access to insurance initiative

Access to Insurance Initiative - Toolkit No.1

MicroInsurance Country Diagnostic Studies: Analytical Framework and Methodology

This document was adapted from:

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About the Initiative Toolkit Series

This document is *Toolkit I* in a series of Toolkits being developed by the Access to Insurance Initiative (referred to in this document as the *Initiative*). The development of practical toolkits for microinsurance development is part of the Initiative's inputs, along with the IAIS/Microinsurance Joint Working Group on Microinsurance, to the G20 Financial Inclusion Action Plan.

- *Toolkit I* sets out the Initiative's analytical framework and methodology for market and regulatory diagnostic studies, so as to serve as a tool for conducting national microinsurance diagnostics.
- This toolkit should be read in conjunction with *Toolkit II: Country Process Guidelines for Microinsurance Market Development.* Toolkit II addresses the broader microinsurance development process in a country, of which the diagnostic study is one important part.
- A further toolkit will be developed for supervisory self-assessment of observance with the emerging IAIS guidance on regulation and supervision supporting inclusive insurance markets.

The Access to Insurance Initiative

The Access to Insurance Initiative was created jointly by the International Association of Insurance Supervisors (IAIS); the German Federal Ministry for Economic Development and Cooperation (BMZ), the Consultative Group to Assist the Poor (CGAP), the International Labour Organization (ILO) and the DFID (the United Kingdom's Department for International Development) funded FinMark Trust in 2009. The United Nations Capital Development Fund (UNCDF) joined as partner in 2010.

The Initiative is a global partnership between insurance supervisors and these founding sponsors. The Initiative also works with regional partners such as the Asian Development Bank, the Inter-American Development Bank (via its Multilateral Investment Fund) and Promoting Financial Sector Dialogue: Making Finance work for Africa Partnership (MFW4A), a partnership between BMZ and other organisations.

The Initiative supports the improvement of the policy, regulatory and supervisory frameworks and works in partnership with insurance supervisory authorities. The core fields covered by the Initiative are knowledge generation and dissemination, dialogue and learning through country diagnostic and thematic research, inputs for the development of standards and guidance, support to country implementation processes in the area of regulatory and supervisory reform, capacity development of insurance supervisors, and advocacy and participating in international platforms. The Secretariat is hosted by the German International Cooperation (GIZ) on behalf of BMZ. For further information, please visit www.access-to-insurance.org

1. Introduction

This document outlines the analytical framework and methodology for conducting a microinsurance country diagnostic study. It is designed to assist readers who wish to gain a deeper understanding of the development of microinsurance markets, as well as researchers, consultants, insurance practitioners, policy-makers regulators and supervisors tasked with the analysis of a national insurance market with a view to develop strategies and recommendations for the growth of microinsurance.

Background

The Initiative follows an evidence-based approach to the design of recommendations for policy and regulatory change that will enhance the growth of national microinsurance markets. This implies that such recommendations must be based on a thorough understanding of the current and potential future market for microinsurance in a country and the dynamics that will drive the evolution of the market over time.

Over a period of more than seven years, the Initiative, its predecessors and Sponsors have undertaken a series of microinsurance country diagnostics to develop an understanding of the typical dynamics that drive the development of microinsurance markets. In the process they have developed both an analytical framework and diagnostic tools to ensure that such a diagnostic is comprehensive and deep enough to deliver defensible recommendations for a national microinsurance development strategy, including appropriate policy and regulatory changes.

This document sets out both the analytical framework developed by the Initiative as well as a detailed methodology for applying the framework as part of a diagnostic study. It therefore consists of two main parts:

- Section 2 sets out the **analytical framework**, culminating in a concise description of the scope of such a study;
- Sections 3 and 4 set out the **process** to follow in a diagnostic study and the **methodology** underlying it, respectively.

Please note that this toolkit is not intended as a template to be completed in a mechanical manner. Rather, it must serve as a guide that ensures that the user covers what is currently considered to be the most important dynamics affecting microinsurance development. As more diagnostics are undertaken and our understanding deepens, the toolkit itself will evolve.

What is a country diagnostic and what does it aim to achieve?

A country diagnostic is an analytical study that analyses the demand for and supply of microinsurance products within a country and the impact that policy, regulation and supervision has on such demand and supply. The analysis is static (depicting the current situation) as well as dynamic (depicting how the market has developed over time). The combination of a snapshot and market evolution analysis enables the diagnostic to build an understanding of the underlying driving forces of the market stemming from the regulatory framework, the structure of the insurance market, the demand features and the broader financial sector, macroeconomic and socioeconomic context. Armed with this understanding, the diagnostic can identify the barriers to and opportunities for the microinsurance market's future development going forward. Based on this, it then formulates recommendations for future market development.

Objective and process: The ultimate objective of an Initiative diagnostic is to trigger change in the operation of the national insurance market to ensure increased access to insurance products for the population of that country. In line with its mandate, the Initiative places strong emphasis on changes in national policy, regulation and supervision to trigger these changes. However, the diagnostic is not purely focused on regulatory change, but also highlights changes that can be effected by market players to increase access to insurance.

Keeping the end-goal in mind, the process of the diagnostic is designed not only to produce a report with detailed recommendations, but indeed to foster dialogue between the different market players and between market stakeholders and the regulator to explore strategies and solutions to current impediments to market development. A typical diagnostic will unfold as follows:

Step 1: The diagnostic is initiated by an interested party (for example a policymaker, insurance supervisor, industry association or donor organisation), funding is secured and the buy-in of the national insurance supervisor is secured.

Step 2: The scope of the diagnostic (see section 2.7 below) is finalised and service providers/consultants are procured to undertake the study.

Step 3: The diagnostic is launched[1] at a forum or workshop which brings together the insurance supervisor, other interested public authorities and financial sector regulators, insurers, intermediaries and other interested third parties. This gathering serves to secure the buy-in of all those persons and institutions who should participate in the diagnostic since they can either benefit from its outcomes or should implement its recommendations.

Step 4: The research process (for more details see sections 3 and 4) is undertaken. It involves primary and secondary research, including interviews with as many interested parties as possible and qualitative demand-side research, but excluding a quantitative survey.

Step 5: The findings are presented to a gathering of the same interested parties involved in step 3. This communication is intended not only to test the findings and ensure the integrity of the final recommendations, but also to start triggering change. If the conditions are right, this gathering may also be used to adopt a coordinated domestic plan for microinsurance development.

Step 6: Finalisation of the diagnostic report.

Step 7: Further debate on the recommendations in the report and subsequent implementation of these.

[1] Note that this step is not necessarily always present, but is preferred.

The diagnostic will form part of a broader process for microinsurance development in a country. The country-level microinsurance development process and the role of the diagnostic study in it can be illustrated in the following simplified way:

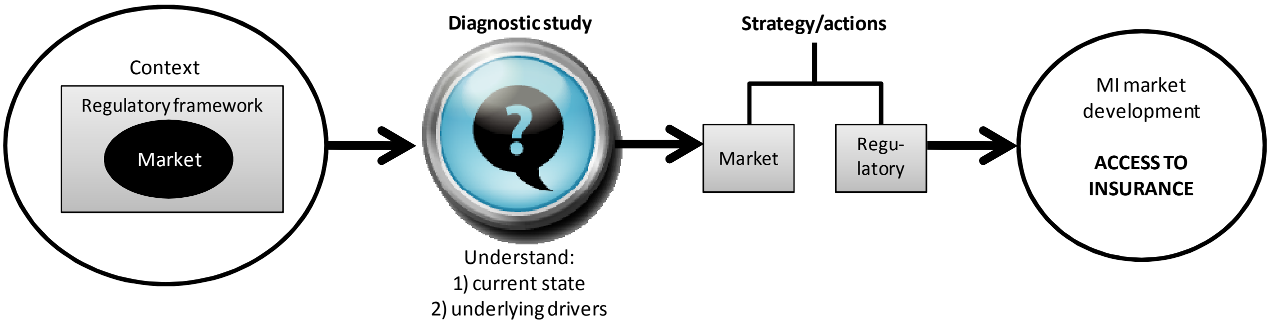

Figure 1. Role of the diagnostic in the microinsurance development process
Source: authors

In this broader process, the meetings with national stakeholders serve as important points of interaction to inform stakeholders of the issues relating to microinsurance development and that start to build domestic buy-in to such a process. The diagnostic is therefore an input to or component of the overall process, but also forms part of the outcome.

2. Analytical framework

This section outlines the basic analytical framework and concepts that underlie the methodology for a microinsurance country diagnostic. Firstly a framework for understanding the drivers of *financial inclusion* is introduced, then the concept of *microinsurance*. Following the conceptual introductions, the analytical framework regarding the demand (section 2.3) and supply (2.4) of microinsurance is unpacked, as well as the regulatory framework within which microinsurance typically operates and the objectives of financial policy (section 2.5). But why do markets not develop optimally by themselves? Section 2.6 will consider market failures and regulatory barriers. The analytical framework concludes with a section outlining the issues of scope (based on the analytical framework) that must be addressed when designing a diagnostic (section 2.7).

2.1. The framework for analysing more inclusive markets

The ultimate goal of the country diagnostic is to facilitate increased access to insurance via the market mechanism, that is, enhanced financial inclusion. Given the central role of the market mechanism, an analysis of how the market operates is required before one can set out to achieve this goal.

Drivers of financial inclusion

Financial inclusion in insurance or any other financial service is achieved when all consumers, particularly low-income consumers, can access and on a sustainable basis use financial services that are appropriate to their needs. The aim of financial inclusion is not only to ensure that users are not excluded from the formal sector, but that they actively use financial services. How to achieve this outcome through the working of the insurance market is what the Initiative diagnostic sets out to uncover. To do so, one has to understand the factors, related to the context, regulatory framework or market, driving financial inclusion on both the demand-side and the supply-side. This is illustrated by the following diagram:

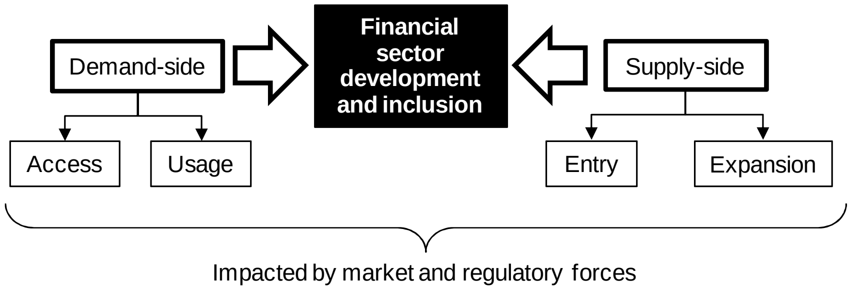

Figure 2: Financial inclusion framework
Source: Bester, Chamberlain (2007)

- On the **demand-side**, there can either be barriers to *access* (that is: factors outside of clients' control, such as affordability or accessibility, that make it impossible for the target market to use the service), or *usage* barriers (factors internal to the target market, for example their preferences or level of understanding, that makes them choose not to use a service to which they technically have access).
- On the **supply-side**, there can either be factors hindering *entry* by a variety of players into the market, or factors preventing the *expansion* of current players into the low-income market.

Section 2.3 and 2.4 will unpack the demand-side and supply-side factors driving financial inclusion in more detail.

