nonfinancial business)
- Insurance regulatory status (licensed and supervised, registered but not supervised, informal).

This knowledge might be relevant in several contexts: dealing more appropriately with currently licensed insurers, formalizing existing informal insurers, and dealing with pilot schemes. It is also relevant if considering opening the market to new types of entities, perhaps because those currently operating are either unwilling or unable to meet the needs of the underserved.

The policy environment should provide enough flexibility in the type of entity permitted to act as an insurer to avoid this being a barrier to access. But this does not necessarily mean that all possibilities must be accommodated. For example, insurers must be large enough to be viable, and their insurance business must be conducted in a manner that allows for adequate supervision.

Policy environment

A supportive policy environment is important, if not essential, to the development of an inclusive insurance market. The G20 Principles highlight the importance of a broad-based government commitment to financial inclusion to help to alleviate poverty. Analysis of the policy environment should, therefore, examine the nature of the government's financial sector policies. Such policies should promote financial inclusion and, ideally, make specific reference to the need for inclusive insurance markets. Formalization of the government's commitment provides an overall context for the development of goals and strategies to improve access to insurance. It also facilitates communications with all relevant stakeholders—including government—regarding specific initiatives designed to improve access and helps to secure their support for such initiatives.

As discussed in the introduction to the ICPs, appropriate financial sector policy is a precondition for effective insurance supervision. This is, perhaps, especially important when seeking to implement regulation and supervision supportive of inclusive insurance markets. The variety of stakeholders involved in financial inclusion efforts, often including multiple regulatory and other government bodies, creates a high risk of confusion and conflict regarding responsibilities and objectives. Such conditions can compromise the effectiveness of insurance supervision. The guidance provided by a financial sector policy that sets out clear objectives and responsibilities can significantly mitigate that risk.

The application paper points out that the insurance supervisor should play a leading role in ensuring that insurance markets are as inclusive as possible while still achieving supervisory objectives. Section C explores what this role might be and what challenges the supervisor might face in fulfilling it.

Analysis of the policy environment often includes a fairly detailed assessment of the insurance regulatory framework and supervisory practices. Such an assessment should be done with reference to the ICPs, paying particular attention to the issues that are highlighted in the application paper as being likely to pose barriers to inclusive insurance markets. Sections D and E of the module discuss those issues.

Exercises

Answer the following questions considering, where indicated, the situation in your jurisdiction. If you are working with others on this module, develop the answers through discussion and cooperative work methods.

4. List at least five aspects of the market and policy environment that can affect access to insurance and that should be examined as part of a comprehensive analysis of the situation in a particular jurisdiction. Has such an analysis been performed with respect to your jurisdiction? If so, what were the most significant findings and recommendations arising from the analysis?

5. The entities that are underwriting insurance risk in a jurisdiction can be classified in a variety of ways. Complete the table below, indicating the number of entities in your jurisdiction, classified in accordance with the nature of their insurance business and their insurance regulatory status. (The table can be modified if additional categories exist in your jurisdiction, for example, banks that are authorized to underwrite certain classes of insurance.)

Type of entity	Conventional insurance only	Both conventional and microinsurance	Microinsurance only	Total
Licensed and supervised				
Registered but not supervised				
Informal				
Total				

C. Role of the insurance supervisor

Supervisory objectives

ICP 1 says, "The authority (or authorities) responsible for insurance supervision and the objectives of insurance supervision are clearly defined," while Standard 1.3 indicates, "The principal objectives of supervision promote the maintenance of fair, safe, and stable insurance sector for the benefit and protection of policyholders." An overall policy objective of increasing the inclusiveness of insurance markets should be translated into clear statements of objectives and assignments of responsibilities to those involved in supervision.

For example, the traditional objectives of fairness, safety, and stability might be supplemented by an explicit objective of inclusiveness. But the manner in which an inclusiveness objective is stated and the authority or authorities that are charged with such an objective could vary by jurisdiction. The fairness objective is related primarily to market conduct, while the safety and stability objectives are related primarily to prudential matters. Certainly both market conduct and prudential supervision can be carried out in a manner that seeks to minimize barriers to inclusiveness. However, because inclusiveness involves extending access to insurance to the underserved, an inclusiveness objective might state or imply the need for proactive supervisory involvement in market development (see Chatterjee 2012).

Some jurisdictions have assigned market conduct and prudential supervision to separate authorities. There are advantages and disadvantages to doing so, but one reason for separation is to avoid the need for an authority to take action that would support one objective but detract from the achievement of another. For example, taking public enforcement action to deal with a market conduct concern might damage policyholder and investor confidence in an insurer and contribute to the weakening of its financial condition.

Similarly, adding an inclusiveness objective to the other objectives of an authority will create the need to consider the relative priority of objectives and to achieve an appropriate balance. For example, allowing an alternative channel for delivery might make insurance more accessible but increase the likelihood that customers will misunderstand the nature of the coverage purchased. Allowing small, community-based organizations to underwrite insurance risk might improve access but provide less financial protection against failure than would be the case with a commercial insurer. As illustrated by these examples, the need to balance inclusiveness and other objectives applies to both market conduct and prudential supervisory authorities. For those that do both types of supervision, achieving an appropriate balance will probably be especially challenging.

The wide range of stakeholders often involved in an inclusive insurance market brings with it the possibility of a variety of supervisory authorities, with responsibilities for supervising various aspects of the operations of particular types of stakeholders. Some of them might be financial supervisors, such as an authority responsible for the supervision of microfinance entities. Others might focus on whether the supervised entities, such as agricultural cooperatives, are operating in an appropriate manner, but pay little attention to the risks that their financial condition might pose to those they serve. Others, such as telecommunications regulators, might focus on the pricing, interoperability, quality, and security of services as well as the transmission and storage of funds.

The challenges an insurance supervisor might face in dealing with such authorities are discussed later in this section. However, the dealings will probably be easier and the outcomes more supportive of inclusive insurance markets if the objectives and responsibilities of the various authorities—particularly as they relate to insurance activities—are clearly defined. Nevertheless, clear definition alone does not ensure that there will not be gaps, overlaps, or conflicts among the objectives and responsibilities of the various authorities. An analysis of the objectives and responsibilities of the relevant authorities can be useful in identifying gaps, overlaps, and potential conflicts. The analysis might, for example, examine factors such as the following:

- Objectives and where they are defined (legislation or elsewhere)
- Entities or activities within the mandate of the authority and the nature of their involvement in insurance activities
- Relevance of the objectives of the authority to the fairness, safety, stability, and inclusiveness of the insurance market
- Powers available to the authority (for example, regulation, licensing, off-site supervision, on-site inspection, imposition of penalties and sanctions, and forcing exit from the market).

Importance of having a supervised market

As noted, supervision should promote the maintenance of a fair, safe, and stable insurance sector for the benefit and protection policyholders. If supervision can contribute to these favorable outcomes with respect to the conventional insurance market, is there any reason it should not be applied when seeking a more inclusive insurance market?

Microinsurance involves small policies and, typically, simple coverage. The risks that most microinsurance activities pose to the stability of the insurance sector are probably minimal. From a macroprudential standpoint, the supervision of microinsurance activities may not be essential. However, some microinsurers are large, and their failure could weaken market confidence and slow economic growth.

The small amounts of insurance provided by individual microinsurance policies do not guarantee the survival of an insurer that is carrying on microinsurance business. Although each claim might be small, the policyholders might be geographically concentrated and subject to catastrophe risk or the lack of good data may result in inadequate pricing. A very small insurer might even lack the capability to employ good governance and sound business practices.

Some might argue that because microinsurance policies are small, customers have little financial exposure if the benefits are not delivered as promised. This is an objectionable argument, which disregards the fact that amounts of money that might be small in absolute terms can nevertheless be very significant to the well-being of poor customers. The following—noninsurance—example illustrates the potential significance: when a large, barely regulated savings scheme collapsed in April 2013, hundreds of thousands of poor people lost their savings, and up to a dozen committed suicide.[3] All policyholders deserve protection from undue financial loss.

Beyond the direct financial losses, the failure of an insurer can destroy public confidence and cause people to avoid using insurance in the future. Inappropriate conduct, such as mis-selling and slow or unfair claims settlement, can have similar effects. Although the policies might be small and the benefits simple, they might nevertheless be difficult to understand for customers who lack exposure to insurance or have low levels of literacy. After all, the workings of insurance are a mystery even to many wealthy, literate customers. If problems do arise, low-income, illiterate, or inexperienced policyholders might find it particularly difficult to achieve satisfactory resolution.

In summary, microinsurance policyholders are in no less need of supervisory protection than are customers in the conventional insurance market. Accordingly, both the ICPs and the application paper call for all insurance to be provided in the supervised market. The benefits of doing so are clear.

But the costs of supervision should not outweigh its benefits (see Hänsel 2010, sec. 4.2). This includes not only the direct costs of the supervisory authority but also the direct and indirect costs imposed on the insurance sector and customers. Disproportionate requirements, or those that stifle innovation, can limit access to insurance or make it unnecessarily expensive.

Providing scope for innovation

The removal of barriers to a more inclusive insurance market often requires innovation. Innovation might usefully occur in any aspect of the insurance business, including the entities underwriting insurance risk and the ways in which they are financed and governed; the

[3] "Indian Banks: Lenders of the Last Resort," *The Economist*, May 25, 2013.

insurance products; the channels for delivery; the ways in which products are explained and documented; and the manner in which the insurance business is administered.

Legislation typically deals with all of the above and more. Most requirements set out in legislation were put there for good reason, often with the ultimate objective of reducing the risks to customers. However, the requirements might have been formulated with reference to the risks and operating practices of the conventional insurance market. Perhaps they provide sufficient scope for innovation to meet the needs of that market, but, particularly if legislation is not up-to-date, they might not.

Standard 1.4 says, "Where, in the fulfilment of its objectives, the supervisor identifies conflicts between legislation and supervisory objectives, the supervisor initiates or proposes correction in legislation." Supervisors should thus consider whether legislation is inhibiting innovation and compromising the achievement of inclusiveness. If so, alternatives to the existing provisions of legislation should be considered. In doing so, a supervisor should think about how the existing provisions might contribute to the achievement of supervisory objectives and assess whether the alternatives would achieve the same ends. The goal is to identify alternatives that maximize the scope for innovation without compromising the ability to achieve supervisory objectives. Wide consultation with stakeholders will help to avoid unintended consequences of a proposed change, such as a weakening of the protections available to traditional insurance customers or regulatory arbitrage.

In some cases, innovations might be accommodated within existing legislation through a more flexible interpretation of requirements. Before doing so, the supervisor should weigh the risks of the proposed interpretation and consider whether it will be applied widely or on a case-by-case basis and whether it might have unintended consequences, such as favoring one type of insurer over another.

Proportionality

Proportionality is widely recognized as a desirable characteristic to be sought in insurance supervision. Although the ICPs apply to insurance supervision in all jurisdictions and for all types of insurance products and services, they clearly reflect the need for proportionality. For example, supervisors are called upon to adjust certain supervisory requirements and actions in accordance with the nature, scale, and complexity of risks posed by individual insurers. This is good supervisory practice, whether one is seeking to achieve financial inclusion or not. In the absence of proportionality, large insurers with complex risks might receive inadequate supervisory attention, while small insurers with simple risks might be crushed by the burden of onerous regulatory requirements.

The following examples highlight the relevance of the nature, scale, and complexity of risks. Supervision of the reinsurance program of an insurer with a portfolio of large commercial property policies in a territory subject to natural catastrophes should be more intense than that of an insurer with a portfolio of small individual life insurance policies. The governance and internal control mechanisms expected of a large insurer with cross-border operations should be more extensive than those of a small MCCO with operations in just one village and the surrounding countryside. Finally, an insurer that is underwriting weather-index crop insurance will require access to more specialized data and actuarial expertise than one that is underwriting only simple personal accident products.

Proportionality is essential when seeking to enhance financial inclusion, given the need for innovation, the predominance of small risks, and the presence of small entities in the market. The G20 principles call on authorities to "build a policy and regulatory framework that is proportionate with 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." Its Global Partnership for Financial Inclusion (GPFI) brings together international standard setters, including the IAIS, to focus on this issue, among others (see CGAP 2011).

The call for proportionality should not be misinterpreted as a call for weak regulations, exemptions from regulatory requirements, or supervisory forbearance. Such approaches would put the achievement of supervisory objectives at serious risk. Rather, achieving proportionality should involve using approaches that optimize the balance between benefits and costs, within the context of a particular jurisdiction and its supervisory objectives—including inclusiveness. In order to be considered proportionate, a measure should be necessary to attain the supervisory objectives, while not going beyond what is necessary. Similar risks should receive equivalent regulatory and supervisory treatment.

In deciding on specific measures, supervisors might be guided by the answers to the following questions:

- What risks—to insurers, customers, or supervisory objectives—are posed by a particular situation?

- What are the likelihoods of the risks being realized and the potential impacts of those risks if realized?

- What alternatives are available for dealing with the risks?

- What are the costs and benefits of each alternative?

- Which alternative offers the lowest costs—in terms of both financial costs and intrusiveness—while adequately mitigating the risks?

As the application paper indicates, the need for proportionality arises in several contexts:

- When designing and implementing regulatory requirements
- When assessing insurers' and intermediaries' adherence to regulatory requirements
- When exercising supervisory powers.

The application paper provides many examples of when proportionality might be particularly important. Some of these are highlighted in sections D and E of this module.

Proportionality considerations appropriately focus primarily on the effects of measures on external stakeholders, such as insurers and customers. Onerous and costly measures should be avoided, as should the creation of an unlevel playing field, but the drive to avoid costs should not compromise the level of protection provided to customers. Nevertheless, the effects on the supervisor of various alternatives should not be ignored. The system must remain supervisable, within the resources available. The potential implications of a more inclusive insurance market on the need for supervisory resources, as well as the approaches that might be used to deal with those needs, are discussed later in this section.

