

Report of the 25th A2ii – IAIS Consultation Call

Supporting responsible MSME insurance



The A2ii Consultation Calls are organised in partnership with the IAIS to provide supervisors with a platform to exchange experiences and lessons learnt in expanding access to insurance.

Introduction

Micro, small and medium enterprises (MSMEs) make up the vast majority of enterprises, and make a significant contribution to employment and economic growth. However, especially for micro and small businesses, insurance products suited to their specific demands often do not exist. In addition, entrepreneurs themselves are often not familiar with insurance as a risk mitigation approach for their families, lives, business assets and transitions, and their employees. Despite the important development potential for the insurance market, regulatory and supervisory frameworks may not sufficiently enable insurance that suits the needs of MSMEs and their owners and employees.

For both social and economic reasons, it is in the interest of policymakers and supervisors to scale up the provision of appropriate and responsible insurance products amongst MSMEs.

MSME insurance is a subject that is relatively new to policy research. There is limited literature that examines the topic in depth, particularly from a regulatory and supervisory angle. The goal of the call and of this report is to explore existing knowledge, and provide a point of reference for future policy discussions on MSME insurance. On this consultation call, Alice Merry of the International Labour Organization's Impact Insurance Facility, and the financial systems policy consultants Martina Wiedmaier-Pfister and Andrea Camargo, explored the topic in more depth. In addition, Seth Eshun of the National Insurance Commission (NIC) of Ghana gave a country-level perspective on the NIC's experience with MSMEs.

This report will first explore what MSMEs are, and why they are important. It will then go over which risks MSMEs typically face, how they manage their risks, and what their insurance needs are. The report will attempt to set out some features that an effective MSME insurance product should have, and will draw some conclusions for supervisors on their role in supporting and supervising the MSME insurance market.

MSMEs: definition and importance

Definition

The Alliance for Financial Inclusion (AFI), a global network of policymakers in the financial sector, researched definitions of MSME from 28 jurisdictions. It found that 60% of the countries in its study have legal definitions of MSMEs, and most definitions rely on sales turnover and number of employees, or total assets¹. However, even if there is no legal and official definition, in most countries there is a national definition provided by an industry association or a ministry. However they are defined, MSMEs are a broad group with a vast range of activities, levels of sophistication, and sizes.

¹ Source; Alliance for Financial Inclusion (AFI); Survey Report: Defining Micro, Small and Medium Enterprises (MSMEs) in the AFI network, March 2017

If we consider companies purely based on number of employees, a typical definition might be:

Micro enterprises	0-9 employees (incl. one-person businesses/entrepreneurs)
Small enterprises	10 - 50 employees
Medium enterprises	50 - 100 employees

As evident from the above definition, MSMEs reflect a wide array of business types, engaging in many different sectors from trade, to production and services. MSMEs often also extend beyond formal enterprises: there are many more informal businesses than formal ones. For instance, India has 1.6 million registered MSMEs while 26 million MSMEs are unregistered².

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Given the variety of enterprises that fall under the definition of **MSMEs**, this report will focus on the micro and small enterprises, both formal and informal, and refer to them as MSMEs or “small businesses”. This means that the report will intend to capture the widest range of business possible under around 100 employees.

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70-80%

of MSMEs are informal and non-employer firms.

On the smaller end of the scale, MSMEs are individuals and micro-entrepreneurs who do business by themselves. Many of these business are informal and are not registered as legal entities. Other MSMEs are small family businesses, where no contractual agreements exist between employees, and which rely heavily on one or two key persons. Other small businesses are more formal, with a few formal employees, but still operate with low margins and cash buffers, rendering them vulnerable to many threats. In 2007, 60% of employment in developing countries was by own-account and contributing family workers³. According to the International Finance Corporation (IFC), between 70 and 80 % of MSMEs are informal and non-employer firms⁴. On the largest side, medium enterprises are professional businesses with up to 100 employees and significant turnover.

In its report on Insurance for *Micro, Small, and Medium-Sized Enterprises*⁵, the ADB writes: “Recently, regulation has been developed to improve access to insurance for low-income people, but little effort has been made in insurance for MSMEs. This might be because MSME insurance is often seen as just traditional insurance.”

This report will make the case that MSME insurance merits separate attention, that increasing MSME insurance penetration should be part of overall policymaker objectives, and then will go into looking at ways in which this can be done.

² Source: (2010) International Finance Corporation (IFC): MSMEs around the world ([link](#))

³ ILO and WTO, Globalization and informal jobs in developing countries (2009)

⁴ IFC – Access to Credit among MSMEs (August 2013)

⁵ <https://www.adb.org/sites/default/files/publication/298101/insurance-msmes.pdf>

Why are MSMEs important?