Market evolution path

Another essential concept in understanding the reasoning or logic underlying the diagnostic study is the *access frontier*. As will be seen below, microinsurance is insurance aimed at the low-income market. In most developing countries, however, the current market is tailored largely to the needs of the higher-income end of the market where most clientele is concentrated. In striving to expand financial inclusion to the lower-income market, it is important to understand that markets evolve gradually from the current to the next most profitable market segment. They will not by themselves, unless incentivised or forced, simply jump over the next most profitable market to serve the poorest of the poor.

The *access frontier* will therefore shift out gradually over time. This concept can be illustrated as follows:

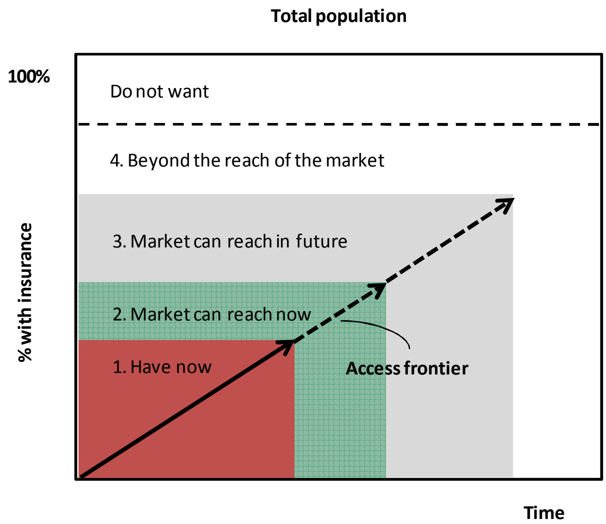

Figure 3. The Access Frontier
Source: Porteous, 2005

The various blocks in Figure 3 can be explained as follows:

- **"Have now":** The current market is defined as people who are currently using the product, i.e. a measure of usage or effective access.
- **"Market can reach now":** The second zone comprises all the people who have access to the product but are not using it. As there are no explicit access barriers, this group is the most susceptible to improving the levels of inclusion for financial products. They could be incorporated into the market by addressing usage factors, without any regulatory changes needed.
- **"Market can reach in future":** The third zone includes all the people who do not currently have access to the product because of reasons such as proximity, affordability, eligibility, terms of the product or knowledge of the product. Regulatory changes, as well as product and distribution innovation, can be used to extend the reach of the market to this segment.
- **"Beyond the reach of the market":** The fourth zone is made up of all the people who are outside the scope of the market because they are simply too poor. These people cannot sustainably be reached by the market without support from government and may remain dependent on social security.

The access frontier is represented by the diagonal line on the diagram and represents the frontier beyond which market provision cannot sustainably reach. It also indicates that there will always be a proportion of the market that simply do not want insurance. The diagram also shows the natural progression of market provision from block one, to block two and eventually to block three. The logical process of market extension is therefore to move along the access frontier rather than to jump over the next most profitable market segment to the very poor.

The purpose of a microinsurance development process is to facilitate or speed up the development process by putting in place the necessary market and regulatory framework conditions to facilitate market expansion along the access frontier.

2.2. What is microinsurance?

The diagnostic considers financial inclusion in the insurance market. This entails a focus on *microinsurance.*

Insurance[2] *for the low-income market*. Though there are a multitude of definitions of microinsurance in different contexts and for different purposes, the conceptual definition adopted for this document is that of the 2007 IAIS-CGAP Working Group on Microinsurance paper titled "Issues in the regulation and supervision of microinsurance". It defines microinsurance as "insurance that is accessed by the low-income population, provided by a variety of different entities, but run in accordance with generally accepted insurance practices (which should include the IAIS Insurance Core Principles). Importantly, this means that the risk insured under a microinsurance policy is managed based on insurance principles and funded by premiums". By implication social welfare or social assistance schemes that are not funded by premiums and managed according to insurance principles are not considered microinsurance.

Microinsurance is not only limited to insurance for individuals, but also includes insurance products developed for and used to manage the risks of small enterprises or groups.

A broad conception of the target market. How the "low-income" market is defined will differ from country to country. It does not necessarily mean just all those falling below a specific poverty-line definition. In line with the market evolution logic as explained in the access frontier concept, the recommended approach for this diagnostic is to include *all individuals not currently served by the financial market*. Broadening the focus ensures that the diagnostic covers the widest possible definition of the low-income market whilst ensuring that the recommendations will facilitate the expansion of access along the income spectrum.

Who provides microinsurance? Microinsurance extends beyond the provision of insurance by microfinance organisations to include all categories of insurers – state-owned, commercial (shareholder based) and non-profit organisations (NGOs, cooperatives and mutuals). It is not tied to a specific insurance model (e.g. partner-agent, direct sales, etc.) or distribution strategy and could include all categories of insurance products. Furthermore, microinsurance providers can be formal (licensed insurers) or informal. The types of formal providers of microinsurance found in a specific country will be determined by the regulatory framework in that country. For example: in some jurisdictions mutuals or cooperatives are not allowed to obtain an insurance license.

Part of the broader market. Microinsurance is not a stand-alone concept, but is integrated into and influenced by the overall insurance environment and financial system. This includes the insurance sector more broadly, as well as the banking sector and payment system on which the insurance sector relies for receiving premiums and paying claims.

Unique product nature. It is important to build an understanding of the typical microinsurance product features. Microinsurance is not traditional insurance products shrunk by a factor of 5, 10 or a 100 to fit the pockets of low-income households. Besides having lower disposable income, low-income households have needs distinctive from those

[2] An insurance policy, and thus insurance, is defined as a contract that promises to pay an agreed amount or provide a defined benefit upon the occurrence of an agreed event in exchange for the payment of an agreed premium.

of their higher income peers. Their experience and thus perception of insurance also tends to be different from traditional policyholders and is often characterised by high levels of distrust of insurance and insures. Their living and income situation is also different from the traditional client segment. To be viable, microinsurance products must be designed to address these characteristics:

- Microinsurance policies tend to offer **low benefit values** against the payment of **small premiums**. Some products offer cover of a few hundred dollars or less (though microinsurance benefits can also go up to several thousand dollars) at premiums ranging from less than $1 to several dollars per month, depending on the type of cover.

- To be understandable to a market with lower levels of financial literacy and higher levels of distrust, products are **simpler in design, have fewer exclusions** and dispense with long and complex policy documents.

- Asset insurance is often provided on a **first loss** (also referred to as sum assured) basis rather than an indemnity basis.[3]

The low premium nature of microinsurance has a number of important consequences, both for the underwriting and intermediation of microinsurance products:

- *Group underwriting*: Microinsurance product pricing is usually done on a group basis rather than through individual underwriting, as individual underwriting is too expensive. As a result, insurers targeting the low-income market often assess the profile of groups rather than of individuals. Insurers' lack of experience with the microinsurance target market means that they have limited actuarial data on this market, in turn implying that it may be difficult to get pricing exactly right. Due to this uncertainty, they are generally (though not always) reluctant to commit to a whole-life/long-term price guarantee or contract, rather opting for renewable cover with a shorter contract duration. A shorter-term contract gives the insurer the option not to renew the contract when it expires or to adjust the price on each renewal in line with the risk experience of the group.
- *Low cost distribution and administration*: Low premiums imply low margins, necessitating high levels of efficiency in the distribution and administration of microinsurance products. Similar to the experience with other bottom of the pyramid products and services, successful microinsurers have to develop new business models, especially on the distribution side, to be financially viable. The pressure of low margins combined with the requirement for active sales have driven most of the innovation in microinsurance distribution:
    - To secure scale, microinsurance is often sold to pre-existing client groups utilising third party sales forces rather than dedicated insurance brokers or agents. Examples of such third party sales forces include microfinance institutions, banks, labour unions, retail chains or community-based groups.
    - Furthermore, the distribution channel and/or an external third party may play a bigger role in administering the policy. The presence of an administrator, in turn, implies that the value chain may become longer and that distribution costs may be higher, proportionally, than for traditional insurance. Even at low absolute

[3] First loss insurance refers to insurance that provides a defined benefit upon a defined event as opposed to indemnity insurance that indemnifies losses, i.e. pays benefits according to the actual value of the loss suffered..

levels (e.g. $0.3), intermediation costs may be high as percentage of premiums if premiums are low (e.g. 30% of a $1 premium). Therefore claims ratios in microinsurance may also be lower than traditionally accepted levels.

Typical microinsurance products. The products with highest penetration in the low-income market in many developing countries are credit life insurance, funeral insurance and personal accident insurance:

- *Credit life* insurance, the most pervasive form of microinsurance worldwide, insures the value of the outstanding debt in the case of a policyholder's death or disability. It may include riders such as funeral insurance for the purchaser or insurance on the value of the product bought on credit if lost or damaged. The pervasive nature of credit life insurance in the low income market is due to the fact that credit providers, to protect themselves against payment default, often make the purchase of a credit life policy a compulsory precondition for the granting of a loan. At the same time, the policy protects the deceased borrower's family from having to repay the debt.
- *Funeral insurance* is term life insurance where the payout – which could be provided in cash or in kind – is intended to cover the expenses of a funeral. For most poor households, especially in cultural contexts where funerals are important events, the cost of a funeral is prohibitive. Informal risk pooling mechanisms to cover funeral, medical or other costs, such as burial societies or self-help groups are therefore often the first type of "insurance" to evolve in low-income communities.
- *Personal accident insurance* provides a payment for loss of life or disability as result of an accident. Such insurance is attractive to low-income persons exposed to high risk transportation or dangerous work environments.
- Illness is one of the highest risks for most low-income households. In some markets, *health microinsurance* is becoming increasingly available. The greatest limitations tend to be affordability and the non-availability of health services and it is often challenging to force successful partnerships with health service providers.
- Due to the high costs of individual loss assessment, as well as the fact that asset insurance is not a high priority for low income households, successful standalone[4] *asset insurance* schemes are rare in the microinsurance space. However, the exception is Latin America, where extended warranties and different forms of home or asset insurance are operating at scale.
- *Agricultural insurance* can potentially play a very valuable role in the low-income market given the fact that so many people in developing countries depend on agriculture for their livelihoods. Traditional multi-peril agricultural insurance is however simply too expensive to be viable as microinsurance. Therefore weather index based insurance is drawing increasing attention, with an emphasis on innovative use of technology and the core role of partnerships within the agricultural value chain. Data availability remains a challenge, though, and few pilots have been successful without donor support.

Along with health insurance and most of indemnity asset insurance, agricultural insurance may therefore be a type of "second generation" of microinsurance products, as they have not yet taken off to the same extent as life, funeral and personal accident insurance.

[4] The inclusion of some kind of asset insurance is common as a rider on a different type of policy, e.g. for personal accident insurance.

2.3. Demand for microinsurance

The starting point for a demand-side analysis is to understand the *profile of the population* (in terms of the demographics, income distribution and economic realities) and *current insurance usage* across the income spectrum. Based on this knowledge, the diagnostic can assess the *potential market* for microinsurance, asking how much of the potential market can or is likely to translate into actual demand in the short and medium term.

In order to make this call, the diagnostic needs to build an appreciation of the *drivers of demand*. The typical drivers of demand are:

i. **The risk experience of the target market**. At the root of the demand for microinsurance are the risks to which the individual household is exposed. These typically include the death of a breadwinner, health risks, accidents, unemployment and various asset risks. The diagnostic incorporates qualitative market research to gauge these and to determine which ones rank most highly in the minds of the target market in terms of financial impact.

ii. **Coping mechanisms**. It is equally important to understand how households currently deal with risks, the various strategies that they employ and the role that insurance plays as coping mechanism, if at all.