Definition of microinsurance in regulation

The IAIS defines microinsurance as "insurance that is accessed by low-income populations, provided by a variety of different entities, but run in accordance with generally accepted insurance practices (which include the ICPs)." This is a straightforward, easy-to-understand, but qualitative definition. Such a definition is probably sufficient and appropriate for purposes such as the establishment of broad policies directed at improving access to insurance. However, it might not be sufficiently precise for regulatory purposes. Accordingly, some jurisdictions define terms such as "microinsurance," "microinsurance product," or "microinsurer" in regulation.

Policymakers seeking to develop more inclusive insurance markets should not be too hasty in defining these terms. Definitions are needed only if different treatment is to be given on matters such as insurance regulatory requirements, other regulatory requirements (for example, regarding anti-money laundering), or taxation. In some jurisdictions, microinsurance has expanded even without explicit recognition or special treatment (see McCord, Wiedmaier-Pfister, and Chatterjee 2008, p. 3). The definitions should be crafted carefully, based on a clear understanding of the purposes they are intended to serve. Appropriate definitions can facilitate innovation, proportionality, and access to insurance. But faulty definitions can have serious unintended consequences, such as restricting the scope for product innovation, creating an unlevel playing field, increasing the level of risk, or providing opportunities for regulatory arbitrage, such as registering a product under a different category in order to avoid the additional requirements to which microinsurance might be subject.

The application paper suggests several criteria that should be kept in mind when formulating definitions. The following discussion expands on why these criteria are important and what might go wrong if they are not applied properly.

Definitions should focus on products. Alternatives would be to focus on defining the customer group in quantitative terms, such as with reference to a particular level of income, or on defining the providers. Defining the customer group in monetary terms might be of little benefit for insurers and could be costly and complex to implement. For example,

- Would the level of income relate to an individual or a family?
- How would small businesses be treated?
- What if a higher-income customer wanted to purchase the same product?
- Would the same level of income be appropriate throughout the jurisdiction?
- How would the level of income be adjusted over time?
- What if proof of income is unavailable?

Definitions that focus on the providers have the potential to create an unlevel playing field. For example, some entities in the jurisdiction might already limit their insurance activities solely to microinsurance, or it might be useful to allow the creation of such entities. However, all insurers should be eligible to issue microinsurance products. If some are not, this might not only limit the choices available to customers but also provoke resistance to financial inclusion initiatives by those ineligible to do so.

Definitions that focus on microinsurers should clearly delineate microinsurance business from others and will require a definition of a risk category or product. Dedicated microinsurers might be subject to lower risk than conventional insurers, which could warrant different regulatory treatment in the interest of proportionality. The size of the insurer is not, by itself, a sufficient basis for differentiation. Small entities might, for example, seek to underwrite complex risks with high exposure to catastrophes. So a definition of microinsurer will need to refer back to a definition of microinsurance product or to limitations on the types of risk that can be assumed.

Quantitative elements of definitions should be set at the highest possible level to ensure that the defined product is as inclusive as possible. Say, for example, that microinsurance is defined as insurance policies with premiums below a specified, very low, monetary amount. In this case, insurers will need to limit the amount of insurance to stay within the premium cap. Some of the underserved, who might benefit from a particular product design, could decide not to purchase insurance because the amount of coverage is insufficient to meet their needs. These same customers might lack access to the conventional insurance market, the minimum amounts of insurance offered in that market might be more than they need, or they might be mis-sold conventional products that are inappropriate to their situation.

Quantitative elements should consider the need to align the resulting business profiles with the expected proportionate regulation and supervision. Quantitative elements of definitions could affect the risk profile of an insurer, which could affect, for example, risk management and capital adequacy requirements. They might also affect which channels for delivery would be practical and cost-effective and therefore require supervision.

Perhaps most important, a regulatory definition should not inadvertently exclude target customers, providers, products, or innovations. As a starting point, a proposed definition should be tested against the current situation in the market. Would anything currently taking place be prohibited or discouraged by the proposed definition? Say, for example, that microinsurance would be defined as a policy where the insurance coverage is below a specified amount. Perhaps this amount is high enough to accommodate all individual life insurance policies generally considered by the market to be microinsurance. However, some insurers offer life insurance products that cover all family members, in which the total amount of insurance exceeds the proposed limit. Other insurers offer products that combine life insurance coverage with health or property insurance, again with total amounts of insurance exceeding the proposed limit. Even if such products are not currently being offered, care should be taken to ensure that the definition would not prohibit such innovations in the future.

As an alternative to a quantitative definition, the supervisor might be given the power to designate particular products as microinsurance. Under this approach, the supervisor could establish criteria for making such determinations, use supervisory discretion in applying such criteria, and modify the criteria to reflect evolving experience and market conditions.

Dealing with diverse market participants

The supervisor faces a difficult task in trying to achieve supervisory objectives while allowing scope for innovation. In part, this is because an inclusive insurance market often brings with it diverse market participants. Legislation might not have contemplated the possibility that some types of entities, such as telecommunications providers and retailers, would have any involvement in the insurance sector. The nature of their involvement could differ from one situation to another and evolve over time. Owners, members of the boards, and senior managers of such entities might have little knowledge of insurance legislation and lack familiarity with supervisory expectations. Similarly, the supervisor might have a limited understanding of entities that are outside its traditional scope of supervision.

Insurance legislation typically defines the types of entities or persons that might be permitted to act as insurers or insurance intermediaries, regulates their activities, and provides for their supervision. Its primary focus is typically on the entities and secondarily on the functions they perform. Often, the functions performed by insurers and intermediaries, respectively, have been clearly delineated in both legislation and practice. However, with diverse market participants and market innovations, the relationship between the type of entity and the functions performed might also vary.

As a starting point in dealing with diverse market participants, it can be useful for the supervisor to consider each from a functional standpoint. What roles do they play, or could they play, in the insurance process? For example, do they underwrite insurance risk? Do they distribute insurance products? If so, do they provide advice to customers? Are they involved in ongoing administration? Do they make decisions, provide advice to decisionmakers, or simply facilitate transactions?

Armed with knowledge of the functions performed by a market participant, a supervisor can consider the risks that might arise. These include risks to customers, to the market participant and any other entities involved, and to the attainment of supervisory objectives. If the performance of a function is poor, what might the consequences be? What conditions could lead to poor performance? What controls exist to reduce the likelihood of poor performance or lessen its impact if it does occur?

Supervisors should also seek to understand the objectives of market participants and the manner in which the insurance-related functions support their objectives. For example, a retailer that sells furniture on credit might provide insurance to reduce its own risk from defaults, while a grocery retailer might distribute insurance as a way to build customer loyalty, sell more groceries, and generate some commission revenue. A health care facility might underwrite and distribute insurance to attract more business, protect itself from bad debts, contribute to the well-being of the community, or increase profitability. The importance of the insurance-related functions could vary significantly from one entity to another.

The role and importance of insurance-related functions to a market participant can have a significant effect on supervisability. If the objectives of an entity are consistent with those of the supervisor and if insurance-related functions play an important role in meeting the objectives, the prospects for cooperation are good. If the objectives are not well aligned with those of the supervisor or the insurance-related functions are relatively unimportant to the entity, supervision might be a struggle.

The need for understanding goes both ways. The supervisor should communicate its objectives and responsibilities clearly to market participants. Communication might also need to highlight which activities and functions are regulated and supervised.

A supervisor might need to take steps to ensure that the regulatory framework accommodates diverse market participants. For example, the types of entities eligible to be licensed as insurers or intermediaries might need to be broadened. Requirements might need to be reoriented to apply to the functions performed rather than to the entities that have traditionally performed them. Consultation with a wide range of market participants, including those operating in the informal insurance market, is important to achieving an appropriate regulatory framework. Such consultation might take place both individually and collectively, for example, through industry associations or apex organizations. The framework must not only include appropriate requirements to deal with the risks but also provide the supervisor with adequate tools to monitor and enforce their implementation.

Dealing with diverse authorities

The diversity of market participants, together with a supervisory objective of inclusiveness or market development, makes it likely that the supervisor will need to deal with diverse authorities. Some authorities might also be financial supervisors, while others might be regulators or supervisors of nonfinancial activities. Still others might have development responsibilities—for example, for agricultural development or education—or deal with taxation. The process of formalizing previously informal insurance activities may also require coordination with a more diverse group of authorities on more diverse topics.

Some of the steps discussed in relation to dealing with diverse market participants apply similarly when dealing with diverse authorities. For example, it is useful to develop a mutual understanding of the objectives and responsibilities of each authority. It is also useful to consider both the entities and the functions that are within the scope of responsibility of each authority. This information can assist in reaching agreement on the roles and responsibilities of each authority that are relevant to the insurance sector (see Hänsel 2010, sec. 6.2). Ideally, supervisory gaps and overlaps can be avoided, and cooperation among the authorities can create synergies that help each to attain its objectives. If the insurance activities of a market participant are significant, the insurance supervisor should play an important role in its supervision.

ICP 3 on cooperation and information exchange is relevant in this context. Where various authorities are involved in the supervisory process, they should ensure that there is sufficient coordination, cooperation, and information sharing to facilitate the discharge of their duties and to reduce the risk of regulatory arbitrage. Legislation might need to be changed to allow for this. For example, it might only provide for the sharing of information with another insurance supervisor or other financial supervisor. If legislation allows an insurance supervisor to share information with other types of authorities, the insurance supervisor should nevertheless ensure that any such sharing of information is subject to confidentiality, purpose, and use requirements. To avoid problems and promote a proactive, ongoing exchange of information, it might be useful to document agreements between the authorities in memoranda of understanding. This could be particularly important if the authorities involved do not have a tradition of sharing confidential information or experience with the safeguards that should accompany such sharing.

Resource implications

Insurance supervisors can and should play an important role in the achievement of an inclusive insurance market. There are various aspects to this role, each of which can have potentially significant implications with respect to the resources needed by a supervisor.

Supervisors should participate in the development of policies that would enhance inclusiveness. The policy development process typically requires the involvement of both senior management and knowledgeable technical staff, which will enable the supervisor to assess the market situation, identify barriers, deal with diverse stakeholders, and develop policies that would remove the barriers without compromising the achievement of supervisory objectives. Although technical assistance might be available from outside experts, it is likely that substantial internal resources will also be needed.

Policy development is not a one-time exercise. As the market evolves, new customer needs will be identified and further innovations will be proposed to better meet those needs, so the policy framework will require ongoing consideration. Of course, this also applies to conventional insurance markets, but perhaps to a lesser extent.

The development work extends beyond the regulatory framework to supervisory practices. Innovative and careful thought will be needed to develop supervisory practices suitable to a wider variety of market participants, some of which might be much smaller than those traditionally supervised and might lack technical expertise, appropriate data, and robust systems. For example, apex organizations might be enlisted to assist in the supervisory effort by developing common administration, accounting, and actuarial software for the entities they serve, providing training on its use, and collecting and validating the quarterly information produced by each entity before forwarding it to the supervisor. If other supervisory authorities are involved, the responsibilities might be shared, thereby reducing the potential burden on each authority.

Supervisory resources will also be needed to implement the regulatory framework and to apply the supervisory practices on an ongoing basis. The supervisor will need to communicate with stakeholders to create and maintain their awareness of the regulatory requirements as well as its own role and responsibilities. Potential innovations will have to be assessed, and a larger and more diverse group of market participants will have to be licensed and supervised.

The regulatory framework and supervisory practices should take account of the preconditions, as described in the introduction to the ICPs, such as the need for skilled, competent, independent, and experienced actuaries, accountants, and auditors. Specific expertise with regard to a particular underserved segment of the market might need to be developed, the supply of professionals might need to be expanded, or other mechanisms might need to be put in place to ensure that capable professionals play a role where their skills are needed and not only in more conventional market segments. For example, small farmers might benefit greatly from weather-index crop insurance, but few actuaries might have the expertise to develop and price such products. Or apex organizations might be permitted to supply actuarial services to MCCOs, rather than requiring each entity to have its own actuary.

When limited skills have a material impact on access to inclusive insurance markets, supervisors should improve or alleviate the shortcomings by sponsoring projects—or encouraging others to do so–that would seek to overcome the limitations. For example, an international reinsurer might be convinced to partner with local insurers and professionals to develop weather-index crop insurance products, thereby transferring knowledge in addition to generating additional business. Or a supervisor might work with the local accountancy professional organization to develop a training program for the auditors of MCCOs. Such initiatives require supervisory resources.

Limitations on available data might be a barrier to the inclusive provision of insurance products. Limitations might relate to information on the underserved market, which can affect policy development and the willingness of entities to participate in the market. They might also relate to the data needed to price insurance risks. For example, reliable historical meteorological data are needed to price weather-index crop insurance; in the absence of such data, coverage may not be available or prices may be uneconomic. Again, supervisory resources might be required to enhance the availability of data or to consider insurance mechanisms that will respond to the shortcomings in data. For example, the supervisor might collect data on microinsurance and make the information available to all insurers. Or regulations might require products that are priced using limited data to have short policy periods or adjustable premium rates and require insurers to review the policy benefits and premium rates of such products regularly in light of emerging experience.

Supervisors should give attention not only to the resources needed but also to where such resources might be obtained. As mentioned, some of the demand for resources might be met by enlisting the support of others, such as apex organizations or other supervisory authorities. The remaining supervisory costs should be financed in a fair and sustainable manner, which does not compromise supervisory independence. For example, if supervisory costs are financed by levies on industry participants, the levy structure should not give one type of entity underwriting or distributing microinsurance products an inherent cost advantage over another type of entity with respect to the same products. In the short run, however, this fairness principle might have to be compromised. For example, as informal entities are being transitioned into the formal system, it might be impossible or unreasonable to levy the additional supervisory costs of the transition on such entities. In this case, additional funding from the general budget of the government or from temporarily higher levies on conventional insurers might be necessary and appropriate.

The role of an insurance supervisor is seldom easy, and seeking to enhance the inclusiveness of the insurance market makes it all the more challenging. The resources and commitment required to succeed in this endeavor should not be underestimated. Neither, however, should the potential benefits that can be achieved—not only for the underserved, the insurance sector, and the broader economy but also for the supervisor. The work can be more varied and interesting, and the opportunity to develop a more effective regulatory and supervisory regime and extend its benefits to a broader part of the public can provide additional satisfaction.