MSMEs are an integral part of a healthy economy, accounting for a large part of economic growth and employment. According to the World Bank, formal SMEs contribute up to 60% of total employment and up to 40% of national income (GDP) in emerging economies. The share is even higher when informal SMEs are included. Notably, the International Labour Organization (ILO) emphasizes that 90% of formal jobs are created by SMEs in low-income countries. If we add self-employed people and microenterprises to this consideration, then we can draw the conclusion that well over 90% of employment comes from MSMEs. Consequently, risks that affect MSMEs have significant aggregate knock-on effects on the whole economy.

Aside from their economic impact, MSMEs also have a social dimension. They aggregate large parts of the population as owners, employees and or family-owned micro businesses. MSMEs provide the potential to reach many people with a variety of coverages and, in this way, make insurance markets more inclusive.

Why are MSMEs more vulnerable?

MSMEs are comparatively vulnerable compared to larger enterprises. It can be observed that many small businesses have a short lifespan, likely an effect of their high risk appetite and the lack of skills and entrepreneurial capacity because they have no other choice to earn a living than self-employment. A 5-year-survival rate of 40% is typical for MSMEs in developing countries.

MSMEs, often driven by one person, are vulnerable to the personal risks of their owners and their family members, compounded with the personal risk of their employees (in many cultures, it is customary for the employer to help when something happens in the family of the employee). These risks affect the business, in addition to the various business risks the enterprise faces.

Lack of access to adequate financial services amplifies such vulnerability. Estimates of the credit gap of informal and formal MSMEs in developing countries are that about 36 – 44 % are unserved⁶. In addition, MSMEs suffer from a lack of expertise on how to best use financial services, how insurance works, or what risks are insurable. Research done on the demand-side has shown that MSMEs often tend to seek cover for uninsurable risks, or misunderstand how coverage works.

In addition, small businesses face a higher exposure to threats and disasters. They operate with smaller margins and with fewer funds available to deal with emergencies. It is also very common for them to overlook, minimize or disregard certain critical risks, by settling in disaster-prone areas, or failing to comply with safety standards.

Finally, MSMEs often have a lack of trust in insurance, or a low perceived value of insurance as a risk mitigation instrument. This skepticism is often based a lack of direct experience of insurance due to a lack of adequate products and distribution channels or previous exposure to exploitative products and unfair treatment.

⁶ IFC SME Banking Knowledge Guide (IFC 2010)

Why is resilience important for MSMEs?

On a jurisdictional level, resilience of small businesses is important from an employment, poverty alleviation and insurance market development perspective. On a global scale, these issues have been at the forefront of policymakers' minds, and have been formulated succinctly under the United Nations' Agenda 2030.

Promoting MSME resilience contributes to several of the sustainable development goals (SDGs), and should therefore be embedded in the respective public policies.

Insurance is one instrument that helps small businesses become more resilient, thereby boosting sustainable development. However, insurance is just one piece of the puzzle and resilience of MSMEs can only be achieved through holistic risk management solutions.

1 NO
POVERTY



2 ZERO
HUNGER



Access to insurance to MSMEs help to reduce poverty and hunger

8 DECENT WORK AND
ECONOMIC GROWTH



12 RESPONSIBLE
CONSUMPTION
AND PRODUCTION



Access to insurance to MSMEs help to sustain employment and responsible production

13 CLIMATE
ACTION



Access to insurance to MSMEs insurance help to mitigate the problems created by climate change, and increases resilience

How do MSMEs cope with shocks?

For better or worse, most MSMEs do not have insurance coverage. In the absence of insurance, when a shock happens, MSMEs rely on risk mitigation tools such as depleting savings, additional borrowing or selling assets to bridge the gap. This leads to them investing less in their business, cutting into critical functions of the business, or in the case of family enterprises, even cutting spending on food or schooling.

An illustrative example of this is a study of Thai MSMEs, carried out by FinMarkTrust. In this study, they observed that MSMEs first deplete their savings in response to a risk. In the case of harvest failure, MSMEs also sold their assets. In all these cases MSMEs relied on strategies that have negative repercussions in the longer term, and that cannot easily be repeated should a second shock affect the business or owner.

Such traditional coping mechanisms have limitations, which hamper the future development of the business and household. This could be improved significantly with appropriately designed insurance products that respond to the variety of needs of the MSMEs related to their business operations and for the assets and persons involved.

Types of risks MSME are typically facing

Small businesses are particularly vulnerable to a wide range of risks, which they frequently struggle to manage. These risks range from theft of assets to illness of a key worker, or a natural disaster that can affect the productive activity. Experience has shown that MSMEs often do not have a clear understanding of which risks are insurable, and which are not.