(i) and (ii) set the scene for an appreciation of the factors driving (iii) access to and (iv) usage of insurance (the so-called demand-side drivers underlying the financial inclusion framework as set out in Section 2.1):

iii. **Access factors**. Access is defined as the ability of individuals to obtain and, on a sustainable basis, use financial services that are affordable, usable and appropriate to their financial needs. The access methodology considers factors that may exclude individuals from being able to use a particular product. There are at least five drivers of access (Porteous, 2004): proximity (physical access), affordability, eligibility requirements[5], whether the product features/terms are appropriate to the needs of the market and regulatory requirements[6].

iv. **Usage factors**. The concept of access focuses on explicit barriers, while the concept of usage focuses on factors that may discourage people from taking up or using formal financial services even if they are not explicitly excluded from doing so. It is of limited use for public policy if the poor have access to appropriate insurance products but most decide not to use them.

    People judge the value of the product and its ability to meet their needs before deciding to buy it. This decision is exercised within a set of considerations, constraints and priorities. Usage drivers may include the value proposition of the formal product (even if an insurance product may technically be affordable, it will not be used unless it is perceived to offer sufficient value for the premium paid), relative cost (e.g. compared to

[5] E.g. when only people above or below a certain age, or only people who are formally employed are allowed to buy an insurance product.

[6] Regulation may inadvertently impact on access to financial services. This may occur through the presence of regulation that excludes specific groups of people or increase the cost of serving particular communities, or by the absence of the basic regulatory infrastructure necessary to provide a facilitating business environment (e.g. the absence of an effective and reliable national identification system). Regulation may also affect the supply-side by imposing barriers to entry into the insurance market.

informal alternatives), the hassle factor and perceptions of formal products and institutions (e.g. fear of officialdom and the belief that financial institutions are for the rich). The level of financial literacy of the target market will also impact on usage, as may the availability of alternative risk management mechanisms (e.g. social security, family/friends). Although it is difficult to quantify, experience suggests that these factors significantly affect take-up and use of financial products.

The methodology for gauging usage levels and for understanding the population profile and the drivers of demand is contained in Section 4.1.2.

2.4. Supply

The supply of microinsurance refers to all the institutions and processes that are involved in the "production" and distribution of insurance products. These institutions and processes form a value chain and can also be delivered informally. This section starts with a description of the various functions involved in the delivery of insurance, followed by a description of the microinsurance value chain and how it differs from the value chain for traditional insurance. This is followed by a brief description of the importance of assessing the informal supply of insurance as part of the diagnostic. Having assessed the actual state of supply, the diagnostic must also take account of the various factors that drive the supply – present, past and future. The section therefore closes with a brief description of these supply-side factors.

Insurance functions

The insurance market comprises a number of functions:

- *Underwriting*. Insurance entails risk management. The insurer underwrites a policy by determining what risk it is prepared to assume for what premium. Across an entire portfolio of policies, risk management requires a thorough understanding of the nature and degree of the various risks present in the policies. The risks must be quantified (a task normally performed by an actuary) and the quantification must be used to determine the actuarial reserves and capital required to ensure the long-term sustainability of a microinsurance operation[7].
- *Investment*. The investment function requires the placement of premium and other income in a portfolio of assets to optimize the value of the investment earnings while maintaining appropriate liquidity and asset security to meet policy obligations as they arise[8].
- *Reinsurance*. Reinsurance is a form of insurance that insurance companies buy for their own protection and whereby one or more insurance companies assume all or part of the risk undertaken by another insurance company[9]. In this way the risk is pooled broader than just the insurer's own book – which is for example important for catastrophic risks. Reinsurance can play a vital role in ensuring the insurability of some types of risk for the low-income population.

[7] See Garand, D and Wipf, J, *Risk and Financial Management.* In: C. Churchill (ed), 2006., Protecting the Poor: a Microinsurance Compendium, p254.
[8] See Garand and Wipf (ibid): 265-267.
[9] Definition taken from the Microinsurance Network lexicon, www.microinsurancenetwork.org.

- *Product development.* Product development entails conceptualising a product need, conducting market research, determining the features of the product and piloting to test the viability of the project and on the basis of which product features can be tweaked. It requires market intelligence as well as knowledge of insurance principles.
- *Intermediation.* Intermediation refers to all activities that happen "in between" the insurer and the client. It will include sales, premium collection, claims settlement and management, policy administration and client aggregation[10]. More formally[11], intermediation can be defined as any action that results in a client entering into a transaction with a product supplier, or any act with a view to buying, selling or otherwise dealing in, managing, administering, keeping in safe custody, maintaining or servicing a financial product purchased from a product provider.

Microinsurance value chain

The functions described above are fulfilled by various entities that together comprise the insurance value chain. Traditionally, underwriting, financial management, product development and much of policy administration are all conducted by insurers, with reinsurers conducting reinsurance and in many instances also being a source of risk management expertise, for example by providing pricing inputs. Most intermediation and some administration functions would traditionally be fulfilled by brokers and agents.

The microinsurance market has however evolved to a situation where there is often a longer value chain with more entities involved. The microinsurance value chain can be represented as follows:

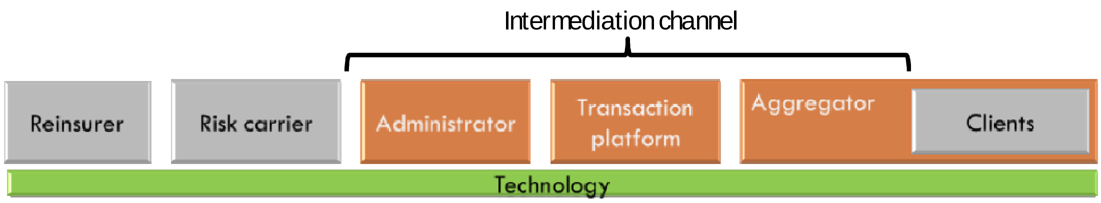

Figure 4. The microinsurance value chain

Between the reinsurer and risk carrier or insurer (which is responsible for underwriting, financial management and some product development) on the one hand and the client on the other hand, the following entities are typically found:

- A professional administrator (who could also be a brokerage firm) that does, or contributes to, product development and conducts all back-office functions related to policy administration.
- A payment system provider that provides the transaction platform for premium collection and claims payments.
- In many cases there will be a client aggregator (e.g. an MFI, a retailer or a community association) that aggregates individuals into a client group and does marketing and selling of policies (fulfils the front-office functions).

[10] Aggregation can also be termed "client mobilisation"; it refers to the formation of client group to which insurance can be sold, or to an existing grouping being used for insurance distribution purposes

[11] As defined for example in the South African Financial Advisory and Intermediary Services Act.

- In some cases, the value chain can become even longer, for example to also incorporate a broker to facilitate the relationship between the aggregator and the insurer, or individual agents who sell the policy.

Underlying all of the entities in the value chain will be the technology and systems that enable all the various functions.

It is therefore apparent that quite a number of entities need to be considered as part of the supply of microinsurance. Likewise, there can be costs and bottlenecks to development – or opportunities – at different levels.

The role of informal markets

In most countries there is a formal as well as an informal market for microinsurance.

What is informality? Formal financial services can be defined as those provided by financial service providers that are registered with a formal regulatory body in order to provide the financial service. In some cases entities may be formally registered (e.g. with a cooperatives authority or a company registration authority) but are not licensed or supervised for insurance purposes. They would then still be regarded as providing informal insurance. In other cases certain risk pooling activities may deliberately be regarded as outside the definition of insurance for regulatory purposes. So, for example, informal community-based risk pooling groups where the benefits are not guaranteed are often allowed to operate unregulated. In addition to acting as informal insurers, informal groups may also serve as distribution points for insurance underwritten by formal insurers.

Role and position of informal providers. It is important to understand the size and nature of the informal market, as the existence of large informal markets can be a key indication of pent-up demand for insurance products as well as potential barriers to formalisation and market development. The informal sector often plays a crucial role in providing access to financial services. Informal providers may provide a low-cost, community-based alternative to formal products, or may provide services where formal players do not reach.

The scale and number of informal insurance providers may also be indicative of the challenges facing supervisors in enforcing formalisation. In many cases, the supervision of the informal sector may simply fall beyond the capacity of the supervisor.

Market development and informality. Facilitating market development usually refers to facilitating the development of and access to the formal financial sector. However, there may be many barriers to formalisation and clients may face a number of access barriers in using the services of formal institutions. Formalisation entails overcoming these barriers and effectively enforcing the regulatory regime to ensure that all insurance providers play by the same rules so that consumers are consistently protected. A market development approach must however also be realistic in recognising that formalisation may take time and that there may be certain critical services provided by the informal sector that should be preserved.

Factors and conditions driving supply over time

Having considered the various institutions making up the microinsurance value chain in a country, the attention must be turned to the drivers or factors that have shaped this state of affairs and will shape it into the future. As explained in the financial inclusion framework (section 2.1), we refer to these as “supply-side factors”. These are twofold in nature: factors that exclude **entry** into the insurance sector, or factors that make it difficult for current players to **expand** their services to the low-income market:

- **Entry factors** operate at the level of the financial institution and impact on the nature and extent of services being offered to lower-income clients and the competitive dynamics in the market. Market and regulatory forces may prevent particular players from operating in the low-income market. For example, regulation may restrict the type of legal entity that may e.g. underwrite or intermediate insurance.
- **Expansion factors**. Some factors do not explicitly prohibit institutions from entering the low-income market but may discourage them. This may include, for example, increased regulatory costs that increase transaction costs, thereby undermining already marginal profitability on low-value transactions. While not necessarily making it impossible to serve the low-income, it makes operating in this market unattractive to insurers and intermediaries.

Apart from these market and regulatory drivers, the *macroeconomic and socio-economic context* can impact on both entry and supply. For example, the market will develop differently in a country where the bulk of the population is poor, or that has recently experienced hyperinflation, than in an upper-middle income or stable context.

2.5. Regulatory and supervisory framework and policy objectives

The Initiative’s primary focus is on the impact of policy, regulation and supervision on access to insurance. The diagnostic seeks to identify what this impact is in the country in question. This section considers the relevant public policy objectives and instruments to take into account, the ambit of regulation (called the “regulatory scheme”) that has an impact on microinsurance market development, as well as the two primary mechanisms used by regulation to impact markets, namely (1) explicit barriers, and (2) increasing or decreasing costs.

Policy objectives. Any recommendations flowing from the diagnostic should take account of and be reconciled with the particular policy objectives of the country. It is therefore important to understand the policy objectives underlying insurance regulation. There is no single or prescribed set of policy objectives for the regulation of the insurance sector. The following are, however, generally accepted as the most relevant objectives for insurance regulation (in the typical order of priority)[12]:

1. Safeguarding the solvency of firms involved in the provision of insurance policies (which can also be described as ensuring the stability of the sector);

[12] See, for example, "Prudential Supervision of Insurance Undertakings", the report on the Conference of Insurance Supervisory Services of the Member States of the European Union (2002). Available from http://ec.europa.eu/internal_market/insurance/docs/solvency/solvency2-conference-report_en.pdf (accessed on 13 October 2006).