Exercises

Answer the following questions considering, where indicated, the situation in your jurisdiction. If you are working with others on this module, develop the answers through discussion and cooperative work methods.

6. State the objectives of your supervisory authority and indicate where they are defined—for example, in primary legislation. Briefly explain how the objectives might explicitly or implicitly support the need to develop or maintain an inclusive insurance market.

7. Provide at least two reasons why an inclusive insurance market should be subject to prudential supervision and at least two reasons why it should be subject to market conduct supervision.

8. List five questions, the answers to which can help a supervisory authority to develop a proportionate approach for dealing with a market innovation that would enhance access to insurance. Provide an example of how your authority responded to a market innovation and describe the steps taken to help to ensure that the response was proportionate.

9. The authorities in a jurisdiction are considering adopting the following definition: "Microinsurance product means an insurance product that is designed to meet the needs of low-income customers, where the amount of premiums, computed on a daily basis, does not exceed 6 percent of the national daily minimum wage rate and the maximum guaranteed benefits do not exceed 600 times the national daily minimum wage rate. In the case of a bundled product, the maximum amounts of premiums and guaranteed benefits apply separately with respect to each component of the product." Provide at least three reasons why such a definition might not support an inclusive insurance market.

10. An insurance supervisory authority intends to formalize informal insurance activities, some of which involve the underwriting of insurance by agricultural cooperatives. Agricultural cooperatives are supervised by the Ministry of Cooperatives. Describe some initial steps that might be taken in dealing with both the cooperatives and the ministry.

11. Provide at least three reasons why creating and maintaining a more inclusive insurance market might require additional supervisory resources. Also provide at least two

examples of how an insurance supervisory authority might be able to reduce the need for additional supervisory resources by involving others.

D. Prudential issues

Prudential supervision focuses on enhancing the safety and security of the insurance market so that insurers will be financially able to meet their commitments to customers. This section discusses some difficult issues that can arise when striving to apply prudential supervision in a manner supportive of inclusive insurance markets. Such issues relate to the licensing and operations of insurers, the solvency regime, and the approach to supervision.

Licensing

Licensing is a key tool used to achieve and maintain a supervised market. Legislation should define the types of activities for which a license is required, those eligible to apply for a license, the conditions that must be met to obtain a license, and the conditions that must be satisfied on an ongoing basis to maintain a license. Supervisors use licensing powers to limit access to the market to those entities likely to meet such conditions, achieve corrective action under the threat of license revocation, and remove unsuitable entities from the market.

Licensing can thus make a significant contribution to protecting customers. But licensing requirements must be appropriate if they are to serve the public interest. If the requirements are weak or limited in scope, customers will be subject to excessive risk. If the requirements are too restrictive or administratively onerous, not only will participation in the market be discouraged and access to insurance adversely affected, but also the supervisory authority itself might be overburdened.

Regulated insurance activities

It is generally in the interest of customers to have a definition of regulated insurance activities that is broad in scope. However, the ICPs provide that, in defining regulated insurance activities, jurisdictions may decide to exclude some limited activities. Some jurisdictions provide exclusions that are related to the product or the service, such as extended product warranties, prepaid funeral services, and motorist assistance programs. Other jurisdictions provide exemptions that are related to the provider, such as insurance provided by small, member-owned entities with a limited geographic scope of operation. Such exclusions and exemptions are sometimes adopted on the basis that the potential regulatory burden is disproportionate to the risks. However, the risks to customers should be considered carefully, along with the existence of appropriate alternative safeguards to protect their interests. For example, prepaid funeral services might be excluded from the definition of insurance if the jurisdiction regulates funeral service providers and requires all prepayments to be deposited in a trust account, which is legally separated from the general assets of the provider.

In some cases, a narrow definition of permitted insurance activities can have the effect of making some insurance coverage unavailable in the supervised market, even if a licensed insurer wants to offer it. For example, legislation might limit authorized insurance activities to the underwriting of risks located within the jurisdiction or the issuance of policies to residents of the jurisdiction. Such a restriction might make it difficult for migrant workers to obtain insurance coverage in their home country and, depending on their legal status, in the host country as well.

Supervisors should review the definitions of insurance and insurance activities to ensure that any insurance-like services posing significant risks to customers can only be provided within the supervised market and that the scope of insurance that can be underwritten within the supervised market is not unnecessarily restricted. This will help to maximize the access to insurance through the supervised market.

Entities to be licensed

The previous subsection dealt with the activities subject to regulation, while this subsection deals with the types of entities that might be allowed to undertake regulated insurance activities. When considering which types of entities might be licensed, issues arise that are similar to those considered when defining regulated insurance activities. For example, access to insurance through the supervised market is enhanced if all entities underwriting insurance are required to be licensed and if the types of entities eligible to apply for a license are defined with the widest possible scope. The ineligibility of a particular type of entity to apply for a license could limit the availability of insurance that such entities might otherwise provide or create an incentive to provide such insurance outside the scope of regulation.

As noted, some jurisdictions provide exemptions from regulation that are related to the provider, such as small, member-owned entities that provide insurance within a limited geographic territory. Some argue that such exemptions are justified because any regulatory burden placed on a very small entity would be disproportionate. However, this argument is valid only if appropriate alternative mechanisms exist to protect customers. But it is difficult to envision alternative mechanisms that would fully support the achievement of supervisory objectives and justify exemption from licensing. For this reason, the application paper emphasizes the need to license—or, at a minimum, to register—any entity that underwrites insurance.

Legislation sometimes restricts the types of entities eligible to apply for a license. Restrictions might be based on factors such as the following:

- **Institutional form.** For example, limiting insurers to corporations

- **Domicile of the entity or its owners.** For example, limiting insurers to entities established in the jurisdiction or owned by persons resident in the jurisdiction

- **Nature of the owners.** For example, requiring an insurer to be widely held or prohibiting an insurer from being owned by a nonfinancial entity

- **Specialization.** For example, prohibiting an entity that engages in any noninsurance activities from being licensed as an insurer.

Some restrictions exist to support supervisory objectives. For example, specialization is a common restriction, which helps to protect policyholders from the risks associated with noninsurance activities. Other restrictions, such as those related to domicile, might exist to support objectives such as the development of local capital markets. Although there might be valid reasons for a particular type of restriction, the restriction could nevertheless have an adverse effect on access to insurance. Supervisors should consider whether there are alternative means to achieve such objectives, which would enable a restriction to be relaxed or eliminated. This could enhance competition, reduce regulatory arbitrage, and facilitate the formalization and integration of unregulated or informal providers into the regulated financial sector.

In some jurisdictions, existing unregulated or informal providers include MCCOs. In other jurisdictions, MCCOs might not be involved in insurance activities currently, but the facility for them to do so could enhance the inclusiveness of the insurance market. If MCCOs are or could be active in the insurance market in a particular jurisdiction, they should, to the extent possible, be eligible for licensing.

This does not necessarily mean that all entities eligible for licensing should receive the same type of license. An entity should only be licensed for insurance activities that it has the capability to carry out. For example, some entities might be restricted to underwriting microinsurance business, either by including in legislation the option for a "dedicated microinsurer" license or by applying conditions to or limitations on their licenses.

Mixed entities

As mentioned, eligibility for licensing is often restricted to entities specializing in insurance. The ICPs recognize the risks associated with mingling insurance and noninsurance businesses together in the same legal entity and stress the importance of effectively managing risks even when life and nonlife insurance products are issued by one insurer. Life insurance products are often purchased to provide for a person's long-term financial support, which could be placed at greater risk if the insurer is also underwriting the more volatile nonlife business.

Considering both the potential diversity of approaches needed to achieve a more inclusive insurance market and the possible existence of informal insurance activities, it is likely that some entities involved in other business activities may provide or seek to provide insurance. Unless the other business activities of a mixed entity are low risk in nature and small in size compared to its insurance business, it would be inadvisable to license the entity as an insurer. Not only would it be difficult to protect policyholders from the risks of the other business activities, but it could be very difficult to regulate and supervise the entity and its insurance activities. For example, governance requirements might have to be adapted to ensure sufficient focus on the insurance business, financial analysis could be complicated, capital adequacy might be hard to assess, and a mixture of insurance and other operational activities could make on-site inspections difficult. Therefore, the most appropriate approach is to require the establishment of a separate legal entity to be licensed as an insurer. Transitional arrangements might be needed to deal with existing mixed entities.

In some cases, access to insurance can be enhanced by allowing the same insurer to issue both life and nonlife insurance. For example, this might facilitate the packaging of different types of coverage in the same policy, which could better meet the needs of customers, reduce administrative costs, and make insurance more affordable. Similarly, allowing the same insurer to offer both life and nonlife insurance, even if separate policies are required, could provide some economies of scale for a small MCCO.

In some jurisdictions, legislation provides for the licensing of composite insurers, which might be authorized to underwrite a wide variety of life and nonlife products. In some other jurisdictions, limited flexibility is provided by allowing both life insurers and nonlife insurers to underwrite some of the same risks. For example, both might be allowed to issue personal accident products or to include small amounts of other types of coverage in package products or as riders. These possibilities might be provided for explicitly in legislation or through the exercise of supervisory powers, such as the power to deem a type of coverage that is usually considered either life or nonlife insurance to be acceptable under the other category.

Regardless of the approach taken, provision should be made for adequate separation of risk. Consistent with the principle of proportionality, if the risks involved are more significant, then more extensive mechanisms might be needed to achieve separation that would be considered adequate. Considering the small size of microinsurance policies, it might be appropriate to limit the ability of an insurer to underwrite both life and nonlife insurance to microinsurance products.

Pilot schemes

Pilot schemes might be used to test an approach that would enhance access to insurance and learn what modifications, if any, may be needed. By their very nature, pilot schemes pose more business risk to those carrying them out than do their established business activities. If a pilot scheme involves the conduct of regulated insurance activities, customers need protection. This implies that the entity underwriting insurance risks as part of a pilot scheme should be licensed and supervised, unless appropriate alternative mechanisms are used to protect customers.

Licensed insurers sometimes carry out pilot schemes that are within the scope of their licenses. Such schemes might well pose risks that would create supervisory concerns, but can at least be supervised using the tools generally available when dealing with licensed insurers. The insurer and the supervisor should understand the risks and take appropriate steps to deal with them. However, a licensed insurer might want to test an approach that would go beyond the scope of its license or the legislation. For example, a life insurer might want to pilot test a microinsurance product that includes nonlife coverage. In such a case, steps such as extending the scope of the license—if the supervisor has the power to do so—or amending the legislation might need to be taken.

Alternatively, an entity other than a licensed insurer might want to initiate a pilot scheme or might already have done so. In such cases, the supervisor can be faced with some very difficult issues. For example,

- The persons responsible for the entity might not realize that the pilot scheme involves regulated insurance activities.

- The entity might not be eligible to be licensed.

- The supervisor might not have the power to obtain information from an unlicensed entity.

- The supervisor might not have the power to supervise insurance activities—even of a pilot scheme—performed by an unlicensed entity.

- The financial resources of the entity might be too little to provide adequate assurance that it will be able to meet its obligations to customers.

- An unlicensed entity might lack access to reinsurance.

- If the entity operating the pilot scheme fails, the provisions for its winding up might provide little protection to customers.

- Customers purchasing insurance through the pilot scheme might not have access to normal protections against market misconduct, such as dispute resolution mechanisms.

- If an unlicensed entity is allowed to operate a pilot scheme that would not be permitted of a licensed insurer, unfair competition could result and regulatory arbitrage might therefore be encouraged.

To deal with these issues, the operation of a pilot scheme by an unlicensed entity should be accepted only on a temporary basis, subject to transitional arrangements. The arrangements should include a timeline for the transition and specify how the outstanding obligations arising from the pilot scheme will be managed or transferred. This might differ, depending on the outcome of the pilot scheme. For example, if a pilot scheme is successful, the entity might be required to apply for a license (if eligible to do so, which might require a change in legislation). But advance arrangements could be required to transfer the outstanding insurance obligations to a licensed insurer in the event a pilot scheme is unsuccessful.

During the transition period, steps should be taken to provide appropriate alternative protection of customers. Such steps could include the following:

- Requiring the entity to register, which would enable the supervisor to identify those involved and to validate their legitimacy

- Requiring the entity to identify separately the assets that will be used to meet the obligations arising from the pilot scheme

- Requiring the entity to make a deposit, as a substitute for having to meet capital adequacy requirements

- Notifying customers that they are participating in a pilot scheme, which is not subject to normal supervisory protections

- Requiring the entity to provide some protections in other ways, such as appointing an independent ombudsman to deal with customer complaints.

Supervisors should avoid unduly holding up the conduct of a worthwhile pilot. However, the potential risks to customers—particularly those in the underserved group, who might be especially vulnerable—must be weighed carefully. Customer protection should not be compromised in the interest of innovation.

Small entities

As mentioned, some jurisdictions exempt certain types of entities from licensing on the basis of factors such as small size, limited geographic scope of operation, or the nature of insurance underwritten. Size alone is not an appropriate basis for exemption, because even though fewer customers might be at risk of loss, the risks faced by any one customer might be no less than those arising from dealings with a large insurer.

If any entity underwriting insurance risk is required to be licensed, does this mean that even the smallest entities should be eligible to apply for and receive a license? The answer to this question is no. In practical terms, some entities are simply too small to be able to operate successfully as insurers. One reason for this is technical in nature: an insurer needs to be large enough for risk pooling to take place. An insurer with a very small number of policies in force, even if such policies are not large, faces a high probability of ruin because of fluctuations in claims experience. Another reason is operational in nature: an insurer needs to be large enough to carry out effectively the business processes involved in managing retained risk.