Risks faced by small businesses can be classified into **four major risk classifications** commonly used in enterprise risk management systems and defined by the Casualty Actuarial Society⁷.

- **Hazard risks** are shocks like fire or sickness. Insurance is well placed to cover this category of risks.
- **Financial risks** include risks that businesses manage around their cash flow, prices of goods or inflation. Insurance has some role to play here, particularly in credit-linked insurance, which can help a business to manage cash flow and pay off loans if a disaster strikes. However, the majority of financial risks cannot generally be mitigated by insurance.
- **Operational risks and strategic risks** are **external** threats like competition or market forces, as well as internal risks around poor strategy and planning. MSMEs are very exposed to these, but insurance cannot cover them. Liability insurance may apply for a very small group of more sophisticated enterprises.

Within the categories of hazard risks and financial risks, the International Labour Organization (ILO) lists a more granular taxonomy of risks in its study "Insurance for small businesses"⁸, as set out here:

⁷ <https://www.casact.org/area/erm/overview.pdf>

⁸ Source: (ILO, 2016) Merry: Insurance For Small Businesses (ILO paper No 43) ([link](#))

- Hazard risks: Fire and other property damage; Windstorms and other natural perils; Theft and other crime; Personal injury; Business interruption; Disease and disability; Liability claims.
- Financial risks: Credit.

This gives a clear starting point on considering the domains in which insurance can offer protection.

Characteristics of MSME insurance offerings

Unfortunately, insurance provision to protect small businesses from these risks is still very limited in most developing countries.

Nonetheless, those products that are already available for MSMEs cover quite a wide range of risks. During the ILO study, examples of the following products were identified: fire insurance, multi-risk property insurance, weather insurance, theft insurance, political violence insurance, money insurance, personal accident insurance, business interruption insurance, health insurance, disability insurance, and credit-linked insurance.

The vast majority of providers interviewed during the study said that a product covering multiple risks was far more attractive to small businesses than single covers. Coverage need not be comprehensive (as this makes the product unaffordable), but rather should provide limited cover across several types of risks. This can be attractive and useful to small businesses owners, who usually prefer limited protection across a range of risks that they can easily imagine occurring, than a high cover on a single risk that may never occur.

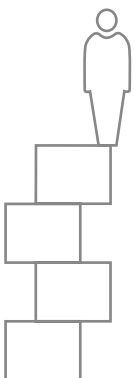
Few insurers can afford sales forces with the time and expertise to explain complex products and options to small businesses owners, who may in turn easily be put off by complexity and too many options. Consequently, the ILO's Impact Insurance Facility argues in its report that customization of benefit packages should be limited. For most insurers, it is more efficient to adapt products to suit a distribution channel or large segments of clients, rather than individual customization and options at the client level.

Segmentation based on business size is the approach taken by Pacifico, for example. The Peruvian insurer offers a more comprehensive package of covers to a segment of its largest small business clients and fewer covers to smaller businesses. For now, this is a viable level of customization for Pacifico to offer to this market; however more extensive adaptation for specific market segments might always be introduced at a later stage.

Some further considerations on demand features and product design challenges:

- It is particularly relevant to include some simple health benefits, as health is a very significant and important risk for small business owners. This may include for instance group insurance for their employees, with accident and hospitalisation insurance.
- MSME insurance culture is often not very high. However, segments with greater education, income, experience with other financial services and with aspirations for their business represent an underserved market and may be more willing to embrace insurance if offered to them.
- A very large part of microinsurance products is made up of credit life products, many of which are issued to informal microenterprises when taking microloans. This insurance is the first experience with insurance products for many MSMEs. However, very often the MFI as a distribution channel does not offer them any other type of insurance products, and the potential to grow MSME insurance through this channel is generally not realized.
- It may be difficult to sell to entrepreneurs with little resources and experience with formal financial services, or who started small businesses due to a lack of other options. Here, insurance may work when it is embedded into another good or service, such as a loan or the purchase of stock or a machine.
- The Microinsurance Centre set out the SUAVE criteria – which means “Simple, Understood, Accessible, Valuable and Efficient”. The SUAVE criteria have been formally required of microinsurance products in some jurisdictions by their regulatory frameworks⁹. This is also a useful set of criteria for features of MSME products.
- Maintaining high product quality is essential, as low quality products undermine confidence in insurance as a risk-mitigation tool. Lack of trust in insurance is already a prominent hurdle in delivering on the social value of insurance.