2. Protecting consumers or policy holders;
3. Ensuring market efficiency (including the adoption of new technologies and innovation generally);
4. Developing the market, including the extension of formal financial services to low-income clients; and
5. Supporting other strategic (non-insurance) objectives such as compliance with international standards or law enforcement (e.g. AML/CFT controls).

Traditionally, ensuring solvency and consumer protection are the main objectives in most jurisdictions. More recently, however, the focus in a number of countries has expanded to also include market development as an explicit objective. The market development objective carries particular weight in emerging markets and developing countries where insurance markets are typically still very small with a very limited reach. At the same time, developing countries are increasingly under pressure to align their regulatory regimes to international standards for solvency and stability. This may entail stringent measures that at first glance come at a trade-off against market development. Regulators are therefore faced with a complex set of objectives to balance within their existing resource envelope.

Public policy instruments. To achieve its stated objectives, a government uses three categories of instruments to influence markets: policy, regulation and supervision:

1. **Policy** denotes the declared intention of a government on how it wishes to order the financial sector.
2. **Regulation** refers to all legislation, regulation, guidance, and other subordinate legislation issued to achieve the policy objectives. The contents of regulation will depend on local conditions and practices. Moreover, different regulatory instruments will be used at different times depending on the policy preferences and general development path of a country.
3. **Supervision** refers to the function of implementing regulation and overseeing compliance. Normally, policymaking is the ambit of the Ministry of Finance, while the Central Bank, a division of the Ministry of Finance or an autonomous regulatory authority will act as regulator. Often, the regulator is also the supervisor.

Regulatory scheme. The body of regulation that will be of relevance to insurance can be grouped into the following six categories:

1. *Financial inclusion policy/regulation.* This refers to policy or regulation promulgated with the objective of extending access to, and usage of, formal financial services. Such regulation takes various forms, for example compulsory or consensual quotas targeting defined population segments, financial literacy initiatives, tax incentives, or measures to extend the reach of the formal payment system. Sometimes a government may choose not to regulate financial inclusion, but simply to adopt a financial inclusion policy stance with the intension that financial institutions would pursue inclusion on a voluntary basis. Although these do not have the force of law, they directly influence the conduct of providers.
2. *Prudential regulation* seeks to ensure that insurers are able to meet their contractual obligations to their clients. This is done by, for example, setting minimum entry requirements such as minimum levels of capital and requiring compliance with a set of

prudential regulations governing the operations of the insurer, including as solvency margins and capital ratios. Rules relating to underwriting (including the requirement for actuarial certification of policies) seek to ensure that commitments are commensurate to risks. Demarcation of services, typically the prohibition on life insurers to provide general/asset insurance and *vice versa*, or of any other insurers to provide health insurance, is used to ensure the integrity of the respective lines of business.

3. *Market conduct regulation* refers to the regulation of the distribution, or intermediation, of insurance products. Regulation of this kind could include requirements as to who can intermediate insurance, fit and proper requirements for agents and brokers and other intermediaries, regulation of the sales process, including disclosure requirements and advice, as well as regulation of the level and structure of commissions paid. Other market conduct requirements may relate to how insurers treat customers, under what conditions policies may be cancelled, whether grace periods should be allowed, and what recourse mechanisms should be available to customers, to mention just a few examples. Such rules are aimed at consumer protection, to protect clients in situations of information asymmetry and low financial literacy.

4. *Product regulation* can be distinguished from prudential and market conduct regulation in that it does not relate to the insurer or the sales/intermediation process, but to the product. While provisions relating to product regulation are usually contained within either prudential, institutional or market conduct legislation, there is a distinct regulatory angle. Product regulation aims to ensure stability and consumer protection by regulating the nature and structure of insurance products. In the most basic form, regulatory systems are often structured around definitions of specific products or product categories.

5. *Institutional regulation*, which includes corporate governance regulation, refers to those statutory requirements that determine the legal forms or persons, for example public companies and cooperatives, that may underwrite insurance, as well as the corporate governance requirements applicable to these legal forms and the reporting requirements that they must meet. The content of institutional and corporate governance regulation is generally not specific to the insurance sector but generic across sectors.

6. *Other regulation*: A number of other regulatory requirements could also affect the development of the microinsurance market. Although not insurance-specific, they affect the underwriting and intermediation of insurance products. Examples include anti-money laundering provisions, taxation, regulation of the payment system (that impacts the ease whereby premiums can be paid), regulation of the microfinance sector and credit regulation generally.

These categories are indicated schematically below:

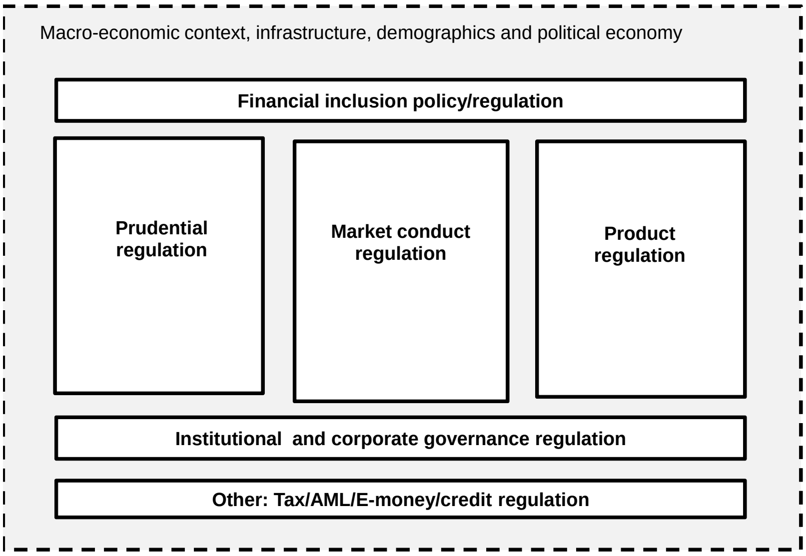

Figure 5: The insurance regulatory scheme
Source: Bester et al, 2008

Impact of policy, regulation and supervision. Policy, regulation and supervision impact the market in two primary ways:

- **Barriers**: In the first instance, regulation determines who may play in the insurance market – as providers or as intermediaries. This it does by setting entry barriers in the form of licensing (including capital) and ongoing operational compliance requirements.
- **Costs**: Regulation also impacts on the market by impacting on the cost structure. Regulatory compliance requirements have cost implications. In a low-margin, small-premium environment such as microinsurance, compliance cost reductions may tip the scale in favour of microinsurance. Likewise, high cost of compliance may disincentivise entry or expansion.

The impact of regulation on the various players in the value chain is conditioned by a number of factors. The most important, but by no means the only, of these are probably:

- The authority and capacity of the body tasked with the supervision of the regulation, coupled with the general law enforcement capacity of the country. Can the state enforce the laws and regulations it makes across the spectrum? If not, it may result in a 'regulating what is within reach' approach, which means that the law-abiding firms carry the bulk of the regulatory cost but have to compete with firms that are beyond the reach of regulation.
- Conflicting (or seemingly conflicting) impacts generated by different regulatory instruments. For example, costly consumer protection rules may undermine the development of institutions with lower-cost business models that may be encouraged by financial inclusion policy. Understanding the real and false trade-offs[13] between different regulatory instruments is crucial to achieving defined policy objectives. Although market development may in some cases introduce risks into the market, it is increasingly recognised that, in the long-term, it actually supports stability and the inclusion (and protection) of a broader consumer base.

[13] See Porteous (2006) for a discussion on the false trade-off between expanding access and stability.

- The absence of conditions in other spheres of regulation or the economy that are necessary for successful implementation of insurance regulation. For example, the absence of a widespread payments infrastructure to collect premiums may inhibit the development of insurance models that rely on electronic payment of premiums rather than cash payments.

2.6. What can hinder the development of microinsurance markets?

The underlying premise of the diagnostic study is that microinsurance market development in a particular country is sub-optimal and needs to be kick-started or enhanced through a set of strategic actions. The diagnostic will therefore result in a set of market and regulatory recommendations for microinsurance development. But why does financial inclusion not just happen by itself?

In building up the microinsurance picture in terms of demand, supply and regulation, it is important that the diagnostic recognises the potential market failures and regulatory barriers that can hinder the development of microinsurance markets:

Market failure

A textbook market characterised by full efficiency and equity hardly ever exists. Microinsurance is no exception. Market failure happens when a market does not allocate resources efficiently. Economic theory highlights four causes of market failure, two of which are particularly relevant for microinsurance (Bishop, 2004)[14]:

- *The existence of market power*. Where competition is not sufficient, the suite of products on offer, the features and the value provided will be suboptimal. There may also not be a large enough variety of players. Where there is not enough competition, existing insurers are comfortable serving the current market and have no incentive to explore new markets.
- *Information asymmetries between suppliers and clients*. Information asymmetries can relate to the insurer's knowledge about the client's profile or the client's financial literacy or awareness of insurance and understanding of the nature of the contract:
    - In some cases, unscrupulous players may exploit clients' limited knowledge. They may not deliver on their promise of value or may provide downright bad value to customers. As insurance is a promise of future value in return for a premium, trust plays an important role. Market failure may undermine that trust.
    - On the other hand, where insurers lack a sufficient history of data on the profile and risk experience of the target market, it may undermine effective pricing and product design.

A third potential form of market failure relates to investment:

- *Investment hurdles*. In some cases insurers in the formal market remain reluctant to invest in microinsurance. In deciding to invest, companies weigh the risk-return ratio. Where the business case of a new market has not yet been proven or there are a number of uncertainties in the market or external environment, as is often the case in microinsurance, it may be difficult to convince the board to invest. Where external

[14] The other two are: the existence of externalities and the existence of public goods.

parties share some of the risk, e.g. through co-funding of innovation, it may help overcome this investment hurdle.

Policy and regulatory barriers

A market may also be characterised by "regulatory failure" of one or more kinds:

- *Restrictions*. Policy frameworks rarely include microinsurance and policymakers often lack awareness of microinsurance. Barriers to entry may also be too high or not be aligned to the realities of microinsurance.
- *Overall regulatory burden too high*. Microinsurance business typically operates with small margins and requires scale and efficiency in distribution to be viable. Microinsurance is therefore particularly sensitive to compliance requirements that impact transaction costs. By unduly increasing the cost of operation, regulation may inadvertently make microinsurance products unprofitable to deliver.
- *Regulatory uncertainty*. The investment hurdle on the market failure side will be amplified in situations where it is not clear whether a specific product or distribution initiative will be acceptable from a regulatory point of view. Regulatory uncertainty often arises in instances of innovation (as will required to reach the low-income market), as clear regulatory parameters have not yet been set.
- *Ancillary regulatory barriers*. Policy and regulatory barriers are not only of an insurance nature, but could also lie in other areas such as financial sector or cooperatives regulation. Furthermore, in spheres such as health financing where multiple regulators or public authorities are involved, coordination failure becomes a serious danger – and one that can plague microinsurance development.
- *Absence of regulation or supervision*. The absence of regulation or enforcement can also be a problem. In situations where there is limited supervisory enforcement capacity to formalise informal business, regulation offers consumers limited protection. The presence of informal players and channels may furthermore create an unlevel playing field vis-à-vis those who meet compliance costs.

2.7. The scope the diagnostic

The analytical framework deliberately casts the net as widely as possible in order to provide potential guidance for the largest variety of national conditions. However, not all of the factors referred to above will be relevant in every country. Whereas some of these factors can be excluded only after investigation, some factors can be excluded *a priori*. What, then, will be the scope of the research and how should it be defined?