Some of these business processes will be necessary to meet regulatory requirements, such as reporting to the supervisor and providing disclosure to customers. Even with careful attention to proportionality when designing regulatory requirements, it might be impossible for a small entity to meet even the minimum requirements necessary to achieve supervisory objectives. The application paper offers some suggestions in this regard in the section on absolute minimum requirements, and this module discusses many of them when exploring the related prudential and market conduct issues in sections D and E.

What is the minimum size that an entity should be to be eligible for licensing? The application paper includes a graphic, which illustrates the need to consider both technical and business factors when establishing a minimum size. In fact, technical and business factors are not necessarily independent of one another. For example, an entity that underwrites only low-risk microinsurance products will probably be able to operate successfully with respect to both risk pooling and business operations at a much smaller size than one that underwrites a wide range of commercial insurance products. Accordingly, it can be justifiable to have different minimum sizes for different types of entities, based on differences in the nature, scale, and complexity of the insurance businesses they intend to conduct.

The minimum size from a technical standpoint can be determined through stochastic modeling of the insurance business an entity is expected to underwrite. Such modeling would typically be done by an actuary, taking account of a variety of factors affecting the frequency, severity, and correlation of claims, the nature and extent of reinsurance, the minimum level of capital the entity would be required to maintain, and the confidence level for solvency acceptable to the supervisor, among other things. Performing such modeling is neither simple nor inexpensive, but opportunities to leverage resources might be available. For example, the supervisor might work cooperatively with apex organizations and reinsurers that serve MCCOs in this regard, with the apex organization gathering detailed information on the insurance portfolios of each of the MCCOs and the reinsurer using such information in its models to determine the potential variability of claims experience.

From a business standpoint minimum size can be determined by analyzing the operational and regulatory compliance needs of a particular type of entity conducting the expected type of business. One point of reference might be to consider the number of people and other resources, such as technology and facilities, needed to operate an entity carrying on business at the minimum size necessary from a technical standpoint. If the expense margins that are likely to be available in the premiums of an entity with that much business would be insufficient to cover the expenses, then the minimum size from a business standpoint would need to be higher than the minimum size from a technical standpoint. Business financial modeling, along the lines of that generally required in connection with license applications, can be used to determine the minimum amount of business an entity would need to write to bring the expense margins into balance with the expenses.

It is useful to supplement such technical analyses by considering experience and practices in the market, both locally and internationally. Such considerations might include the following:

- If a particular type of entity is currently operating in the informal market, what is the smallest such entity that appears to be operating in an acceptable manner? What additional resources might that entity need to enable it to satisfy regulatory requirements?

- Among the entities currently licensed as insurers in the jurisdiction, what is the smallest one that usually operates without creating significant supervisory concerns?

- If a particular type of entity is operating in the formal market in other jurisdictions, what is the smallest such entity that appears to be successful? When making such comparisons, care should be taken to consider factors that might differ among jurisdictions, such as the nature of the insurance risks and the support available from apex organizations.

Of course, those in the market will have their own views about minimum size. The supervisor will need to take account of such views, while being careful to distinguish between arguments that have technical merit and those that might be motivated by commercial interests. The establishment of a minimum size that is higher than the size required by sound practices would be a barrier to access.

Implementation of licensing

Once decisions have been made regarding which activities require a license and which types of entities are eligible to apply for a license, the implementation of licensing requirements can begin. Licensing can be a difficult and complicated exercise for both the applicant and the supervisor. It can be especially challenging when seeking to develop more inclusive insurance markets. There might be various reasons for this:

- Some entities operating in the informal sector might not realize that their activities require a license.

- Some entities operating in the informal sector might not be eligible for a license.

- The supervisor might need to adapt licensing requirements and procedures to make them more suitable for smaller entities, different types of entities, and pilot schemes.

- Small entities or those operating in the informal sector might have difficulty understanding or coping with licensing requirements and procedures.

- The supervisor itself might be overburdened if it has to apply complex procedures, particularly if there are many entities to be licensed.

Licensing requirements and procedures can be barriers to the development of an inclusive insurance market if they are not well designed, clearly communicated, and appropriately applied. Entities that might be able to enhance access to insurance could be discouraged from operating or decide to remain in the informal sector. Supervisors might also be able to reduce potential licensing barriers by providing additional guidance or directing applicants to relevant resources, such as guidance on business planning (see Wipf and Garand 2011). For more information on licensing, see the core curriculum module on this subject.

Formalization and transitional arrangements

Although informal insurance is undesirable, in most cases it would also be undesirable to shut down all informal insurance activities immediately. Providers of informal insurance products and services are meeting certain needs of their customers, so shutting them down might leave those needs unmet. Also customers could lose any money they had invested or paid as premiums. A better alternative generally is to seek to formalize informal insurance activities. Transitional arrangements can enable formalization to take place in an orderly manner, which deals fairly with the interests of both customers and other stakeholders.

Formalization can best be accomplished by starting with a clear picture of the informal sector. The entities operating in the informal sector should be identified and information gathered on their form, ownership, management, and scope of activities. This might be facilitated by establishing a registration requirement as a precursor to licensing.

The possible and preferred outcomes of a formalization process should also be considered. The outcomes might vary depending on the starting points. For example, some entities might be too small to qualify for even a restricted license. Such entities might be encouraged to merge into larger entities or to transfer the risk-taking function to licensed insurers and act solely as a channel for delivery. Other entities might be eligible for licensing as a dedicated microinsurer and be encouraged to apply for such a license. Still others might be able to qualify for an unrestricted license as a regular insurer. To the extent possible, entities operating in the informal sector should be free to choose among outcomes that are viable in light of their circumstances.

If formalization is not immediate, it should include transitional arrangements and processes. During the transition period, the protections that would otherwise be available to customers under the formal insurance sector will be incomplete. Accordingly, transition periods should be limited in duration, and the activities of an entity during its transition period should be constrained. The length of the transition period should be based on how long it would reasonably take an entity to accomplish the steps needed to move from its current state to the preferred outcome. For example, it might take only a few months to negotiate the transfer of informal insurance coverage to a licensed insurer, but a year or more to arrange the merger of several small entities.

Transition processes should be clear and transparent. When designing such processes, consideration should be given not only to the pathway that would be followed if everything goes as planned but also to what steps might be taken in the event problems arise. For example, what if two informal entities express an intention first to merge and then to seek a license, but fail to reach agreement on the terms of the merger before the end of the transition period? What if they successfully merge, but then fail to satisfy the licensing requirements? Extending the transition period is often an expedient measure, but repeated extensions not only leave customers subject to continued higher risk but also can damage the credibility of the supervisor and make the transition process unmanageable.

The transition process can also be difficult to manage if many entities are subject to transitional arrangements, particularly if the outcomes are highly uncertain. In such a situation, a supervisor might seek opportunities to leverage its resources. For example, an apex organization might assist in communicating requirements to the entities and help them to develop acceptable transition plans. Other authorities might also be helpful, especially if they have longer experience, or deeper interaction, with the transitional group. They might have existing systems that can facilitate access to entities or collect data in an interim period. For example, the ministry responsible for agricultural cooperatives might have systems that can be used to collect data from cooperatives that offer insurance to their members. Some, such as fiscal authorities, might also have options for leverage or enforcement actions that could be efficient or effective in the transition period.

Restrictions might be placed on the activities of entities during the transition period through the use of conditional licenses—licenses restricting entities to the underwriting of specific products—if the supervisor has the power to grant such licenses. Alternatively, it might be necessary to enter into an enforceable agreement with an entity, which would impose restrictions and subject the entity to supervisory oversight, in exchange for being permitted to continue its operations. (In the absence of such an agreement, the supervisor should have the power to force the cessation of regulated insurance activities by an unlicensed entity.)

Any restrictions imposed should be commensurate with the nature, scale, and complexity of the risks to which the informal entity is subject. For example, a very small insurer might be limited to issuing a particular product and to investing its assets in licensed banks. Considering these restrictions, it might be exempted from some of the requirements, such as those related to risk management, that are applicable to licensed insurers. If the entity wanted to remove the restrictions in order to serve its customers better, it would have an incentive to seek to qualify for an unrestricted license, which would come with proportionate risk management requirements.

Care should be taken to ensure that transitional arrangements are not unduly attractive to the entities involved, compared to the requirements faced by existing insurers. Unfair competition could result, which might lead to regulatory arbitrage, as existing insurers take steps to achieve the same advantages. For example, an existing insurer might establish a dedicated microinsurance subsidiary to avoid the more onerous regulatory requirements that such business would attract if written directly on its own books. Perhaps even worse, an existing insurer might be forced to establish a subsidiary if certain products cannot be written by licensed conventional insurers but only by those with restricted microinsurance licenses or under transitional arrangements.

Changes of control and exit from the market

Although changes of control and exit from the market are typically considered in connection with licensed insurers, they are also worth considering in the context of the licensing process. Informal insurers might fail to meet the conditions for formalization and therefore be required to exit from the market. Likewise, pilot schemes undertaken by unlicensed entities might fail or not achieve sufficient scale to be viable, and the outstanding obligations to policyholders would need to be dealt with. The mechanisms that might be used to accomplish exit from the market or transfer obligations to other entities should be considered by the supervisor when designing or assessing transitional arrangements. This is particularly important if the entities involved have different legal forms than those contemplated when the winding-up provisions of insurance legislation were written.

If the market includes, or potentially includes, MCCOs, legislation should provide for how demutualization and mutualization could be accomplished. The likelihood that an entity might seek to demutualize or mutualize—either as part of a transitional arrangement or subsequently—could be relevant to the licensing decision.

Operations

The discussion of licensing highlighted the possibility that some of the types of entities that might be licensed when moving toward more inclusive insurance markets could be different from those with which a supervisor has traditionally dealt. Furthermore, some of their insurance activities—even those of conventional insurers, with respect to innovative approaches—might be carried out in different ways than in the conventional insurance sector.

Supervisors should be attentive to the ways in which such differences might affect the operations of the entities involved. They should seek to ensure that such entities have appropriate and effectively implemented governance and control mechanisms in place to protect the interests of customers. The issues paper on the regulation and supervision of MCCOs (IAIS and MIN 2010) discusses the key elements of such organizations that are relevant to considering the approach to their regulation and supervision. Elements related to the operations of MCCOs and other entities that might be involved as insurers in inclusive insurance markets are discussed below.

Corporate governance

Requirements regarding corporate governance exist with the objective of ensuring that organizations develop strategies and plans that appropriately balance the interests of their stakeholders and implement them in an effective manner. Stakeholders include, but are by no means limited to, the owners, managers, and employees of an organization, along with the customers that it serves. In the case of insurers, corporate governance requirements and the efforts of supervisors should focus on ensuring that the interests of customers are given high priority.

In the case of shareholder-owned insurers, corporate governance requirements commonly attempt to achieve this in various ways. For example, the board and senior management might be required by legislation to give high priority to the interests of policyholders and to have mechanisms in place to identify and deal with potential conflicts of interest. Some members of the board might be required to be independent of both the owners and senior management. If the insurer issues policies that provide for participation in its profits, some board positions might be reserved for representatives of the participating policyholders.

Many of the same issues and corporate governance mechanisms are equally relevant to MCCOs. However, unique issues can arise with them. For example, MCCOs are often owned by their policyholders, so the potential trade-off between improving returns for shareholders and providing better value for policyholders might not exist. Nevertheless, conflicts of interest can arise if not all policyholders have ownership rights and if the profits are shared among various types or generations of policyholders.

Members of the boards of MCCOs are often drawn from their membership. This is generally desirable from the standpoint of aligning the interests of an entity with the interests of those that it serves. However, a potential weakness of this governance structure is that the membership might not include persons with the technical competence, management experience, and breadth of experience needed to direct an entity that is underwriting insurance. Such a situation, combined with the absence of a shareholder group seeking to protect its own interests, can create a heightened risk that management of the entity might control the board rather than the other way around. This risk might increase with the size of the entity and its geographic scope of operation and with the decrease in personal connection and sense of solidarity.

Also, as discussed, pilot schemes might sometimes be operated by unlicensed entities. In such cases, the corporate governance arrangements of the entity are unlikely to include mechanisms specifically designed to protect the interests of policyholders.

A supervisor should take steps to identify potential corporate governance issues and ensure that they are being dealt with. These might include the following:

- Analyzing each entity to identify the relevant stakeholders, assessing the nature of their interests, ascertaining the governance structure, and determining how the structure balances the interests of the stakeholders, paying particular attention to the interests of policyholders
- Reviewing the responsibilities of the various groups involved in the governance of an entity to ensure that responsibilities are clearly defined and adequately documented and that mechanisms exist to hold those involved accountable for performance
- Considering the reporting mechanisms and ensuring that those involved in governance—including policyholders, if they have ownership rights—have sufficient, appropriate, and timely information to enable them to carry out their responsibilities
- Assessing the operation of governance to ensure that it is being carried out in the manner envisioned and is achieving the desired results.

Suitability of persons

The ICPs highlight the importance of having insurers directed and operated by suitable persons. Board members should be individually competent, and the board as a whole should have an appropriate mix of individuals to provide the range of expertise necessary. Senior managers and key persons in control functions should be competent to carry out their respective responsibilities. All of these individuals should satisfy appropriate standards of propriety.

In emerging markets, even conventional insurers may have difficulty populating their board with an appropriate mix of competent individuals. The difficulties can be even greater with respect to MCCOs, if the rules require that directors be members and the membership does not include individuals with the full range of expertise necessary. Likewise, attracting and retaining competent management and technical staff can also be a challenge, particularly for very small insurers.

Supervisors should be sensitive to these challenges, but this does not mean that suitability standards must be abandoned in the interest of increasing the access of customers to insurance. Some positive steps might be taken:

- Encouraging or requiring insurers to strengthen individual competence through the training of board members, managers, and technical staff and providing direct access by board members to specific expertise
- Encouraging or requiring the modification of rules to enable nonmembers to serve on the boards of MCCOs
- Ensuring that assessments of suitability take appropriate account of the nature, scale, and complexity of an insurer's operations, as well as any external support received by the insurer, such as from an apex organization or reinsurer.