⁹ Proportionate Regulatory Frameworks in Inclusive Insurance Regulation: Lessons from a decade of Microinsurance Regulation (A2ii, 2017)



Considerations for supervisors

1 Including MSMEs as beneficiaries of inclusive insurance frameworks

Inclusive insurance regulations (including microinsurance or mass insurance regulations) are often conceptually designed around individual consumers, not MSMEs. The IAIS definition of inclusive insurance is sufficiently comprehensive to incorporate MSME insurance. The “IAIS Issues Paper Conduct of Business in Inclusive Insurance (2015)” states that “inclusive insurance is used in this paper in the broad sense of the word, denoting all insurance products aimed at the excluded or underserved market, rather than just those aimed at the poor or a narrow conception of the low-income market. In developing countries, the majority of the population is often classified as un- or underserved. Thus inclusive insurance is a mainstream topic of relevance to the development of the retail insurance market as a whole”¹⁰.

As many small MSMEs share similar vulnerabilities to inclusive insurance customers, it is worth evaluating at country level whether a jurisdiction’s approach to inclusive insurance sufficiently includes MSMEs.

In that respect, the Microinsurance Resolution of 2009 in Peru did not recognise specifically MSMEs as the target market of the microinsurance regulations, but in the recently issued Microinsurance Regulation of 2016, MSMEs are specifically recognised as beneficiaries of microinsurance products.

2 Ensuring that insurers have the incentives to innovate in the design and distribution of MSME products

The insurance regulatory framework should allow specific distribution channels and transactional platforms that are trusted and accessible by MSMEs (e.g. input suppliers, financial institutions, agent networks), and allow for insurers to innovate in their business model to extend coverage to MSMEs. Areas for innovation can often be found by considering the wider MSME value chain, and identifying places where they are exposed to more risks, or where many MSMEs are aggregated in some collective services, which can be leveraged as distribution channels.

3 Adapting consumer protection frameworks to protect MSMEs effectively

Inclusive insurance products are often subject to a higher requirements of consumer protection on the assumption that the inclusive insurance consumer is more vulnerable. MSME owners and their employees lack insurance experience and education, and have vulnerabilities similar to the inclusive insurance consumers. They therefore need a similar level of protection.

To provide this, similar consumer protection strategies to those used in other areas of inclusive insurance should be considered:

- Ensuring that MSMEs are beneficiaries of inclusive insurance regulations
- Ensuring complaints mechanisms are effective and accessible
- Ensuring products are designed in a way that will reliably deliver value
- Setting timeframes for claims settlements
- Providing insurance education measures for MSMEs as public good
- Monitoring client value, product performance data and enforcing quality criteria

Conclusions

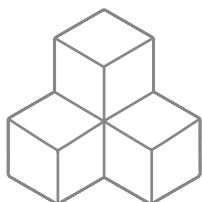
As mentioned in the introduction to this call report, the policy discussions on MSME insurance are still at an early stage, with limited research conducted. As such, we will here set out the conclusions of this call as a contribution to future discussions.

Empowering MSMEs to cover their insurable risks contributes to a healthier MSME sector, which has a large aggregate positive impact on the economy as a whole, and impacts the social protection of a huge segment of society. The sheer number of MSMEs and people involved in them makes them a significant element in inclusive insurance market development.

The regulatory framework influences the provision and uptake of insurance in a number of ways:

- MSME protection can be part of the national inclusive insurance framework and definition, which allows the incorporation of elements of the regulatory framework specific to the needs of MSMEs.
- MSMEs should benefit from strong consumer protection. They often do not have the experience or capacity to fully understand their risks or the technicalities of insurance policies.
- MSMEs need broad, affordable and streamlined products. Insurers need to have the ability to provide such products in innovative ways.
- Leveraging the right distribution channels can reduce the cost of sales, allowing for the provision of more affordable products at scale. Allowing innovation in distribution can stimulate this, and new opportunities can often be found in the wider value chains in which MSMEs work
- Regulatory requirements on enterprises should be proportionate to the nature, scale and complexity of the business.

Finally, explicit industry encouragement related to insurance offerings for MSMEs on behalf of the supervisory authority can be an important incentive for insurers to take the first steps in covering MSMEs' needs.



Case Study: Ghana

The Ghanaian case study was presented by Seth Eshun of the National Insurance Commission (NIC) of Ghana. MSME insurance and regulation in Ghana is an area that has been least explored compared to other sectors, such as mobile insurance.

MSMEs provide for large parts of employment. In Ghana, the definition of MSMEs refers to the number of employees and fixed assets that a firm has. MSMEs make up over 90% of businesses in Ghana. They contribute significantly towards the country's GDP (an estimated 70%) and provide employment to more than 60% of the labor force with a majority in the rural areas.