The actual scope of the study will be determined by the financial resources available, the preference and priorities of the insurance supervisor of that country and any prior work done that already fills in part of the picture. The scope will be defined by the funders as part of the design phase of the diagnostic to ensure that the resources available can cover the work and are optimally targeted given the priorities for a particular country.

The scope will/should be set in terms of the following parameters:

1. **Products to be covered**. In general, the following scope guidelines apply:

- *Risk rather than savings*. The primary focus is usually on risk-only insurance products with some reference to insurance-based savings products where applicable. A full review of the savings environment will have to cover many other non-insurance savings products and typically falls beyond the scope of insurance-focused diagnostics.
- *Life as priority, others included.* Life insurance (including credit life insurance and funeral insurance) tends to be the most developed category of microinsurance globally and should therefore be analysed in detail in a country diagnostic. Life risk events are easily identifiable and manageable (compared to, for example, property or health risks), which makes it suitable to the microinsurance environment where simplicity and scale is essential. Life insurance is however not the only product of relevance to the low-income market. Disability, asset and agricultural insurance should also be included in the analysis, to the extent that each is relevant in the domestic context.
- *Health complications*. Health insurance, though important to include, typically presents some challenges or political sensitivities to be taken into account. The regulatory framework for health insurance is often not well developed and in many cases an issue of regulatory demarcation arises in determining whether health insurance should be supervised by the Ministry of Health or the Ministry of Finance. Where health insurance (and particularly indemnity cover) is regulated under the Ministry of Health it often makes it difficult to incorporate health in a microinsurance development strategy unless the Ministry of Health is a participant in the strategy process. Ultimately, the Ministry of Health's participation will be determined by whether its health policy approach allows room for insurance mechanisms in the financing of health care.
- *Insurance mechanism only*. Given the definition of microinsurance as discussed in Section 2.2, social welfare or other risk management mechanisms provided by government and not based on insurance principles are typically not covered as part of a microinsurance diagnostic. These areas could, however, be reviewed to provide the broader risk mitigation context for a specific country.

2. **Particular target markets**. Depending on the specific country context, the income category that will be considered as low-income for the purpose of the diagnostic will be determined. In larger countries and depending on the objectives of the policymaker, regulator and supervisor, the scope may also be set in terms of the urban/rural divide.

3. **Geographic scope**. If the country is large, it may not be feasible to cover the whole country, especially in terms of the target market analysis and regional-specific microinsurance products or channels. Geographical prioritisation is therefore an important part of the design of the diagnostic.

4. **Types of players**. Usually, a diagnostic will cover all players, formal and informal, mutual/community-based or corporate. In certain instances, depending on the market conditions and the regulatory objectives, it may however be necessary to limit the scope to the formal market or to the formal market plus a subset of the informal market.

5. **Distribution channels/models to be included**. In smaller countries, it is desirable to consider all current and potential distribution channels. In large, complex countries this may

however simply not be feasible within the available budget. In such instances, the most relevant distribution models will be identified.

6. **Whether particular microinsurance products or pilot projects should be evaluated**. The same goes for the microinsurance product focus. The ideal is to cover the full universe. However, as microinsurance grows in a country, the landscape may become heavily populated. It is therefore important to choose models that are representative. In some countries the insurance supervisor may have licensed or approved particular microinsurance pilot projects and want these evaluated as part of the diagnostic.

3. Diagnostic process

In the Sections leading up to this point, the document provided the context to take into account before embarking on a country diagnostic study and the analytical framework for the analysis. Now the attention shifts to the contents and process of the actual diagnostic study. Before giving practical tips on how to undertake a country diagnostic (Section 4), this section considers a typical research process from the point of view of the team undertaking the diagnostic. This research process fits within the overall diagnostic process as set out in section 1 above.

In order to arrive at a comprehensive analysis, each country study will entail a number of steps set out in Figure 6 below:

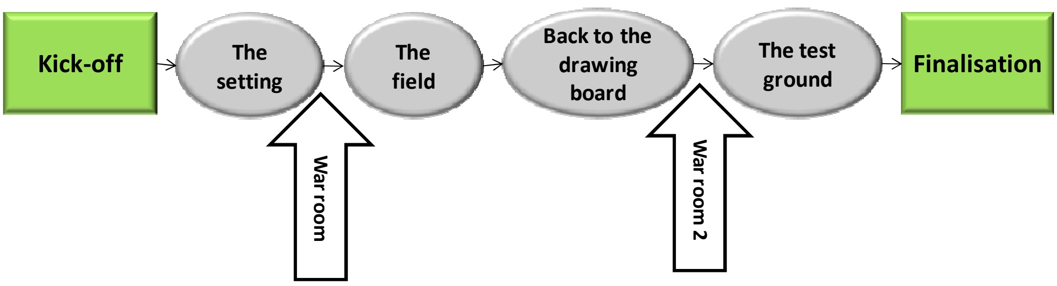

Figure 6. Country diagnostic study process
Source: authors

Though these steps will not necessarily always hold and may need to be tweaked to the specific country context, they provide a guide for a process that can deliver a credible diagnostic and, at the same time, contributes to the overall country strategy process.

1. **Kick-off:**
   - A kick-off session forms the basis for project inception. It is important to get clarity on the project elements and desired outcomes, to brainstorm on the issues to be addressed, likely data sources, people to consult and challenges to expect.
2. **The setting**:
   - A background review of all existing materials, scan of the body of relevant regulation and identification of all the possible sources of quantitative data.
   - Preparation for the country consultations – arranging the program and holding exploratory meetings (by telephone or in person).

3. **The "war room"**:

   - It could be useful at this stage to incorporate a team brainstorming session to talk through the likely issues and elements to cover. Each consultant should decide, based on their method of working, whether this is required and what format it should take.

4. **The field**:

   - The heart of the study is a country visit to gather information, visit pilot projects, and consult/interview all the interested parties. Meetings need to be held with stakeholders across the insurance value chain (insurers, brokers, current and potential aggregators), the insurance policymaker, regulator and supervisor, as well as other government agencies of indirect or direct relevance to the insurance market (e.g. the cooperatives authority or the health ministry). It may also be necessary to meet with support or development agencies with an interest in insurance in the country. See Toolkit II for a full overview of stakeholders.

5. **Back to the drawing board**:

   - After the country visit follows an analysis phase where existing surveys and other data sources able to supply quantitative information are considered and insights of relevance to the study are tapped.
   - Together with the insights and information gathered in the country visit, the analysis of secondary information feeds into the synthesis of findings into a set of findings. The synthesis phase may require follow-up discussions.

6. **"War room" round 2:**

   - As accelerator of the synthesis process, another team brainstorming session will be useful to discuss the key trends and drivers emerging and the strategic implications thereof in order to inform the write-up of the draft report. Once again, the need for and format of such a session will be at the discretion of the consultants.

7. **The test ground:**

   - Once the consultants have arrived at their own set of draft findings, it is important to test these findings with local stakeholders. A stakeholder workshop gives the opportunity for the presentation and verification of preliminary findings with national stakeholders, including the national regulator and supervisor as well as market players.

8. **The final push**:

   - Formulation of final findings into a report that includes strategic recommendations.

But what are the steps within the steps? What must you cover in each aspect of the analysis? Below, the proposed methodology for each aspect of the market and regulatory analysis is set out.

4. Methodology

A country diagnostic study sets out to develop an integrated picture of the forces – market-related and regulatory – that have shaped and will in future shape the development of the microinsurance market in a particular country. Each diagnostic will:

1. *Undertake a market analysis*: The market analysis explores the country context, as well the demand- and supply-side of the insurance and microinsurance landscape in order to identify the drivers of, opportunities for and challenges to microinsurance market development.

2. *Undertake a regulatory analysis:* The regulatory analysis seeks to identify the most critical regulatory provisions that have an impact on microinsurance, both in insurance regulation as well as other regulation such as banking.

3. *Make strategic recommendations*: Based on the findings of these scoping exercises, the diagnostic will propose potential strategies across all role players to support the development of the microinsurance market in that country.

This document sets out the practical methodology for completing the above analyses. It provides guidance and tips on what to cover that each consultant can shape and adapt to the specific country context. Each section below is divided into four components:

1. The objective of the particular analysis;
2. The content or substantial areas to be covered as part of the analysis;
3. The institutions and stakeholders to be consulted; and
4. Sources of information and specific questions to be asked.

4.1. Market analysis

4.1.1. Context

Every market operates within a broader context or environment. The microinsurance market is no exception.

The financial sector at large, the broader macroeconomic, socio-economic and demographic context, as well as physical infrastructure forms the backdrop to microinsurance market development. Moreover microinsurance, like any other product or service, is subject to the forces of the political economy.

For example: a country where most of the population are poor will face different consumer education, product design and delivery challenges than an upper-middle-income country. If most of the population live in rural areas, innovative distribution strategies will be needed to reach them. If the country experienced a financial crisis or hyperinflation in the past that eroded the value of life insurance, building trust among the target market may be a particular challenge. Culture will also be a determinant of the need for insurance as well as of the structure of the market. For example: in some countries the cultural need for a dignified funeral drives demand for life insurance, notably funeral insurance, whereas in another country an aversion to talk about death may cause an avoidance of life insurance.

Objective: The objective of the context analysis is to obtain an understanding of the financial sector, socio-economic, macroeconomic and political economy context within which the insurance sector functions, as well as the demographic profile and other contextual factors that impact on the development of the insurance market.

What to cover?

1. *Economic context*: What are the general economic trends and dynamics that may impact the development of microinsurance? Have there been episodes of hyperinflation or other macroeconomic instabilities in the past that may have shaped the market? Issues of relevance include prevailing macro-economic conditions, substantial processes of economic restructuring and the level of formality in the economy (e.g. a large reliance on the informal economy means that incomes tend to be less secure and more erratic. It will also be more difficult to partner with informal employers for distribution.)

2. *Political economy*: What is the political system followed in the country, i.e. how are the legislative, executive and judicial powers distributed? How does this impact market development? For example, a congressional system of politics with a bicameral legislature may cause long delays in passing primary legislation. That would mean that legislative changes may not be feasible in the short term and the way forward for microinsurance may rely more heavily on changing regulations if that is within the delegated power of the insurance supervisor or regulator to do. Are there broad ranging political policies or objectives that impact insurance, for example a broad-based social upliftment or empowerment policy? Who are the most important policy-making bodies? These need to be consulted and their pronouncements examined. To what extent is the government directly engaged in the market, for example through state-owned insurance providers or via subsidies and other social programmes? What is the policy on foreign ownership of insurance providers? Has this changed in recent times? These are just a few of the possible political economy questions to consider, each of whom may impact on insurance market development in some way.

3. *Demographic and socio-economic profile of the country*: Potential relevant questions here include: What is the size and age distribution of the population? What are the income levels and income distribution? What are the levels of urbanisation? The more rural the population, the tougher the distribution challenges. What is the level and nature of employment and sources of income? For example, the higher the levels of informality, the more unpredictable the income flows and the more important it is that requirements for premium payments are structured with this in mind.

4. *The penetration of social welfare*: What is the nature, extent and distribution reach of public social welfare programmes? These programmes, for example public health systems, are designed to mitigate risks for poor households and, to the extent that they operate efficiently, they obviate the need for privately purchased risk mitigation.