Consideration should be given to both substantive and administrative aspects of suitability requirements to ensure that they are not barriers to access. For example, some jurisdictions emphasize formal educational and professional qualifications, along with years of experience in the insurance industry. Such criteria are certainly useful indicators of competence, but perhaps the necessary level of competence might be equally well achieved in other ways. Formal documentation of suitability might be difficult for some individuals to provide, such as a prospective board member of an MCCO who lacks an educational degree and has worked mostly in informal employment. Alternative demonstrations of suitability might be considered, such as an interview with the supervisor regarding competence and an attestation as to good character by a trusted community leader.

Internal controls and risk management

Insurers should have adequate and effective internal controls and risk management, including control functions with the necessary authority, independence, and resources. When seeking to enhance access to insurance, several issues related to internal controls and risk management might be particularly relevant:

- Innovative approaches to operations, such as premium collection and claims payment involving different technological platforms or allocations of responsibilities, can create control risks that might also require innovative solutions.
- The involvement of mixed entities and noninsurance entities in the underwriting of insurance risk or the performance of specific functions can create control risks similar to those involved in outsourcing.
- If the activities of an insurer are restricted, by license conditions or otherwise, the internal controls and risk management processes needed might be less extensive.
- Small insurers often have difficulty establishing effective control functions, with respect to both resources and independence.

- Insurers in developing markets might have difficulty securing persons with the expertise needed to develop and maintain sophisticated control functions.

Apex organizations might be able to assist MCCOs in overcoming such challenges. For example, they might develop standardized systems and procedures that can be implemented by the MCCOs. They might also provide some control functions on a centralized basis, such as actuarial and internal audit services. Supervisors should be attentive to the possible need to seek changes to legislation to accommodate such approaches.

Solvency regime

ICPs 13 to 17 deal with elements of the solvency regime: reinsurance, valuation, investment, enterprise risk management, and capital adequacy. Various aspects of these ICPs that might require additional consideration when seeking to enhance access to insurance are discussed here.

Insurers should have reinsurance and risk transfer strategies appropriate to the nature, scale, and complexity of their business. This is relevant to small and large insurers, to those underwriting small policies or large policies, and to those taking on simple risks or more complex risks. Although some dedicated microinsurers might be very small, they should nevertheless have access to and make use of reinsurance to the extent necessary to manage their risks appropriately. For example, a microinsurer that underwrites crop and property insurance and has a geographically concentrated customer base might be highly exposed to natural catastrophes. For more information on reinsurance, see the core curriculum module on this subject. If the necessary reinsurance is unavailable, then risk taking should be restricted; this could, in turn, constrain access to insurance. Access to reinsurance might be enhanced in the following ways:

- Formalizing informal insurers, which might enable reinsurers to deal with them
- Allowing conventional direct insurers to assume microinsurance risks from other insurers, rather than requiring that such reinsurance be placed with specialist reinsurers
- Allowing insurers to reinsure microinsurance products that include both life and nonlife coverage with the same reinsurer
- Allowing insurers to reinsure new or complex risks, such as weather-index crop insurance, with foreign reinsurers
- Encouraging MCCOs to cooperate with one another in arranging reinsurance, developing a risk-sharing pool, or perhaps even jointly forming an insurer to take on the risk, leaving the existing entities to carry out distribution and some aspects of administration.

If many small, low-risk, and less-complex insurers are operating, it may be useful to leverage sector-wide expertise to develop valuation guidance that such entities would be capable of applying. If the valuation of certain types of assets and liabilities would be too difficult for an entity to perform, then it should be restricted to investing in assets and taking on liabilities that are simple to value. For example, a small MCCO might be restricted to issuing microinsurance products and investing in commercial bank deposits or government bonds.

The availability of shared actuarial services, perhaps through an apex organization, might enable small insurers to value—and make use of—more complex assets and liabilities. In such cases, the supervisor should ensure not only that the insurer is capable of performing the valuations but also that its board and management understand the risks involved and are capable of managing them effectively.

Supervisory expectations regarding enterprise risk management should be proportionate to the nature of the risks undertaken, keeping in mind that small policies or small entities do not necessarily translate into low risks. For example, weather-index crop insurance can create both modeling risk and basis risk. As in the case of valuation, shared actuarial services might also facilitate enterprise risk management by small entities.

Capital adequacy requirements should apply to all insurers. ICP 17 provides that such requirements should be risk based. Accordingly, the requirements should take account of the special characteristics of products that may increase access to insurance. In many cases, the products provide small amounts of insurance, with simple coverage and short policy duration. However, some products might be innovative, complex, or priced using limited historical data.

If very small insurers are involved, the simple risk profiles typical of such insurers should be considered. For example, the absolute minimum capital requirement might be lowered to reflect a lower risk profile. But when doing so, potential countervailing factors should be considered. For example, small insurers might have greater difficulty achieving risk diversification, while both small entities and innovative operational approaches might come with higher operational risk. The methodology for calculating required capital should not be more complex than warranted by the risks involved.

Special considerations might also relate to defining the capital available to meet requirements. MCCOs are sometimes started with the support of third-party guarantees, which might be considered as a substitute for capital, for example, during a limited transition period. MCCOs might also be able to raise capital through future calls on their members, which might be included in available capital if evidence exists that such calls would be met. But MCCOs generally have more difficulty raising capital than do shareholder-owned insurers, which should be considered in connection with their own risk and solvency assessments and when seeking a fair but prudent distribution of profits to policyholders—a challenge also faced with takaful insurance, which operates in accordance with Islamic principles.

Supervision

Prudential supervision should be both risk based and proportionate. These criteria are equally relevant when supervising insurers operating in the conventional insurance market and those providing insurance to the underserved. However, differences in the nature, size, and risk profiles of the insurers involved might mean that traditional prudential supervisory approaches would be inappropriate.

A risk-based supervisory framework should consider the nature of an insurer's business, the risks arising from the business, steps taken by the insurer to mitigate the risks, the likelihood of the risks being realized in spite of mitigation, and the potential impact if the risks are realized. When assessing the risks of a large, complex insurer or an insurer with complex products, sophisticated supervisory risk assessment methodologies might be appropriate. Likewise, such an insurer should also be expected to employ sophisticated risk management practices.

Conversely, if there are many small insurers with simple risk profiles, a proportionate, risk-based approach to supervision would probably be simple and perhaps standardized. But supervisors should not assume that small insurers, small policies, and low risks always go hand-in-hand. Whenever higher risks are identified, both the insurer and the supervisor should move toward more sophisticated risk assessment.

A possible advantage of the more complex stakeholder landscape that might exist in an inclusive insurance market is the opportunity for synergy. If insurers are served by apex organizations or are also subject to supervision by another authority, the insurance supervisor might be able to work with them in the supervisory process. The result could be more effective supervisory oversight as well as less work and lower costs for the insurance supervisor, other authorities, and the insurers.

However, the more complex landscape might also make it more likely that the supervisor will need to include entities other than the licensed insurer within the scope of supervision. All entities involved in the insurance delivery chain should be identified and, where relevant to the risk profile of the insurer, subjected to supervision. This might require a broadening of the powers to conduct group-wide supervision as well as cooperation with other supervisory authorities, both local and foreign.

Reporting and off-site analysis

Reporting requirements should provide sufficient information to facilitate the supervision of all entities licensed as insurers and to ensure that unlicensed entities subject to registration meet the minimum registration requirements. The required information must facilitate analysis of earnings and capital adequacy as well as assessment of compliance with relevant regulatory requirements, such as investment limitations or minimum claims ratios. It should also meet market analysis and policy needs—for example, the determination of whether accessibility and penetration targets are being met. Reporting requirements should also provide the information needed to supervise market conduct, as discussed in section E.

Depending on the nature of the entities involved, the reporting requirements might appropriately be less extensive than those applicable to conventional insurers. But supervisors should be attentive to the ability of entities to comply even with simplified reporting requirements. For example, some entities might be using manual recordkeeping and reporting systems or might not be capturing all of necessary data. Instructions should be clear, and active communication and training might be needed, Apex organizations might be of assistance in this process. Another resource is the reporting forms and financial analysis tools prepared by Microfact, which are designed for use when dealing with microinsurers. They are freely available in Excel format on the organization's website and can be used as is or adapted to the needs of a specific jurisdiction.[4]

The special characteristics of microinsurance should be considered when establishing reporting requirements and undertaking off-site analysis. For example, supervisors often analyze financial results by class of business. However, if "microinsurance" is defined as a class of business or if microinsurance products combine several types of coverage in the same policy, reporting requirements might involve splitting various items among classes of business to facilitate such analysis.

Also, benchmarks for various financial ratios might differ for microinsurance and conventional business or by the type of entity underwriting the business. Comprehensive guidance on performance indicators for microinsurance is available on the Microfact website (see Wipf and Garand 2010).

On-site inspection

Supervisors might need to adapt the approach to on-site inspection to reflect the nature of the inclusive insurance activities in their jurisdiction. For example, if there are many small MCCOs, frequent on-site inspections could be very costly and time-consuming, especially if some are geographically remote. The planned frequency of on-site inspections might be reduced and the possibility of creating a self-regulatory organization to carry out certain supervisory activities might be considered.

When performing an on-site inspection of a dedicated microinsurer, the scope of the inspection, preliminary data requests, on-site activities, and questionnaires might need to differ from those used with a conventional insurer. For the sake of efficiency, small entities might well be subjected to full-scale inspections, rather than a series of focused inspections. On the other

[4] See "Microfact Factsheet." Available at http://www.microfact.org/microinsurance-tools/microinsurance-factsheet/.

hand, if conventional insurers are underwriting microinsurance, focused inspections of their microinsurance activities might be useful. However, the methodology of such focused inspections might depend on the manner in which insurers have organized their microinsurance activities. Although some insurers establish separate departments to handle certain functions associated with microinsurance, others integrate all microinsurance activities within their traditional organizational structures.

Ideally, supervisors should have on-site access to all entities involved in the insurance delivery chain. If such access is not provided for by legislation, it might be secured in other ways. For example, a legally binding agreement to provide access might be required as a condition of licensing or for the registration of a pilot scheme.

Prevention, correction, and enforcement

The basic framework for supervisory intervention, including preventive, corrective, and enforcement measures, might appropriately remain largely unchanged when seeking to make insurance markets more inclusive. However, some potential differences in application should be considered (see Hänsel 2010, sec. 5).

Some of the individuals and entities involved might be unfamiliar with insurance legislation or unaccustomed to dealing with supervisory authorities. Although ignorance of the law is no excuse for violating it, the supervisor might consider taking extra care in explaining the requirements and expectations in such circumstances, rather than taking immediate and strict enforcement action.

Transitional arrangements, such as those used in a formalization process, should be reasonable and enforceable. Once in place, the conditions of such arrangements should be enforced. Where relevant, the supervisor should have contingency plans that will protect the interests of policyholders, not just penalize the entity or its management.

Supervisors sometimes require the replacement of a key person as a means to address management or governance problems. Finding an appropriate replacement might be particularly difficult if an entity is small, geographically remote, or engaged primarily in activities other than insurance. Alternative measures, such as requiring training or performing closer monitoring, could be more practical in some circumstances.

Financial penalties should be meaningful but proportionate. This can be particularly important in the case of small MCCOs. If large financial penalties are imposed on a small, member-owned entity, an action intended to protect policyholders could actually cause them financial loss or place them at greater risk.

Exercises

Answer the following questions considering, where indicated, the practices in your jurisdiction. If you are working with others on this module, develop the answers through discussion and cooperative work methods.

12. As part of exercise 5, you identified the number of entities in your jurisdiction that are underwriting insurance in the informal market. For each such entity (or type of entity, such as cooperatives) indicate whether legislation would restrict its eligibility to apply for a license on the basis of factors such as institutional form, domicile, domicile of the owners, nature of the owners, mix of business activities, size, or other factors. Explain how you would expect each of the relevant restrictions to be dealt with, for example, by changing legislation, requiring the affected entities to implement changes, or requiring affected entities to exit from the market.

13. Discuss why it is important that a transition period for formalizing informal insurance activities be neither too short nor too long.

14. The board of a particular small community health care cooperative is drawn from the membership of the organization. Discuss the potential advantages and disadvantages of such a composition from the perspective of the insurance supervisor. Explain how your answer would differ in the case of a large health care cooperative operating within a broad geographic territory.

15. Describe at least three steps that might be taken to support inclusive insurance markets by enhancing the access of insurers to reinsurance. Which of these are employed in your jurisdiction?

16. Discuss how the financial reporting requirements and off-site analysis of insurers underwriting microinsurance business might differ from those of insurers underwriting only conventional insurance business.

E. Market conduct issues

While prudential supervision focuses on enhancing the safety and security of the insurance market, market conduct supervision focuses on issues related to the fairness and propriety of dealings between insurers, intermediaries, and their customers. This section discusses some difficult issues that can arise when striving to apply market conduct supervision in a manner supportive of inclusive insurance markets. Such issues relate to the channels for delivery, conduct of business, disclosure, fraud, AML/CFT, and the approach to supervising market conduct (see Lester and McKee 2012).

Attainment of a more inclusive insurance market might require innovations in products, distribution, and service delivery. Different types of entities might be involved in dealing with customers, and the functions performed by market participants might differ from those they have traditionally performed (see Chatterjee 2012). In order to supervise effectively in such an environment, supervisors should consider various factors:

- What is being done and by whom?
- What risks does an approach pose to customers?
- How can the risks be mitigated in a proportionate manner?
- How can conduct be supervised?

Criteria and some key considerations relevant to product development, partnerships, and customer protection are described in “Smart Microinsurance” (Smart Campaign and MIN 2012), which also suggests that market participants observe the following basic principles:

1. Appropriate product design and delivery

2. Prevention of over-indebtedness

3. Transparency

4. Responsible pricing

5. Fair and respectful treatment of clients

6. Privacy of client data

7. Mechanisms for complaint resolution.

For a complete description, see www.smartcampaign.org.