There are various challenges that MSMEs face in Ghana. These include:

- Access to finance – Irregular cash flows affect their ability to receive or pay back bank loans and also ability to pay premiums.
- Access to markets – MSMEs narrow down their target market to the local community or in some cases, they do not have access to the wider market.
- Access to technology – There is a lack of technology take-up by most MSMEs.
- Infrastructural bottlenecks – These include infrastructural challenges such as limited power supply and poor road infrastructure that affects not only MSMEs but all markets in Ghana

To address these, insurance can solve these challenges in a number of ways:

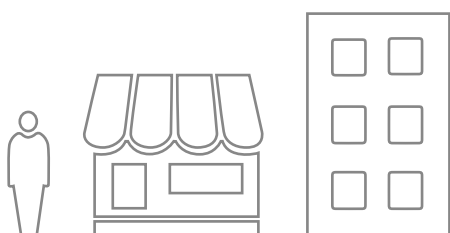
- Insurance reduces risks by smoothening consumption, managing risks associated with uneven and irregular income that characterizes micro and small and some medium scale enterprises. If sufficiently insured, insurance also mitigates the impact of unforeseen eventualities by serving as “shock absorbers” for businesses.
- Insurance helps break the cycle of poverty and gives some level of peace of mind to the micro-insured.
- Insurance can specifically target the needs of MSMEs by providing tailor-made products.
- Insurance companies and microinsurance companies can educate the MSMEs on efficient use of current technology to enhance their business operations and on the sections of the market they can target through various target market practices.

MSME insurance are not a target market currently. There are specific insurance products, like fire policy, consequential loss policy, employer's liability policy, burglary insurance policy, and fidelity guarantee policy, that exist in the market in Ghana. However, these are designed for traditional companies i.e. big companies which have regular cash flows and are therefore able to pay premiums regularly. MSMEs are neither targeted by insurance companies nor are they able to buy these insurance products due to irregular cash flows. In addition, in considering insurance policyholder protection, regulators only think about individuals as opposed to entities.

No regulatory dispensation for MSME insurance. In terms of regulation of insurance sold to MSMEs in Ghana, there are no specific regulations for MSMEs. Hence, there is a need to kick start specific focus on MSMEs regulation. In addition, most firms in Ghana are MSMEs so products sold by insurers to corporate firms are primarily to MSMEs. There are questions around whether additional products should be designed specifically to meet the needs of MSMEs and what can regulators do to facilitate this market.

Overall, the main potential regulatory concerns that remain are;

- Lack of data – Lack of mechanism for collecting credible and reliable data (both quantitative and qualitative data). This makes it difficult to design products that are specific to MSMEs.
- Premium payment patterns which are not suited to MSMEs – Premium payment patterns may not be adjusted to the economic cycle of MSMEs especially when it is contrary to regulatory requirement on the maintenance of validity of coverage.



Questions from the participants

> **In which ways are the jurisdictions on the consultation call considering MSMEs?**

In Namibia, the coverage of MSMEs is limited due to existing laws. However, laws are currently being redrafted both in the insurance and financial sectors to include new provisions that will allow insurance coverage to reach MSMEs.

In Uganda, insurers are keen to get into the MSMEs market but the risks are high given their premium expectations. Microinsurance regulations in Uganda are currently under discussion. Most MSMEs there find insurance expensive and not tailored to their needs

> **The handling of complaints in Ghana is tailored to individuals. Is there any country or jurisdiction that has tailored its handling of complaints to meet MSMEs needs and how did they go about it?**

There seemed to be no knowledge from the call participants on specific complaints mechanisms tailored for MSMEs.

> **It was mentioned that in some countries the claims process can take extremely long. What can be done to avoid this?**

A long and tedious claims process is prohibitive for MSMEs insurance. It should be analysed in a flow chart and not take many different steps or very long periods involving the customer and insurance provider to respond to submissions of documents. This makes it prohibitive for any retail insurance market or inclusive insurance market.

> **Apart from Pacifico in Peru, are there any other best practice examples from countries or insurance providers when it comes to MSME insurance?**

An example of a successful model would be the Kalanjiam Development Financial Services (KDFS) in India, which is a financial institution/distribution channel whose product is underwritten by an Indian insurance company. The KDFS has unique individual-tailored models for their clients who are micro-business owners.

In most African countries, micro-insurers have a lot of multi-risk products, many of them offered through financial institutions.

In the Philippines, insurers are more advanced in serving small businesses. They have many multi-risk products offered through financial institutions and one example in the ILO study is offered through supermarkets.

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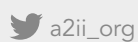


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