5. *Community structure, support networks and social cohesion:* Has any mutual/cooperative risk management structures evolved in communities? To what extent do they meet the risk management needs of poor households?

6. *The broader financial sector within which the insurance sector operates*: Relevant issues here include the penetration of bank accounts and the cost of utilising this for premium collection; the nature and development of the credit market (of relevance for credit life insurance); the state of the payment system, especially payment instruments available to low income households, the environment around e-money and the availability of non-bank payment system partners (e.g. mobile phone networks).

Who to consult?

The consultation list will look different for each country, but can for example include:

- *General context and demographic and socioeconomic profile*: Academic and research organisations; statistical agencies; development agencies.

- *Financial sector context*: ministry of finance; central bank; financial institutions, e.g. banks and microlenders; financial sector consulting firms and consultants.

- Questions relating to the *political economy and social cohesion* should be covered across all stakeholder interviews to get as broad as possible an impression. Government departments responsible for social welfare can also be consulted.

Where to get the information?

- Government statistical publications (such as household surveys, income/expenditure surveys and labour force/employment surveys) and available socio-economic survey data.

- Central Bank publications, financial institutions' annual reports, studies by multilateral agencies, e.g. the World Bank or other available secondary research. Reports on the state of financial inclusion in the country will be very useful.

Be on the lookout for…

In going through the various available statistical reports and other publications, look for any data that will help you to understand the socio-economic and demographic profile:

- How is the population constituted?
- Where do they live?
- How do they earn their livelihoods?
- What is their income profile?
- What is the state of infrastructure? Any information on rural population's proximity to e.g. retail stores/markets and other infrastructure?

Also prompt those you meet with regarding these aspects.

In going through financial institutions' annual reports and other reports on the financial sector, or in interviewing financial sector stakeholders, look for any information that will help you to understand the financial landscape:

- State of development of the financial sector?
- Number and nature of players?
- Number of people that are banked/number of bank accounts, credit cards?
- Financial sector infrastructure: number of ATMs/POS devices?
- State of the payment system, including mobile payments.

4.1.2. Demand-side

The second component of the market scoping exercise is a demand-side analysis of the need for and perceptions of insurance among the target market.

Objective: The objective of the demand-side analysis is: (1) to understand the economic *realities* of the target market; (2) to understand the most pressing risk mitigation *needs* of potential microinsurance consumers; (3) to gauge the *awareness, understanding* and *perceptions* of insurance among the potential client base; and (4) to evaluate whether there is unmet *demand* for microinsurance for which the poor may look beyond government provision and provision within the household (i.e. for which they look towards the market). Large informal insurance markets are often, but not necessarily, a proxy for pent up demand. Understanding the needs of the market will help to prioritise potential policy interventions.

What to cover?

The purpose of the analysis will be to paint a picture of the current usage of as well as the potential demand for microinsurance products amongst the low-income population in a country. The demand-side aspect of the scoping exercise sets out to understand:

1. *Current usage*: What is the actual usage of microinsurance products? What is required here is a quantitative analysis indicating the percentage of the adult population that use microinsurance products, as well as specific categories of products where this information is available. The usage of both formal and information products must be covered.

2. *Profile of potential microinsurance clients*: The diagnostic will develop a profile of the microinsurance target market. Questions to be answered include:

   - What is their income and socio-economic profile? What are their expenditure priorities?
   - What are the specific risks faced by low-income households and what risks do they fear most?
   - How do low-income individuals cope with risks and what are the various strategies in the community for doing so?
   - Are there specific cultural aspects that impact the demand for microinsurance?
   - What are the market's perceptions and understanding of formal financial institutions and specifically insurance?
   - To what extent do existing insurance products meet the needs of the low-income consumer? Identify potential gaps.

3. *Potential demand for microinsurance:* Having assessed risk appreciation amongst low income households as well as their usage and perceptions of insurance, an estimate is made of the potential microinsurance market and which segments of that market can be more easily reached than others. In this part of the analysis, the demand-side research

combines with the market analysis of players, products and distribution channels to take a view on the potential going forward.

It is important to build an understanding not only of those that are currently served by the insurance market, but also of those outside of the market, to better understand what it is that will drive uptake of insurance and what barriers they currently face.

Who to consult?

In addition to dedicated demand-side research (see below), demand-side insights are generated across all the in-country consultations. Be on the lookout for any statements about client profiles, culture and other demand-relevant aspects during the interviews. In addition, incorporate specific questions related to the demand-side in the interviews with regulators and value chain players. However, take care to distinguish between opinion, anecdotal evidence and fact. Challenge assumptions and, where possible, verify opinions against external evidence.

Example interview questions

For value chain players:

1. What is the income profile of your client base/target market?

2. Have you done any market research to better understand the realities of the low-income customer? If so, what insights did it render?

3. What target market features have informed your product or channel design and/or what demand-side aspects have prompted you to change product features?

4. Which of your products are most popular and why?

For supervisors/development agencies:

1. What do you see as the main demand-side challenges to the growth of the insurance market?

2. What are the cultural and other drivers of insurance behaviour in the country?

3. What is the nature of complaints that you receive about microinsurance products?

4. Have you conducted/do you know of any research on consumer financial literacy or any consumer education initiatives?

How to get the information?

In addition to the insights generated through interviews, demand-side information will be collected through (i) an analysis of existing household surveys (where these are available), as well as (ii) through dedicated qualitative market research among low-income consumers. Note that, with the exception of focus groups or other qualitative market research methods, the country studies will not undertake primary surveys. The implementing teams will therefore be limited to existing data for quantitative information.

1. Survey data analysis and secondary research

Where available, it will be important to consult survey data that illuminate insurance usage trends. It is important to scope what data is available (e.g. by reading through the summary reports or survey questionnaires) in e.g. general household surveys, labour force surveys or income and expenditure surveys, as well as any other survey that may be of relevance. The purpose of the survey data analysis will be to analyse and summarize all available primary and secondary information on the current and future market size, and trends in overall life insurance product usage over time.

In some countries, notably in Africa, dedicated demand-side financial services usage surveys are available to draw on. In others, one would have to investigate what data is captured by standard household, expenditure or other surveys conducted by the statistical bureau. With the caveat that survey data may be outdated, may only capture stated usage (rather than actual)[15], or may not include informal sector usage. Survey analysis remains an essential tool in understanding market penetration. Often, survey data will also capture the geographical and income distribution of those with and without insurance, as well as their education profiles and even financial literacy and understanding of certain concepts.

Aspects of available survey data or secondary reports to be on the lookout for

- Number of policyholders in the insurance sector, broken down by class of policy if possible
- Any information on profile of customers (where possible compare this between the insured and the uninsured market)
- Income
- How people earn their livelihoods
- Whether they live in rural or urban areas
- Other financial services usage, e.g. savings or credit. Do they have a bank account?
- Do they belong to associations or other networks that could be potential touch points for insurance distribution?
- Do they have a mobile phone?
- Any information on risk experience in the economy?

How to analyse the data?

- While statistical and econometric skills may come in useful, statistical or regression analysis is not required for the purpose of the country diagnostic study.
- Rather, simple tabulations and cross-tabulations of data are required to form a picture of usage and profiles.

[15] Often, for example, survey respondents are reluctant to disclose that they have credit or their level of indebtedness. They may also not even be aware of some financial services (for example where a family member has covered them on an insurance policy. In household surveys another drawback is that the household head or surveyed member may not be fully informed on the financial status of the rest of the household.

- Cross-tabulations[16] can be a powerful tool to understand linkages and trends within segments. For example: after determining what insurance usage is in general, it may be useful to do a cross-tabulation to determine insurance usage by gender type, by rural vs. urban split, by income category, or by mobile phone usage.

Where no reliable survey data is available, a picture of the market needs to be triangulated from different available sources. This will include asking insurers and other market players for estimates of their number of clients and demand-side insights from past market or other research. Such an exercise will render a crude estimate at best, but may in some circumstances be the only available avenue. Where no definitive data or estimates exist, the consultant may form an informed opinion or guesstimate based on the insights gained in meetings and various other sources. It is important to be upfront about the fact that a guesstimate or opinion is provided and not to put this forth as fact.

2. Qualitative market research[17]. Qualitative market research, through focus group discussions or other methodologies such as individual interviews, play an important role in the microinsurance diagnostic study. Whereas quantitative research such as surveys will provide results that can be generalised to a larger population, depending on the sampling technique, this is not the case for qualitative research (Sebstad, Cohen & McGuinness, 2006). Rather, it aims to better understand the motivations behind observed market phenomena; it provides more depth and detail on the "why" and probes factors relating to clients' decisions and behaviour. It allows us to get a sense of the priorities and perceptions amongst the target market. In doing so, qualitative research can inform strategy, the regulatory framework and opportunities and imperatives for market players.

The role of qualitative market research in the diagnostic is to understand the target market (their economic realities, the risks they face and the financial implications of such risks, the coping strategies that they employ and their awareness and perceptions of insurance) in order to complete the demand-side of the picture. There are a number of potential market research tools that can be applied, for example focus group discussions, participatory rapid appraisals, individual interviews or community immersion. For an overview of possible tools and the role each fulfils, see Sebstad, Cohen & McGuinness (2006).

Which tools will be most appropriate will depend on the country context and the budget realities of the project. Here we consider a tool often used for country diagnostic studies, namely focus group discussions:

Focus groups as tool to understand demand-side issues

What are focus group discussions? Focus group discussions (FGD) are one of the suite of available qualitative market research tools. The central methodology is to form small groups (usually 8 to 10 individuals) and then to test their views and perceptions on a certain matter through interactive discussion between the group and a professional moderator. As the findings are qualitative, they cannot be used to draw valid conclusions on the population as a whole, but can only give an

[16] Cross tabulations are used to compare how two variables correspond with one another; a cross tab displays the distribution of one variable 'across' the categories of a second variable.
[17] For a detailed overview of the role of and methodology for market research in microinsurance, see Sebstad, Cohen & McGuinness (2006).

indication of the experience of the sample.

Group members are selected according to gender, age and socio-economic class. At recruitment stage it can be noted whether the person has insurance and a bank account so as to allow disaggregated analysis and comparison between people with and without insurance. Likewise, groups can be segmented according to whether they are from rural, urban or peri-urban areas.

Role of FGDs. The objective of focus group discussions is to understand the lower-income market's income and expenditure profile, experience of risk (the severity of different risks) and interaction with insurance. It also prompts the group's decision-making criteria (whether to buy or not to buy insurance) and their perceptions of the insurance market. Though survey data can also shed light on these factors, it does not provide the level of qualitative insights required to understand perceptions and the motivation behind behaviour. Focus groups provide the opportunity to probe these issues through discussion. The moderator will raise a certain topic, such as "what bad things can happen to you that will impact on you financially" and will then lead the discussion on various risk events (typically death, illness and loss of income), how to cope with such events (for example community or extended family support, taking out a loan, or selling assets) and, eventually, what insurance is and the value proposition to them.

As focus group discussions require specialist moderator skills, it is a function usually best outsourced/subcontracted to a market research firm. The same holds for other qualitative market research techniques. This means that the consultant needs to build time into the project to draw up terms of reference for a qualitative market research assignment, to communicate with potential market research firms, assess proposals and appoint a service provider. The diagnostic consultants will, where possible, attend some or all of the focus group research sessions and will engage with the market research providers after the initial few sessions to provide feedback and shape the rest of the discussions.