Channels for delivery

In many markets, insurance has traditionally been distributed through intermediaries, such as agents and brokers. Their roles typically include identifying prospective customers, helping them to appreciate their insurance needs, selling them appropriate products to meet those needs, and providing follow-up service to help to keep the policies in force. Intermediaries have traditionally been compensated for their work through commissions or brokerage fees.

Although the traditional distribution model can be appropriate when selling large policies and complex products, it is not necessarily ideal as a means of reaching the underserved. Customers might be geographically distant from the intermediaries, they might distrust the intermediaries, and the commission generated by the sale of a small insurance policy might be insufficient to interest an intermediary. To overcome these barriers, many innovative channels for delivery have been tried in various jurisdictions, including banks (bancassurance), microfinance institutions, nongovernmental organizations, direct marketing, direct mail, alternative sales forces (such as those of telecommunications companies and utility service providers), technology-based distribution, retailers, post office outlets, social and religious associations, trade unions, specialized microinsurance agents and brokers, and MCCOs (for insurance underwritten by themselves or by others).

Many of the issues discussed in section D with respect to the licensing of insurers are also relevant in the context of channels for delivery. The activities subject to regulation need to be defined carefully, because some entities involved in innovative channels for delivery might have a more limited role than traditional intermediaries and others might have a more expanded scope of insurance activities. For example, a retailer might not provide advice regarding products to fit the customer’s needs, while an MCCO might advise its members on insurance matters and also collect premiums and pay claims. Both individuals and entities with a variety of legal forms might be involved in delivery.

Changes to legislation might be necessary to accommodate a wide range of channels for delivery and the various combinations of functions that those involved might perform. Regulatory requirements and supervisory approaches should be carefully matched to the situation, to ensure that they deal adequately with the risks involved and are proportionate. Various issues, for example, might need to be considered:

- Both individuals and entities should be able to engage in insurance intermediation, although the functions that they are permitted to perform might differ.
- Requirements should identify clearly which of them are applicable to individuals and which are applicable to entities.
- If the functions performed by an individual include providing advice, the suitability requirements should be proportionate to the nature of the advice; for example, an

agent who is restricted to selling microinsurance products might require less education and training than one who is permitted to sell more complex products.

- If an individual is employed by or acting as an agent of an entity, the respective responsibilities of the individual and the entity should be clear.
- If an individual or entity is involved in collecting premiums or otherwise handles policyholders' funds, provision should be made for the security of these funds.
- If multiple entities are involved in various aspects of delivery, their respective responsibilities should be clear.
- Sufficient financial resources should be available to protect customers from the effects of errors, omissions, or misconduct by those involved in delivery; depending on the situation, such resources might take the form of capital, insurance coverage, or guarantees.
- Any maximum limits or other restrictions on compensation should take account of the functions performed; for example, maximum rates of commission established with traditional agents in mind might be insufficient to allow appropriate compensation of an entity that is not only selling insurance but also handling premium collection and claims settlement.

Conduct of business

ICP 19 on conduct of business should be implemented in a manner that will increase financial inclusion while adequately protecting policyholders. The diversity of customer situations and approaches that can be used to enhance access to insurance makes it impossible to set out in detail regulatory and supervisory solutions that would be universally appropriate. Supervisors should therefore focus on the basics, such as the purpose that each of the standards under ICP 19 is intended to serve in protecting policyholders and how this might best be accomplished in the local context.

When considering regulatory and supervisory alternatives, supervisors should keep in mind that the underserved tend to have a low level of financial literacy and limited incomes. These characteristics can limit the usefulness of some traditional customer protection measures, such as disclosure and the right to seek legal redress of complaints. Special care must therefore be taken and supervisors should be open to the possibility of innovation in the design of customer protection measures. Some specific issues are discussed next.

Product development

Insurers should take into account the interests of different types of customers when developing and marketing insurance products. The needs and preferences of underserved customers with respect to both protection and the approach to premium payment can vary significantly, based on factors such as occupation, community, culture, and location. They can also differ significantly from the needs and preferences of traditional insurance customers.

Insurers have responded to such differences—as well as the need to keep the expense component of the premium reasonable and manage underwriting risks—by designing innovative products. Innovations include group cover and underwriting, the embedding of insurance with noninsurance products, and the bundling of different types of coverage. As noted in section B, the basic features of products oriented toward enhancing inclusion often differ from those of more conventional insurance (see also Iravantchi and Wenner 2012, table 1).

Insurers and supervisors should be attentive to the possible implications of such product differences in relation to both solvency and policyholder protection. For example,

- **Relatively low premiums.** Premiums should be sufficient to cover both expenses and claims costs, but historical claims data might be unavailable or inadequate for the purpose of calculating premium rates; expenses might account for a higher proportion of the premiums and claims might account for a lower proportion of the premiums for smaller policies than for larger ones.
- **Defined and limited cover.** Premiums should be consistent with the nature and extent of cover. Cover should meet the needs of customers, and limitations should be clearly communicated.
- **Short policy terms to limit risk.** The absence of long-term guarantees can reduce the risk related to claims costs but might have an adverse effect on persistency and expense recovery. Policyholders might lack the ability to maintain needed coverage over the longer term, particularly if their insurability deteriorates.
- **Few, if any, exclusions.** Premiums might need to be higher to cover additional claims costs, which could be exacerbated by antiselection; any remaining exclusions should be communicated clearly.
- **Preference for group underwriting.** Claims costs can be significantly higher than those of individually underwritten business. The manner in which product and other information is communicated between an insurer and those covered by the insurance is typically less direct, but the involvement of the group policyholder might enhance the effectiveness of such communication.
- **Simple and rapid claims processing while still controlling for fraud.** Processes should include adequate controls. Legitimate claims should not be denied as a result of a claims process that is focused on speed and efficiency.
- **Embedding of insurance with noninsurance products.** Any underwriting will necessarily be group underwriting. Special efforts may be needed to ensure that customers are aware of the existence, nature, and terms of the insurance cover.
- **Bundling of different types of coverage.** If bundling is achieved through packaged distribution of products from different insurers, the manner in which administrative responsibilities, premiums, and claims costs are shared among them should be appropriate and clearly defined; it should also be clear to the customers who is

underwriting which coverage and how to obtain service and submit claims. Customers should not face the possibility of being caught up in a dispute among the insurers.

Some products might provide for the sharing of profits with policyholders. In the case of conventional insurance, insurers generally adopt methods designed to provide a fair allocation of profits on a policy-by-policy basis. However, if very small policies are involved, such an approach might not be practical or cost-effective. Alternatives such as across-the-board increases in the amount or scope of coverage or reductions in the premium rate might be more appropriate. In the case of insurance provided by an MCCO, all or part of the profits might be used to provide other types of services to members, such as providing training on farming techniques for members of an agricultural cooperative.

If insurers are required to submit products to the supervisor for review or approval, both the requirements and the criteria applied by the supervisor might need to be revised. Requirements should be proportionate to the risks involved. The manner in which pricing assumptions can be justified in the absence of relevant historical data on factors such as claims costs, expenses, and policyholder behavior should be considered. The governance structures of the insurers and the professional resources available to them might also be relevant. For example, an MCCO might not have its own actuary, but actuarial services in support of product development might be provided through an apex organization.

Communication with customers

Experience has shown that customers are more likely to use insurance if they understand and appreciate its value. Achieving such understanding and appreciation is challenging enough when dealing with educated customers who have experience using financial services. To accomplish this when dealing with the underserved requires careful attention to the form and content of communication with customers.

Several issues related to content were raised in the discussion of product development. Additionally, it is important for the information provided to customers to represent what the insurer and its products and services truly offer. Information should describe not only benefits but also costs, limitations, and policyholder responsibilities. Customers should receive information identifying the insurer and intermediary and be readily able to determine whether the insurer and intermediary are licensed or registered. Customers should be informed about how they can obtain service, submit claims, file complaints, and seek redress if they believe they have been treated unfairly. Policyholders should be informed in advance when insurance coverage will no longer be in force, whether through their own actions, cancellation by the insurer, or the exit of the insurer from the market.

Sometimes content-related communication requirements deal with the advice provided by intermediaries or insurers to customers regarding their insurance needs and products that might meet those needs. The relevance of such requirements should be considered in the context of alternative channels for delivery, particularly those that do not involve personal dealings with individual customers.

Legislation has traditionally favored written communication as the form most likely to ensure the effective communication of such information. Written communication should be as clear and as simple as possible, preferably in the native language of the customer. However, written communication might not be the best choice in all circumstances—for example, if the customers are illiterate or financially illiterate. Alternatives, such as oral presentations to groups of customers, might be more appropriate, particularly if the channel for delivery involves groups formed for other purposes. For example, insurance matters might be communicated to customers who are members of a social organization in conjunction with its regular meetings.

Service to customers

Insurers should service policies appropriately through to the point at which all obligations under the policies have been satisfied. In the conventional insurance market, such service is sometimes compromised by the turnover of agents, which can result in orphan policyholders. Service disruptions can also occur in more inclusive insurance markets, sometimes for the same reason. However, some alternative channels for delivery might make this more likely to occur, while others could have the opposite effect. For example, turnover of dedicated microinsurance agents might be higher than that of traditional insurance agents. Pilot schemes might fail or be discontinued, so arrangements should be made for the ongoing servicing of customers in the event this occurs. But the delivery of insurance through group mechanisms might result in better customer service because of the active involvement of the organization in the servicing process or its ability to attract the attention of the insurer.

Insurers should have policies and processes in place to handle claims in a timely and fair manner. This is particularly important in the context of enhancing the inclusiveness of insurance markets. Timely and fair settlement of claims can contribute greatly to the confidence of customers in insurers and their willingness to make use of insurance. Conversely, burdensome documentation requirements, slow claims settlement, and the rejection or arbitrary reduction of legitimate claims can irreparably damage the reputation of the insurer involved and lower the confidence in the insurance mechanism in general.

Accordingly, some jurisdictions have established specific and more rigorous requirements around claims handling for microinsurance. For example, insurers might be required to pay all legitimate microinsurance claims within seven days of receipt. Care should be taken that such requirements are reasonable and balance the objectives of simplicity and speed against the need to assess the legitimacy of claims.

Insurers and intermediaries should have policies and processes in place to handle complaints in a timely and fair manner. Such policies and processes should be simple and easily accessible, taking account of the characteristics of the customers, such as their location and level of literacy. For example, having a local ombudsman or a complaints department with toll-free telephone access might be more appropriate than requiring complaints to be submitted in writing and to include certified copies of relevant documents.

Disclosure to the market

ICP 20 provides that insurers should disclose to the market information on their operations and financial situation. Such information should not be materially different in scope, regardless of whether an insurer is operating in the conventional insurance market or is a dedicated microinsurer. However, the specifics of the disclosures might vary according to the type of entity and the size and nature of its business. Although 50 pages of detailed information might be appropriate for a large, complex insurer, something more proportionate would be expected in the case of a small MCCO.

The information disclosed should be sufficient and appropriate to enable customers to make their own assessments of insurers, although the underserved might find it especially difficult to do so. Nevertheless, such information is particularly important in the context of member-owned MCCOs. In this case, the customer might use the information not only to make insurance-buying decisions but also to support the exercise of ownership rights. The information should also be sufficient for market participants to be able to benchmark their performance against the market as a whole and a limited subset of the market.

Fraud and AML/CFT

Supervisors should regularly assess the potential fraud risks to the insurance sector and require insurers and intermediaries to take effective measures to address those risks. Fraud risks in an inclusive insurance market are not necessarily greater than in a more conventional market, but some potential differences warrant consideration. For example,

- Customers who lack knowledge of insurance might be more likely to commit fraud, perhaps because they do not understand that a particular act, such as submitting an inflated claim, constitutes fraud.
- Simplified underwriting and claims payment processes must be carefully designed to limit the exposure of insurers to fraud by customers.
- Given the nature of the products and the small amounts involved, the financial effects of fraud committed by customers might be less significant.
- Customers who lack knowledge of insurance might be particularly exposed to fraud committed by insurers, intermediaries, and others involved in the delivery of insurance services.

- The involvement of noninsurance entities in the delivery process might expose both customers and insurers to additional fraud risks.

Supervisors should disclose information to the market that supports the fair treatment of customers. For example, many supervisors issue notices warning customers of entities or individuals that are operating illegally as insurers or intermediaries. Alternative communication mechanisms might need to be used to ensure that such warnings reach the relevant audience, particularly among the underserved.

Standards and guidance encourage supervisors to understand the risks of money laundering and terrorism financing in the insurance sector and to follow a risk-based approach. The issues paper in regulation and supervision of microinsurance (IAIS and MIN 2007) recognizes that the possibility for money laundering in microinsurance is low, which is because the nature of the products and the small size of the policies do not suit the needs of money launderers.

If the AML/CFT regime does not recognize the potentially low risk created by microinsurance, it could impose barriers to the access to insurance (see CGAP 2011). The costs to insurers and intermediaries of applying customer due diligence procedures to small policies could be prohibitive. The costs to customers of obtaining due diligence documents might also be prohibitive, or the required documents might not even exist. Accordingly, alternative approaches might need to be developed. For example, an employer or community leader might be authorized to certify the identity, occupation, and place of residence of a customer. Regulations should also allow for the use of alternative channels for delivery.

Supervision

Supervisors might need to take a more proactive approach to monitoring market conduct than would be necessary in the conventional insurance market. Customers from the underserved markets might be less likely to raise issues to the supervisor and might face barriers to doing so. The use of alternative channels for delivery and pilot schemes might also increase the likelihood of misconduct. The following are some possible areas for additional supervisory attention:

- Monitoring claims and expense ratios to assess whether microinsurance products are offering reasonable value to customers
- Investigating whether low claims ratios or high expense ratios are caused by inappropriate market conduct
- Analyzing complaints against insurers and intermediaries to identify inappropriate conduct or inadequate processes for dealing with complaints
- Analyzing claims approval rates and claims payment times to help to identify slow or unfair claims payment practices.