The questionnaire to be used by the facilitator as the basis for discussion in each focus group session, called the *discussion guide*, can be based on examples used in previous country studies. However, in each case it will be adapted to local circumstances, local language and cultural orientation. An example discussion guide is included in Appendix 1. Further, more detailed examples are contained in the annexes of Sebstad, Cohen & McGuinness (2006).

Main elements to cover in the focus group discussion guide

The focus group discussion guide normally has four objectives (note again that this is not prescriptive, but will depend on the country context):

1. *Introduction/background*. Understand the economic circumstances of the respondents: their employment and income profile, their spending priorities, whether they have a bank account or other financial services, whether and how they save. If they work in the informal economy: do they belong to some kind of network?
2. *Risk experience*. The next step will be to prompt the respondents to discuss what the main risks are that they face – and to focus on adverse events that will have a financial impact for them and the orders of magnitude of that impact (all of this without mentioning that the discussion will be about insurance).
3. *Coping mechanisms*. The next step is to ascertain how they cope with the impact of such events.

They should be allowed to spontaneously mention coping strategies, which normally will include: family support, borrowing, drawing on savings, selling assets, informal risk-pooling groups such as burial/funeral societies or self-help groups, etc. The idea is to ascertain perceptions of risk and how to deal with it. This step will also gauge whether they mention insurance as one of the strategies and how highly it ranks in their minds, as well as what the insurable risk “gaps” are that could be served by insurance.

4. *Insurance perceptions.* Lastly, the focus group discussions will build an understanding of the participants’ understanding and perceptions of insurance: what is insurance, what value it can give, do they trust insurers? Do they know what it means to pay a premium, to claim, etc? What has been their experience with insurance, or what have they heard about insurance from family members or others in the community? What would they be willing to pay for insurance and what would be the prerequisites (in terms of product suite, product features, distribution, etc) for them to buy insurance? This part should once again be a spontaneous discussion, but if awareness is limited, the moderator can also give some explanations, ask certain prompting questions.

Another prerequisite to successful FGD research will be the *recruiting questionnaire*. Issues to be covered in this questionnaire as well as the main elements of the FGD discussion guide are set out in the box below.

Recruiting participants

The recruitment of participants is core to ensuring that the FGDs will render meaningful results that can be segmented by different types of people. The market research firm in charge of the FGD research will conduct recruitment and it is important to draw up a recruitment questionnaire to ensure that they recruit the right participants. A recruitment questionnaire is simply a few questions that will be used to select people for the groups. Questions should for example relate to:

- Age
- Gender
- Monthly income
- Whether they have insurance or not
- Whether they have a bank account or cell phone
- Whether they live in a rural or urban area

Based on these recruiting criteria, the groups can then be constituted so as to enable comparison between people of different profiles, for example: the insights from female groups vs. male groups; rural groups vs. urban groups; how perceptions differ between different age

Gender	Age group	Income	City1	City2	City3	Rural
Characteristics			**Groups**			
Male	Age A	Income category 1	**1. No insurance**		**9. Have insurance**	**13. No insurance**
		Income category 2		**5. No insurance**		
	Age B	Income category 1		**6. No insurance**		**14. No insurance**
		Income category 2	**2. Have insurance**		**10. No insurance**	
Female	Age A	Income category 1		**7. Have insurance**	**11. No insurance**	**15. No insurance**
		Income category 2	**3. No insurance**			
	Age B	Income category 1	**4. No insurance**			**16. No insurance**
		Income category 2		**8. No insurance**	**12. Have insurance**	
Total			4 groups	4 groups	4 groups	4 -groups

groups; etc. Generally, at least two groups of a certain profile will be needed to enable meaningful comparison.

The table gives an example of a possible method of group segmentation. Note that this is not a template that should be followed in each country. The exact segmentation will depend on the number of groups (which will in turn depend on the budget) as well as the profile of the specific country.

The findings from the qualitative demand-side research, with as many as possible quotes from the participants to illustrate a point, will be written up by the market research firm into a report, accompanied by transcripts of the actual focus group discussions or interviews. The diagnostic consultants will provide feedback on the draft report to ensure quality. After the finalisation of the market research report, the diagnostic consultants will integrate the main findings from the market research report into the demand-side component of the diagnostic study. It is important to take into account that, while focus groups and other tools may provide insights on the needs of the market, **needs do not necessarily translate into demand**. Focus groups and surveys can gauge stated willingness to pay but will not always predict actual take-up of insurance and the results should therefore not be represented as such[18].

4.1.3. Supply-side

The third component of the market scoping exercise is to map the supply of insurance products, and especially microinsurance products.

Objective

The objectives of the supply-side analysis are to:

1. Build an understanding of the players and products in the insurance market as well as the context in which they operate. To do so, it must provide a sufficiently detailed understanding of the key players in each part of the value chain as well as the products relevant to the lower-income market. A detailed analysis of every product and institution is not required. Rather, the focus should be on information relevant to inform the regulatory analysis.
2. Identify and describe the key dynamics and trends that are shaping the insurance market in general and the microinsurance market in particular.

What to cover?

The supply-side analysis generally has four aspects: providers, products, distribution and take-up. Specific tasks to be undertaken/questions to be answered include:

[18] Rather, what can be termed the insurance decision will be determined by a number of factors. One hypothesis holds that the insurance decision will only be positive if the perceived value exceeds the perceived cost of taking out insurance. The emphasis on *perceptions* is important, as it is people's perceptions that will drive decisions in the absence of concrete knowledge. For low-income individuals who need to make tough budget decisions every day, the opportunity cost of dedicating resources to insurance premiums will be higher. The perceived value, in turn, will be determined by the person's knowledge of and trust in insurance. Trust may be higher where mutual/member-based entities known in the community provide the insurance..

Providers of (micro)insurance

1. Identify and categorise the formal and informal players operating at the low-end of the market across the various functions of the value chain. Where possible their relative market size and position should be noted. For the various categories consider:

    - *Role and position*: Outline the position of the various categories in the value chain and their role in the microinsurance sector. For example: identify re-insurers and their role in the low-end of the market (e.g. are they able to link directly with non-insurers? Are they allowed to reinsure registered mutual insurers?).
    - *Description and types*: Provide sufficient description of category features as well as intra-category variation.
    - *Market failures and dynamics* (including abuses): Market failure or abuse is often the motivation for promulgating new regulation. It is thus important to have a grasp of the existence of such practices in the market.
    - *Management and corporate governance:* This should not be a general analysis of corporate governance, but should focus on the governance dynamics/features that will influence the nature of regulation (notably failures in governance). This will be particularly relevant for informal insurers and other categories of institutions that are currently unregulated.

2. Analyse the role and impact of government involvement in the market (e.g. government schemes, taxation etc)

3. Identify and describe important industry associations, their membership and role in the development of the microinsurance industry (this includes associations of informal insurers, e.g. cooperatives)

4. Identify market factors and trends affecting the expansion of insurance (to include barriers to entry and barriers to formalisation, competitive structure of the market, etc).

Distribution:

1. Evaluate the various distribution models employed for microinsurance and the regulatory characteristics of these. Describe and assess these models in terms of the characteristics discussed in the analytical framework.
2. Identify key options and means for collection of premiums, summarising key advantages and disadvantages.
3. Identify particularly innovative players, products or technologies that are (or potentially could be) operating in the low-income market.

Product specification and access

1. List the key features of all product categories available which target the low-end and, where possible, provide estimates of relative market size/share. If the number of providers and products are too numerous, propose products and institutions (or categories) relevant to focus on.

2. Based on the product analysis, identify the shared product features found among microinsurance products in the country. For example: do microinsurance products tend to be written on a first loss basis? Do they tend to incorporate group pricing rather than individual underwriting? Do they tend to have short renewable contract terms?
3. Identify regulatory constraints to the design of products and further roll out of products, as well as specific regulatory access barriers that could prevent people from using such products.
4. Identify market barriers to access (e.g. complex products, products not available within easy reach of where most people live).
5. Where relevant, extend the general picture with case studies of products and institutions, including pilot schemes, that illustrate interesting regulatory or market dynamics or dilemmas.

Take-up (from a supply-side perspective) and product value

To complement and corroborate the analysis of the usage of microinsurance from the demand-side perspective, as assessment is made of the take-up of insurance from the supply-side perspective and the value offered by products:

1. How many insurance clients/policies are there? How does this translate into persons covered by insurance policies?
2. What proportion of it is likely to be microinsurance? If data is not gathered for microinsurance specifically, what are the product categories that are most likely to include microinsurance?
3. What is the premium break-down, especially management costs, commission (if separately indicated) and claims ratios, for microinsurance products or insurance categories most likely to include microinsurance?
4. Is there an informal market outside of registered insurance and, if so, what estimates are available of how many people it reaches and in what ways?

Who to consult?

It is important to consult a representative sample of players across the insurance value chain that will be able to give an indication of the full range of microinsurance-relevant products and distribution mechanisms. Stakeholders to consult include:

- Commercial insurers
- Insurance administrators/underwriting managers
- Insurance associations
- Microlenders
- Microfinance associations
- Brokers/agents and/or broker association
- Banks involved in bancassurance
- Market associations, utilities, retailer chains, mobile phone networks or other client aggregators that currently are involved in insurance distribution or may potentially be candidate distribution channels.

Example interview questions and things to be on the lookout for

- Nature of operations, product focus, whether retail or corporate orientated?
- How many clients/policyholders/members they have?
- Current activities in low-income market and motivation for being present in this market segment?
- Challenges/opportunities for expanding the client base down the income spectrum, or reasons why this is not a strategic priority?
- Overview of low-income market-relevant products – benefit components and levels, product options, premiums, payment options, other features?
- Planned activities/pipeline products?
- Claims ratios – if not willing to disclose, ask for indication of orders of magnitude and how that differs between product classes?
- Commission rates - if not willing to disclose, ask for indication of orders of magnitude and how that differs between product classes?
- Solvency trends, the financial state of the company/industry, main challenges?
- Main regulatory challenges/barriers faced?
- Distribution channels used and how they think about channels needed to reach scale in the lower-income market?

How to get the necessary information?

It is important to look for information on overall insurance industry performance and trends, including the nature and categories of players and products in the market, the nature of distribution and the entities involved, and the presence of foreign players. Include government participation in the market as provider or intermediary or as client aggregator.

1. Interviews and secondary research. The primary method for gathering the supply-side information will be the stakeholder interviews, combined with whatever desktop information can be sourced:

- The insurers and other players will be an important depository of information and it is important to ascertain what documents they have available and to obtain access to it.
- In some instances there will also be other secondary research that provides a handy overview.

An initial desktop scan through an internet search engine should be conducted to identify relevant documents. Furthermore, it may be useful to schedule a discussion pre-country visit with one or two key stakeholders who will have a bird's eye view of the market and to ask them what documents to consult. Also probe for relevant documents to consult during the interviews. You can then follow up on these leads in the analysis and synthesis phase following the country visit.