A handbook of social performance indicators for microinsurance is available, which provides guidance for supervisors, market participants, policymakers, and others in assessing whether microinsurance activities are delivering product value, customer protection, and inclusion (see Sandmark 2013).

As in the case of prudential supervision, opportunities to leverage supervisory resources might be considered. This might involve cooperation with other supervisory authorities, self-regulatory organizations, or apex organizations.

Exercises

Answer the following questions considering, where indicated, the practices in your jurisdiction. If you are working with others on this module, develop the answers through discussion and cooperative work methods.

17. In a particular jurisdiction, the existing requirements on intermediaries include the following: insurance can be sold by agents, brokers, or directly by insurers; agents must be individuals; brokers must be corporations; agents cannot represent more than one insurer in respect of each type of insurance (life or nonlife); agents and the principals of brokers must meet suitability requirements, including examinations of their insurance knowledge; and agents and brokers must assess the needs of customers and recommend suitable products. Briefly explain how these requirements might need to change to accommodate the delivery of insurance through microfinance institutions.

18. List at least two reasons why disclosure to customers might need to differ for microinsurance as compared to conventional insurance.

19. Explain why microinsurance presents a lower risk of money laundering than conventional insurance.

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Posttest

After studying this module on regulation and supervision supporting inclusive insurance markets, answer the questions below. The questions are designed to help you to gauge your understanding of this topic. An answer key is presented in appendix I.

For each of the following questions, circle the response that is correct.

1. An inclusive insurance market can help to reduce poverty, enhance social welfare, and promote economic development, but the ongoing government subsidies needed to make it successful could pose a risk to financial stability.

   a. True

   b. False.

2. Inappropriate insurance regulation and supervision can adversely affect the supply of insurance but not the demand for insurance.

   a. True

   b. False.

3. Conventional insurers might avoid broadening their markets to include the underserved because they lack the information and expertise to do so successfully.

   a. True

   b. False.

4. The availability of simple, affordable insurance products that meet the protection needs of the underserved can be insufficient to increase the demand for insurance significantly.

   a. True

   b. False.

5. The removal of barriers to an inclusive insurance market often requires innovation, which can be costly and pose significant risks to the achievement of supervisory objectives.

a. True

b. False.

6. An insurance supervisor with all of the powers required by the ICPs will be able to take the necessary steps to remove barriers to a more inclusive insurance market without involving other authorities.

   a. True

   b. False.

7. A comprehensive diagnostic analysis of the market and policy environment can help to identify the barriers to an inclusive insurance market that exist in a particular jurisdiction, but such analyses are too complex to be performed by a supervisory authority.

   a. True

   b. False.

8. Protection needs and preferences of the underserved can vary based on factors such as income, level of literacy, and culture.

   a. True

   b. False.

9. Market analysis should identify the insurance products and services that are currently available in the formal market but need not extend to the informal market.

   a. True

   b. False.

10. Market analysis should identify the entities that are underwriting insurance risk in a jurisdiction, so that the regulatory and supervisory frameworks can be adapted to accommodate all types of entities.

    a. True

    b. False.

11. A government commitment to financial inclusion is most important to financial supervisors because it ensures that they will be able to obtain the resources needed to handle the additional supervisory work.

    a. True

    b. False.

12. An explicit supervisory objective of inclusiveness might state or imply the need for proactive supervisory involvement in market development, which might sometimes have to be balanced against other supervisory objectives.

    a. True

    b. False.

13. If several authorities are involved in efforts to enhance the inclusiveness of insurance markets, then having clearly defined objectives for each of the authorities prevents gaps and overlaps in the supervisory framework.

    a. True

    b. False.

14. Customers have little financial exposure in the event a microinsurer fails, so the importance of having a supervised market is mostly to ensure that customers receive fair treatment.

    a. True

    b. False.

15. Unfair claims settlement practices can be more harmful to microinsurance customers than to conventional insurance customers, who might be better able to achieve satisfactory resolution of their complaints.

    a. True

    b. False.

16. A supervisor might be able to help to provide scope for innovation by proposing changes in legislation and interpreting existing requirements more flexibly.

    a. True

b. False.

17. Proportionality is essential when seeking to enhance the inclusiveness of the insurance market, although it necessarily means that small insurers will be more weakly regulated than large insurers.

    a. True

    b. False.

18. Microinsurance is designed to meet the needs of the underserved, so the definition of microinsurance can best support inclusiveness by defining the customer group in quantitative terms.

    a. True

    b. False.

19. To help to deal with diverse market participants, a supervisor should identify the functions each performs, or proposes to perform, in the insurance process.

    a. True

    b. False.

20. If the insurance-related functions of a market participant are relatively unimportant in the context of its overall activities, then it will probably be easier to supervise because the cost of conforming to supervisory expectations will be small in relation to its overall revenues.

    a. True

    b. False.

21. An insurance supervisor might need to cooperate with other financial supervisors, regulators or supervisors of nonfinancial activities, development authorities, and taxation authorities when seeking a more inclusive insurance market. However, confidential information should only be shared with other financial supervisors.

    a. True

    b. False.

22. An insurance supervisor seeking a more inclusive insurance market will need sufficient resources to support the development of an appropriate regulatory framework and supervisory practices and to help to deal with barriers such as limitations of skills or data.

    a. True

    b. False.

23. To avoid placing a financial burden on market participants, any additional resources needed by a supervisor to help to develop and supervise a more inclusive insurance market should be provided by the government as part of its general budget.

    a. True

    b. False.

24. Regulated insurance activities should be defined in a manner that excludes any activities for which the potential regulatory burden would be disproportionate to the risks.

    a. True

    b. False.

25. Restrictions on the types of entities eligible to apply for a license to underwrite insurance should preferably be limited to those that exist to support supervisory objectives.

    a. True

    b. False.

26. If a jurisdiction does not allow composite insurers in the conventional market, then it should not allow them in the microinsurance market.

    a. True

    b. False.

27. Pilot schemes should be of concern to supervisors only if they are operated by unlicensed entities.

    a. True

b. False.

28. An unlicensed entity should be allowed to operate a pilot scheme for an indefinite period of time, as long as steps have been taken to provide appropriate alternative protection to customers.

    a. True

    b. False.

29. An entity should be eligible to apply for a license to underwrite insurance only if it is large enough for risk pooling to take place and is able to carry out effectively the business process involved in managing retained risk.

    a. True

    b. False.

30. A simple and appropriate way to determine the minimum size entity that should be eligible for licensing is by examining the regulatory requirements of other jurisdictions within the region.

    a. True

    b. False.

31. Some entities operating in the informal insurance sector might not realize that their activities require a license.

    a. True

    b. False.

32. To avoid creating an unlevel playing field, the length of the transition period for formalization should be the same for all informal insurers.

    a. True

    b. False.

33. The activities of an entity should be constrained during its transition to formal status, because the protections that would otherwise be available to customers in the formal sector will be incomplete.

a. True

b. False.

34. Conflicts of interest can arise in the governance of an MCCO, even if it is owned by policyholders.

    a. True

    b. False.

35. Assessments of the suitability of persons should take appropriate account of a person's position and the nature, scale, and complexity of the operations of the insurer. However, for a particular position, the educational and experience requirements should not differ from one insurer to another.

    a. True

    b. False.

36. An apex organization might be able to assist a small MCCO in establishing effective internal controls.

    a. True

    b. False.

37. A small microinsurer that offers only simple products might need to make use of reinsurance to manage its risks appropriately.

    a. True

    b. False.

38. If appropriate risk weights are established, the same capital adequacy requirements can be applied to all insurers, regardless of their type and the nature, scale, and complexity of their business.

    a. True

    b. False.

39. Whether or not “microinsurance” is a defined class of business, a supervisor might need to revise reporting requirements and benchmarks for various financial ratios to facilitate the analysis of earnings of insurers that underwrite microinsurance.

    a. True

    b. False.

40. The scope of on-site inspections of dedicated microinsurers should not differ from that used with conventional insurers, but the frequency of inspections might be reduced.

    a. True

    b. False.

41. Some of the participants in inclusive insurance markets might be unfamiliar with insurance legislation and supervision, so it might be appropriate for a supervisor to take extra care in explaining requirements and expectations, rather than taking immediate and strict enforcement action in the case of a violation.

    a. True

    b. False.

42. The channels for delivery in an inclusive insurance market might differ significantly from those in a conventional insurance market with respect to both the types of participants involved and the functions they perform.

    a. True

    b. False.

43. Any maximum limits or other restrictions on the compensation of those involved in delivery should take account of the functions they perform.

    a. True

    b. False.

44. If a microinsurance product involves the bundling of different types of coverage, all coverage should be underwritten by the same insurer in order to facilitate good customer service.

a. True

b. False.

45. If insurance is embedded in a noninsurance product, customers should always receive a certificate of coverage to ensure that they are aware of the existence, nature, and terms of the insurance cover.

    a. True

    b. False.

46. An advantage shared by all alternative channels for delivery is that they better enable insurers to service policies appropriately through to the point at which all obligations under the policy have been satisfied.

    a. True

    b. False.

47. The need to disclose to policyholders information on its operations and financial situation might be greater for a small MCCO than for a large conventional insurer.

    a. True

    b. False.

48. Certain characteristics of an inclusive insurance market might expose both insurers and their customers to a greater likelihood of fraud than in a conventional insurance market.

    a. True

    b. False.

49. Although the small size of microinsurance policies is a deterrent to their use in money laundering schemes, the nature of the products and the illiteracy of many customers are often taken advantage of by money launderers.

    a. True

    b. False.

50. The monitoring of microinsurance claims and expense ratios can help a supervisor to identify inappropriate market conduct.

a. True

b. False.

Appendix I. Answer key

Pretest

1. c

Financial inclusion is defined as a state in which all working-age adults have effective access to credit, savings, payments, and insurance from formal providers. An inclusive insurance market should provide such access for insurance customers.

2. b

False. Barriers might include not only barriers to supply but also barriers to demand, so dealing only with barriers to supply might not be sufficient to create an inclusive insurance market.

3. d

It is true that some informal insurance mechanisms do not involve the issuance of insurance policies, some provide for the sharing of profits, and some insure persons who are working in informal employment. However, the characteristic shared by all informal insurance mechanisms is that they are outside the scope of insurance regulation.

4. b

False. Relative to conventional insurance, the basic features of products oriented toward enhanced inclusion may include not only low amounts of cover and simple policy wording, but also relatively low premiums, defined and limited cover, short policy terms to limit risk, few, if any, exclusions, preference for group underwriting, and simple and rapid claims processing while still controlling for fraud.

5. a

True. The dealings among multiple authorities will probably be easier and the outcomes more supportive of inclusive insurance markets if the objectives and responsibilities of the various authorities—particularly as they relate to insurance activities—are clearly defined. Nevertheless, clear definition alone does not ensure that there will not be gaps, overlaps, or conflicts among the objectives and responsibilities of the various authorities. An analysis of the objectives and responsibilities of the relevant authorities can be useful in identifying gaps, overlaps, and potential conflicts.

6. b

False. An essential step toward removing the barriers to an inclusive insurance market in a particular jurisdiction is to identify them. A comprehensive analysis of aspects of the market and policy environment that can affect access to insurance can be a very useful way to identify barriers.

7. b

False. Some entities are simply too small to be able to operate successfully as insurers. One reason for this is technical in nature: an insurer needs to be large enough for risk pooling to take place. An insurer with a very small number of policies in force, even if such policies are not large, faces a high probability of ruin because of fluctuations in claims experience. Another reason is operational in nature: an insurer needs to be large enough to carry out effectively the business processes involved in managing retained risk.

8. b

False. The solvency regime applicable to dedicated microinsurers should include all elements applicable to conventional insurers. Insurers should have reinsurance and risk transfer strategies appropriate to the nature, scale, and complexity of their business. This is relevant to small and large insurers, to those underwriting small policies or large policies, and to those taking on simple risks or more complex risks. For example, a microinsurer that underwrites crop and property insurance and has a geographically concentrated customer base might be highly exposed to natural catastrophes.

9. b

False. Any maximum limits or other restrictions on compensation should take account of the functions performed. For example, maximum rates of commission that are established with traditional agents in mind might be insufficient to allow appropriate compensation of an entity that is not only selling insurance but also collecting premiums and settling claims.

10. b

False. Insurers cannot ignore the risk of fraud by microinsurance customers. Although the amounts of insurance are small in absolute terms, customers might still seek to profit unfairly from it. Customers who lack knowledge of insurance might even commit fraud without criminal intent if, for example, they do not understand that a particular act, such as submitting an inflated claim, constitutes fraud. The simplified claims payment processes often used in microinsurance should include controls to mitigate the risk of fraud by customers.

Exercises

1. Financial inclusion can help to reduce poverty, enhance social welfare, promote economic development, and contribute to financial stability. Briefly explain how the access of a small seller of household goods to property insurance might contribute to the achievement of these objectives.

Access to property insurance might help the seller to avoid financial loss from theft or damage of the unsold household goods. Without property insurance, such losses might destroy the seller's business and contribute to the poverty of the seller. With property insurance, poverty might be avoided and the seller might even be able to maintain a wider inventory of goods to sell—perhaps purchased with the assistance of a small loan, the granting of which might be subject to property insurance coverage on the collateral. With a wider inventory, the seller might be able to earn a higher income, hire staff, and move to a better facility, thereby contributing to economic development and the social welfare of the seller, the seller's staff, their families, and the customers, who would have a wider range of goods from which to choose. The stronger financial position of these people might contribute to financial stability by making them better able to cope with economic and other risks and less likely to default on loans or to rely on government support to deal with adversity.

2. Provide at least three examples each of potential barriers to the supply of insurance and potential barriers to the demand for insurance. Do any of these exist in your jurisdiction?

Potential barriers to the supply of insurance include insurers or intermediaries lacking a strong business incentive to broaden their markets, insurers lacking sufficient information to do so, insurers lacking expertise to do so, operational factors (such as practices unsuitable for dealing with small policies, geographic distance, and unavailability of efficient premium collection mechanisms), and inappropriate regulation and supervision. Potential barriers to the demand for insurance include low income, seasonal or irregular patterns of income and expenses, lack of knowledge about insurance and its uses, illiteracy, tradition of relying on other mechanisms for coping with adversity, lack of trust of insurers, intermediaries, or large, formal institutions, and inappropriate regulation and supervision. Consult with colleagues regarding the existence of any of these barriers in your jurisdiction.