Useful documents to obtain:

- Annual reports and annual financial statements (to gauge solvency, profitability, claims ratios and performance of product lines) of insurers
- Regulator's annual report or database of information reported by insurers

- Internal research reports compiled by insurers
- Product brochures: it is important to gather as many product brochures of microinsurance-relevant products as possible in order to be able to map the product features.
- Regulatory reports generated by the insurer
- International insurance overview reports covering the specific country
- Existing country reports on the financial sector or insurance sector in particular e.g. commissioned by multilateral agencies such as the World Bank

2. Supervisor data analysis. Every country with an insurance supervisor will require registered insurance providers to report standardised information to the supervisor to enable it to perform its oversight functions. This will include information on their financial position, products offered, policies sold (often according to specified categories), gross premiums, claims ratios, commissions paid, reinsurance, etc. The supervisor will capture some of this information in a summarised version in its annual or quarterly reports which will be publicly available, often on their website. However, the supervisor should also be requested to make additional data available if sufficient analysis cannot be made using the publicly available data. The purpose of the analysis should be clearly spelt out to the supervisor, i.e. to extract the information specified in the "what to cover" section above. In some cases the supervisor will be prepared to extract requested information. In other cases, the raw data may be made available for further analysis. In such cases, make sure that the data comes in a format that can be easily manipulated electronically.

4.2. Regulatory analysis

The fourth component of the diagnostic exercise considers the characteristics and role of the regulatory framework in shaping the microinsurance market. Regulation is critical because: (i) it determines who can enter and operate in the market; (ii) it has cost implications, through compliance requirements, for insurers that may determine their willingness to operate in the low-income market; (iii) it can compel provision of certain types of insurance; (iv) it can create compulsory insurance regimes such as social health insurance; and (v) it impacts on the development of the payment system.

The purpose of the regulatory analysis will be to gather information, but also to t prompt the regulator and other stakeholders to start thinking about microinsurance market development and the role that regulation can play in it. Importantly, it is not only regulation that affects market development. The absence of regulation can play an equally powerful role. Similarly, even if regulation exists, a supervisory approach of "benign neglect" or "forbearance" can allow the market to develop in ways that cannot be foreseen ex ante by a regulator.

Objective*:* The objectives of the regulatory analysis are to:

1. Understand the *policy objectives* of the government as they currently stand and also as these evolved over time.

2. Sketch the *regulatory scheme* that is currently in place. The regulatory scheme is the overall approach which the government is taking to insurance regulation. A regulatory scheme may consist of more than one piece of legislation or regulation,

each of which fulfils a particular function in the overall scheme. The various pieces of regulation must be read together to understand the overall approach to the sector.

3. Present the *material details* of the relevant pieces of legislation/regulation. Not every regulatory detail needs to be captured; only those that are material to the objectives of the project or that provides the necessary context.

4. Understand the *supervisory processes* being used and the supervisory capacity available in the country.

What to cover?

This component will consider the full body of regulation and policy that impact on the development of the insurance market, as well as the capacity and approach of the supervisor. The specific tasks to be undertaken/questions to be answered include:

Policy objectives

What are the express policy objectives being pursued by the government? Not all governments are expressly pursuing all potential financial sector policy objectives (including stability, consumer protection, market efficiency, market development). For most governments, market development may not be an express or articulated objective at this point. Determining what the government itself is trying to achieve will assist with the overall mapping of the regulatory landscape.

The policy objectives of governments are normally to be found in:

- Legislation
- Official policy documents
- Public statements of political office bearers
- Interviews with senior officials responsible for regulating the sector.

Regulatory instruments

- What regulatory instruments are being used?
- The legislation/ regulation in which these are captured.
- The relevant details of the statutory provisions relating to each part of the regulatory scheme, e.g. licence requirements, mandatory processes, governance arrangements, etc. Institutional forms permissible for insurance providers are specifically included in this review.
- How regulatory instruments are being supervised.
- Other relevant regulatory regimes, e.g. those relating to payment systems, telecoms infrastructure or banking, with a direct bearing on the insurance sector;
- Other regulatory instruments that may impact on the life insurance industry such as privacy regulation, AML/CFT regulation (which may provide an overly onerous

requirement on identification of clients which may not have adequate documentation).

- Key changes to regulation over time, i.e. some historical perspective on how the current regime evolved.
- What are the current policy debates which may lead to likely future changes in regulation? Such debates may be captured in policy proposals, draft legislation/regulation, media statements or even just in conversion with government officials, sector representatives or political office bearers.

Regulatory impact

Here the actual and potential impact of regulation described in the previous section needs to be sketched. These can vary greatly, for example:

- A thriving unregulated microinsurance sector has developed because the government is following a policy of regulatory forbearance for providers of a particular institutional form, such as community-based cooperatives;
- Formal insurers are moving into the lower-income market due to a specific government requirement that they do so;
- Promising categories of organisations offering microinsurance that has not really taken off because they are denied access to re-insurance, etc.

The factors potentially conditioning policy impact need to be kept in mind here.

It would be particularly useful to the ultimate objective of the project if a picture of the dynamic impact over time, showing how particular regulatory initiatives brought about changes in the market, can be painted.

Who to consult?

The insurance supervisor will be the primary stakeholder to consult and time should be allowed for in-depth consultations with them. Furthermore, it would be important to have meetings with:

- The policymaker in the insurance/financial sector sphere: typically the Ministry of Finance or the Central Bank.
- If applicable: the body or authority that houses a financial sector development strategy or plan, for example a financial inclusion or microfinance strategy. This would typically be the Central Bank.
- Ministries or authorities responsible for areas of regulation that will be of relevance to the development of the insurance sector, for example the ministries tasked with cooperatives, health, social development and economic development, as well as the tax authorities.

Example interview questions

Interview questions will include but not be limited to:

- Is there some kind of financial inclusion policy?
- What are the various pieces of legislation that are applicable to insurance in the country?
- Where is prudential regulation housed?
- Is there demarcation between life and non-life insurance?
- Where is medical/health insurance housed and how is it treated vis-à-vis other types of insurance?
- Who may become a licensed insurer and under what conditions?
- Who may sell insurance and under what conditions?
- Is product approval required?
- What areas of regulation outside of insurance regulation will be of relevance to the microinsurance market? In what way?

Where to get the necessary information?

The inputs into the regulatory analysis will be:

- desktop research of the body of applicable legislation;
- insights gained through the consultations; and
- any secondary reports available that assess the regulatory landscape, for example a financial sector assessment (FSAP) report conducted by the World Bank/IMF or previous studies in related fields that included an overview of financial sector or insurance regulation.

After an initial desktop search to identify the body of regulation, the insurance supervisor can be approached to check that the list is complete and to request access to the various pieces of legislation and subordinate legislation, as well as any other relevant policy documents, guidance notes, etc. Normally, industry players will also have a good idea of the body of applicable regulation and can be asked for references to such documents. For many countries primary legislation or regulations may not be available in English. It is important to assess the availability of legal instruments in English early on and ensure that the most critical pieces are translated into English prior to the country visit.

Aspects of regulation to be on the lookout for

Though not an exhaustive list, the following aspects will be important to consider in order to cover the full regulatory scheme:

- The section in the insurance law that defines an insurer, taking specific note of the permissible institutional form and requirements regarding separation of business
- The definitions of different classes of policies
- The solvency and capital requirements

- The section of the primary law or subordinate legislation dealing with commissions (if any)
- The section of the primary law or subordinate legislation stipulating who may intermediate insurance and what requirements they must meet
- The elements of the banking regulatory framework that mention bancassurance and of the microfinance regulatory framework that set out the functions that a microfinance provider may perform
- The elements of the cooperative regulatory framework detailing what functions a cooperative may perform

Digging deeper

A mechanical analysis of the various parts of the regulatory framework will not suffice to get to the bottom of the regulatory drivers of and barriers to market development. The diagnostic study will only be meaningful if it adds interpretation. To do so, it is important to:

- Establish what the overall regulatory burden is. This will require an overarching understanding of the full regulatory scheme and then taking a step back to assess its impact. It will be useful to ask the value chain stakeholders how they experience the overall regulatory burden. Subjective opinions can be reflected as long as they are not represented as fact.
- Determine what aspects of the regulatory framework create uncertainties, challenges or barriers in the market. Once again, this will entail going beyond an analysis of the letter of the law and getting an understanding with how the market understands and interacts with regulation
- Determine in what way regulatory uncertainties are exploited for regulatory arbitrage or avoidance by market players. It is also important to establish where there are coordination failures between different government departments, for example where a provision in the banking or cooperatives law may contradict the insurance law.

All of these will be important to take into account in determining the regulatory drivers of market development and in making strategic recommendations regarding what policy, regulatory or supervisory changes are necessary to facilitate microinsurance market development.

4.3. Synthesis, drivers and conclusions

The market analysis and regulatory/supervisory review will culminate in a set of findings and recommendations.

Objective: The objective of the synthesis exercise will be to draw together the insights from the context, demand, supply and regulatory components of the analysis into a set of findings that will be comprehensive and substantive enough to justify a set of recommendations for national policy and regulatory changes and/or strategic considerations for industry.

What to cover?

Typically, the synthesis of findings will have four components:

1. *The departure point*. Arrive at an assessment of the salient features of the current state of the microinsurance market, its reach and characteristics and the key trends witnessed in demand, supply and regulation.
2. *The drivers*. Identify the drivers of microinsurance market development. Be on the lookout for the undercurrents to observed phenomena and trends in the market. Drivers can relate to each of the four parts of the analysis: context, demand-side, supply-side

and regulation and it is important to distinguish between the different spheres. Drivers can be things within the sphere of influence of the stakeholders or beyond it. They can be positive (e.g. economic growth drives poverty alleviation, which in turn contributes to insurance uptake) or negative (e.g. the fact that there is no functional electronic payment system undermines efficiency in the insurance sector).

3. *The destination, low-hanging fruit and hurdles*. Identify the likely size of the potential market, where it is that the market is heading. This can be triangulated from the take-up and demand-side analyses. An important element in defining the destination will be to consider the opportunities and challenges to development:

    - Identify the key opportunities for market development, for example pockets of the market where there is most potential for growth, particular channels that could be harnessed for distribution, specific products where there is latent demand to be unlocked, or areas of regulatory reform that bode well for market development. Consider where the immediate opportunities or "low-hanging fruit" are and what opportunities are more long-term or will require more change or effort.
    - Identify the challenges or barriers to development, for example an underdeveloped insurance sector or where regulation for example prohibits mutual entities from becoming insurers). It is important to take the political economy and landscape into account.

4. *The roadmap.* Based on the above, formulate strategic recommendations for market development. This may relate to the value chain, demand-side interventions and regulatory change, respectively, or can be cross-cutting. Part of the strategy may be to highlight critical information gaps and recommendations for bridging such gaps. The diagnostic study *does not need to include the strategy*, as the strategy will be developed out of a local stakeholder process following the diagnostic study. The diagnostic should however make strategic recommendations based on the findings that can form an input into the strategy formulation process.

5. Conclusion

This document aims to provide a roadmap for research teams undertaking an Access to Insurance Initiative microinsurance diagnostic study. It gives an overview of the rationale for a diagnostic, its purpose and the typical steps in designing a diagnostic. It then goes on to provide an analytical framework of the concepts and constructs underlying a diagnostic study – in terms of the definition and drivers of financial inclusion, the definition of microinsurance, the demand, supply and regulatory components of the analysis, and in understanding what the market and regulatory failures are to be overcome and what the scope of the diagnostic will entail.

This sets the scene for an overview of the diagnostic research process and, importantly, the methodology to be followed for each component of the analysis. The methodology is not prescriptive or exhaustive. Indeed, the domestic context and priorities will always be the final determinant of the scope and most appropriate methodology. Rather, this toolkit aims to give practical tips to the research team in tackling a diagnostic in the most comprehensive, meaningful way possible.

Good luck!

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