3. The development of a more inclusive insurance market often requires innovation. Briefly explain why innovation might be difficult to achieve.

Successful innovation requires competence, imagination, and a good understanding of the needs of customers—any of which might be lacking. Innovation can be costly, even if it is successful. Unsuccessful innovation can pose significant risks to customers, insurers, and the achievement of supervisory objectives, so customers, insurers, or supervisors might resist potential innovations as a result of the perceived risks. Legislation might need to be changed to allow for innovation, and the process of accomplishing changes to legislation can be long and difficult.

4. List at least five aspects of the market and policy environment that can affect access to insurance and that should be examined as part of a comprehensive analysis of the situation in a particular jurisdiction. Has such an analysis been performed with respect to your jurisdiction? If so, what were the most significant findings and recommendations arising from the analysis?

Market analysis should quantify the size of the underserved market, identify the characteristics of the underserved, and examine their protection needs and preferences. It should identify the insurance products and services that are currently available and the types of customers who are using them. Market analysis should also identify the channels currently being used for the delivery of insurance, their relative importance in reaching various types of customers, and the entities that are underwriting insurance risk in the jurisdiction. Analysis of the policy environment should examine the nature of the government's financial sector policies. It should also include a fairly detailed assessment of the insurance regulatory framework and supervisory practices, with reference to the ICPs and with particular attention to the issues that are highlighted in the application paper as being more likely to pose barriers to inclusive insurance markets. Consult with colleagues regarding the existence of such an analysis in your jurisdiction. If one exists, review its findings and recommendations and discuss with colleagues which of these were most significant.

5. The entities that are underwriting insurance risk in a jurisdiction can be classified in a variety of ways. Complete the table below, indicating the number of entities in your jurisdiction, classified in accordance with the nature of their insurance business and their insurance regulatory status. (The table can be modified if additional categories exist in your jurisdiction, for example, banks that are authorized to underwrite certain classes of insurance.)

The number of entities in each of the categories might be obtained from a market analysis report or the records of your authority. If some of the necessary information is not available, consult with colleagues to develop estimates.

6. State the objectives of your supervisory authority and indicate where they are defined—for example, in primary legislation. Briefly explain how the objectives might explicitly or implicitly support the need to develop or maintain an inclusive insurance market.

Identify the objectives and where they are defined by reviewing legislation and the annual report of your authority. Explicit objectives that refer to inclusiveness or market development support proactive involvement of the authority, for example, encouraging conventional insurers to broaden their target markets or participating in the development of financial literacy programs. Objectives such as proportionality or promoting good business practices provide implicit support for the removal of barriers to innovation.

7. Provide at least two reasons why an inclusive insurance market should be subject to prudential supervision and at least two reasons why it should be subject to market conduct supervision.

Reasons for prudential supervision include the small amounts of insurance provided by individual microinsurance policies do not guarantee the survival of an insurer that is carrying on microinsurance business; the potential losses created by a failure might be small in absolute terms but nevertheless be very significant to the well-being of poor customers; and the failure of an insurer can destroy public confidence and cause people to avoid using insurance in the future. Reasons for market conduct supervision include the following: inappropriate conduct, such as mis-selling and slow or unfair claims settlement, can result in direct financial losses to customers; inappropriate conduct can destroy public confidence and cause people to avoid using insurance in the future; even simple products might be difficult for customers who lack exposure to insurance or have low levels of literacy to understand; and low-income, illiterate, or inexperienced policyholders might find it particularly difficult to achieve satisfactory resolution of problems.

8. List five questions, the answers to which can help a supervisory authority to develop a proportionate approach for dealing with a market innovation that would enhance access to insurance. Provide an example of how your authority responded to a market innovation and describe the steps taken to help to ensure that the response was proportionate.

What risks—to insurers, customers, or supervisory objectives—are posed by a particular situation? What are the likelihoods of the risks being realized and the potential impacts of those risks if realized? What alternatives are available for dealing with the risks? What are the costs and benefits of each alternative? Which alternative offers the lowest costs—in terms of both financial costs and intrusiveness—while adequately mitigating the risks? Consult with colleagues, if necessary, to identify a relevant example and the steps taken to ensure that the response was proportionate. For example, perhaps a formal assessment of potential costs and benefits was performed, and stakeholders were consulted to seek their suggestions for improving a proposed approach.

9. The authorities in a jurisdiction are considering adopting the following definition: "Microinsurance product means an insurance product that is designed to meet the needs of low-income customers, where the amount of premiums, computed on a daily basis, does not exceed 6 percent of the national daily minimum wage rate and the maximum guaranteed benefits do not exceed 600 times the national daily minimum wage rate. In the case of a bundled product, the maximum amounts of premiums and guaranteed benefits apply to the total of all components." Provide at least three reasons why such a definition might not support an inclusive insurance market.

Such a definition might be problematic for various reasons:

- Insurance products currently available to low-income customers might have premiums or guaranteed benefits that exceed the proposed limits, which could lead to the withdrawal of some products.
- The limits might discourage the bundling of different types of coverage within one product, which could make them less useful in meeting the needs of customers or encourage the costly issuance of separate policies.
- The definition does not explicitly provide for products that cover more than one individual, such as family-plan life or health insurance, which could restrict availability or make the amounts of coverage per person unnecessarily low.
- The definition does not distinguish between benefits that would be paid once per policy (such as a life insurance death benefit) versus those potentially payable multiple times during the policy period (such as medical expense benefits).
- The national daily minimum wage rate might not be equally relevant for all segments of the underserved. For example, income levels (and costs of living) might differ significantly by region or between rural and urban customers.
- The national daily minimum wage rate might go unchanged for a long period of time, which could make the amounts of coverage available insignificant.

10. An insurance supervisory authority intends to formalize informal insurance activities, some of which involve the underwriting of insurance by agricultural cooperatives. Agricultural cooperatives are supervised by the Ministry of Cooperatives. Describe some initial steps that might be taken in dealing with both the cooperatives and the ministry.

With respect to cooperatives, the supervisor might obtain information on their objectives, the nature of the insurance activities in which they are engaged, how the insurance activities support their objectives, and the risks posed by the insurance activities. With respect to the Ministry of Cooperatives, the supervisor might obtain information on its objectives, the nature of its supervisory activities, and the extent to which its supervisory activities relate to the insurance activities of the cooperatives. The supervisor might also inform the cooperatives and the ministry about its own objectives, responsibilities, and expectations.

11. Provide at least three reasons why creating and maintaining a more inclusive insurance market might require additional supervisory resources. Also provide at least two examples of how an insurance supervisory authority might be able to reduce the need for additional supervisory resources by involving others.

Additional supervisory resources might be needed to support initial and ongoing policy development, to develop suitable supervisory practices, to implement the regulatory framework, to apply the supervisory practices on an ongoing basis, to facilitate the development of necessary expertise, and to deal with limitations on available data. A supervisory authority might be able to involve other supervisory authorities, apex organizations, professional organizations, reinsurers, and others to share the workload. For example, other authorities might cooperate in developing suitable supervisory practices, apex organizations in dealing with limitations on available data, and professional organizations and reinsurers in developing necessary expertise.

12. As part of exercise 5, you identified the number of entities in your jurisdiction that are underwriting insurance in the informal market. For each such entity (or type of entity, such as cooperatives) indicate whether legislation would restrict its eligibility to apply for a license on the basis of factors such as institutional form, domicile, domicile of the owners, nature of the owners, mix of business activities, size, or other factors. Explain how you would expect each of the relevant restrictions to be dealt with, for example, by changing legislation, requiring the affected entities to implement changes, or requiring the affected entities to exit from the market.

Review the licensing eligibility requirements in your jurisdiction and identify which of these requirements the various entities underwriting insurance in the informal market would be unable or unlikely to meet. Consult with colleagues on how the relevant restrictions might be dealt with and over what period of time.

13. Discuss why it is important that a transition period for formalizing informal insurance activities be neither too short nor too long.

The length of the transition period should be based on how long it would reasonably take an entity to accomplish the steps needed to move from its current state to its preferred outcome. If the transition period is too short, extensions might be expedient but can damage the credibility of the supervisor and make the transition unmanageable. The transition can also be difficult to manage if many entities are subject to transitional arrangements, so sufficient time should be provided for supervisory oversight. However, during the transition period, the protections that would otherwise be available to customers under the formal insurance sector will be incomplete. Also, transitional arrangements should not be unduly attractive to the entities involved, compared to the requirements faced by existing insurers, as unfair competition and regulatory arbitrage could result. Accordingly, transition periods should be limited in duration, and the activities of an entity during its transition period should be constrained.

14. The board of a particular small community health care cooperative is drawn from the membership of the organization. Discuss the potential advantages and disadvantages of such a composition from the perspective of the insurance supervisor. Explain how your answer would differ for a large health care cooperative operating within a broad geographic territory.

A potential advantage of such a governance model is that the interests of the entity are aligned with those of the customers that it serves, reducing the likelihood of conflicts of interest.

However, a potential disadvantage of this governance structure is that the membership might not include persons with the technical competence, management experience, and breadth of experience needed to direct an entity that is underwriting insurance. Such a situation, combined with the absence of a shareholder group seeking to protect its own interests, can create a heightened risk that management of the entity might control the board rather than the other way around. This risk might increase along with the size of the entity and its geographic scope of operation—and an attendant decrease in personal connection and sense of solidarity.

15. Describe at least three steps that might be taken to support inclusive insurance markets by enhancing the access of insurers to reinsurance. Which of these are employed in your jurisdiction?

Steps that might be taken to enhance access to reinsurance include formalizing informal insurers, allowing conventional direct insurers to assume microinsurance risks, allowing insurers to reinsure products that include both life and nonlife coverage with the same reinsurer, and encouraging MCCOs to cooperate with one another in arranging reinsurance. Review legislation and consult with colleagues to determine which of these are employed in your jurisdiction.

16. Discuss how the financial reporting requirements and off-site analysis of insurers underwriting microinsurance business might differ from those of insurers underwriting only conventional insurance business.

Depending on the nature of the entities involved, the reporting requirements might appropriately be less extensive for dedicated microinsurers than those for conventional insurers. If "microinsurance" is a defined class of business or if microinsurance products combine several types of coverage in the same policy, reporting requirements might involve splitting various items among classes of business to facilitate the analysis of financial results by class of business. Also, benchmarks for various financial ratios might differ between microinsurance and conventional business or by the type of entity underwriting the business. Market analysis and policy needs might differ—for example, requiring the determination of whether accessibility and penetration targets are being met.

17. In a particular jurisdiction, the existing requirements on intermediaries include the following: insurance can be sold by agents, brokers, or directly by insurers; agents must be individuals; brokers must be corporations; agents cannot represent more than one insurer in respect of each type of insurance (life or nonlife); agents cannot collect premiums from policyholders; agents and the principals of brokers must meet suitability requirements, including examinations of their insurance knowledge; and agents and brokers must assess the needs of customers and recommend suitable products. Briefly explain how these requirements might need to change to accommodate the delivery of insurance through microfinance institutions.

A microfinance institution might be able to deliver insurance to its customers without changing the existing requirements. For example, it might purchase group insurance policies from agents or brokers, which would cover its customers as members of the group. The agent or broker would be responsible for assessing the needs of the microfinance institution and its customers as a group. However, if the microfinance institution seeks to advise its customers on their individual insurance needs, then changes to the existing requirements would be needed. Changes might include allowing entities to act as agents, allowing agents that are entities to collect premiums, and revising the suitability requirements to require less extensive knowledge of those distributing only microinsurance products.

18. List at least two reasons why disclosure to customers might need to differ for microinsurance as compared to conventional insurance.

The underserved tend to have a low level of financial literacy and limited incomes, which can limit the usefulness of some traditional customer protection measures, such as disclosure and the right to seek legal redress of complaints. Written communication might not be the best choice in all circumstances, and any written communication should be as clear and simple as possible, preferably in the native language of the customer. If the channels for delivery do not involve personal dealings with individual customers, alternative methods of communicating the relevant information should be considered. Policies and processes for submitting claims and complaints should be simple and easily accessible, taking account of the characteristics of the customers, such as their location and level of literacy. Information on the operations and financial situation of the insurer is particularly important in the context of member-owned MCCOs, where the customer might use the information not only to make insurance-buying decisions but also to support the exercise of ownership rights.

19. Explain why microinsurance presents a lower risk of money laundering than conventional insurance.

The nature of the products and the small size of the policies do not suit the needs of money launderers.

Posttest

1. b.
See section A.

2. b.
See section A.

3. a.
See section A.

4. a.
See section A.

5. a.
See section A.

6. b.
See section A.

7. b.
See section B.

8. a.
See section B.

9. b.
See section B.

10. b.
See section B.

11. b.
See section B.

12. a.
See section C.

13. b.
See section C.

14. b.
See section C.

15. a.
See section C.

16. a.
See section C.

17. b.
See section C.

18. b.

See section C.

19. a.
See section C.

20. b.
See section C.

21. b.
See section C.

22. a.
See section C.

23. b.
See section C.

24. b.
See section D.

25. a.
See section D.

26. b.
See section D.

27. b.
See section D.

28. b.
See section D.

29. a.
See section D.

30. b.
See section D.

31. a.
See section D.

32. b.
See section D.

33. a.
See section D.

34. a.
See section D.

35. b.
See section D.

36. a.
See section D.

37. a.
See section D.

38. b.
See section D.

39. a.
See section D.

40. b.
See section D.

41. a.
See section D.

42. a.
See section E.

43. a.
See section E.

44. b.
See section E.

45. b.
See section E.

46. b.
See section E.

47. a.
See section E.

48. a.
See section E.

49. b.
See section E.

50. a.
See section E.