

Regulatory approaches to inclusive insurance market development

Cross- country synthesis paper 2

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About the project

The Access to Insurance Initiative (A2ii) is the implementation arm of the International Association of Insurance Supervisors (IAIS) on inclusive insurance. Part of this role is to extract relevant learning and build supervisory capacity.

It has been five years since the findings from the original five access to insurance diagnostics were synthesised into a cross-country report and a series of focus notes¹. In the interim a number of further microinsurance diagnostics have been completed under the A2ii umbrella, and several other studies² have become available that can inform a cross-country stock-take of trends and insights in microinsurance.

To update the cross-country synthesis picture the A2ii, with co-funding from FinMark Trust, has commissioned two new synthesis papers to extract key overarching themes across jurisdictions. The aim is to enable insurance supervisors³ to better understand the workings of their low-income insurance markets, as well as to provide guidelines on potential regulatory and supervisory implications and responses.

This first paper identifies evolving microinsurance business models, the risks they give rise to and the consequent regulatory implications, whilst the second paper identifies the different approaches taken by regulators to catalyse microinsurance markets and the factors or determinants leading to a particular approach.

Interplay between the papers. Paper 1 discusses potential regulatory implications and responses for supervisors arising from the evolution of specific business models within their markets. Which specific responses are deemed most appropriate within each market circumstance is determined by a range of broader constraints and considerations, foremost amongst which will be the overall regulatory approach adopted by the insurance supervisor – the topic of paper 2. However, this is not a one way relationship as the choice of which regulatory approach will be optimal to adopt rests, at least in part, on the existing market environment and risks. Hence there is a two-way causal relationship between the market environment and regulatory responses to it, on the one hand, and the overall regulatory approach adopted on the other hand.

Methodology and scope

The two synthesis papers are based on an analysis of all A2ii diagnostics and several other studies. In total, 25 different jurisdictions were considered (see Table 1)⁴. Eight of the countries considered have already incorporated some form of microinsurance-specific

¹All five of these case studies as well as the synthesis paper can be accessed at: www.access-to-insurance.org

²E.g. the “mini-diagnostic” in Ghana, the CIMA diagnostic and the Pakistan diagnostic, as well as several cross-country insights as captured in the second volume of the Microinsurance Compendium

³Insurance Supervision refers to both regulation and supervision. Supervisors include regulators. (Insurance supervision within an individual jurisdiction may be the responsibility of more than one authority. For example, the body that sets out the legal framework for insurance supervision may be different from the body that implements it (IAIS, 2012).

⁴Note that the four SADC (Southern African Development Community) countries which fall in this category (Botswana, Namibia, Malawi and Zimbabwe) were analysed as part of a wider study on the entire SADC region. A diagnostic was underway in Peru at the time of writing. There has also been work done on Mexico’s microinsurance sector, albeit no comprehensive overview diagnostic or study. There has also been work done on Mexico’s microinsurance sector, albeit no comprehensive overview diagnostic or study.

regulation⁵. These do not all constitute comprehensive microinsurance frameworks. A further eight of the countries have proposed some form of microinsurance-specific regulation (indicated with a * in the table below):

Country	MI Diagnostic/ country study	Year published	MI-specific regulations	Country	MI Diagnostic/ country study	Year published	MI-specific regulations
China	✓	2014	✓	Nigeria	✓	2012	
India	✓	2008	✓	Uganda	✓	2008 & forthcoming	
Mongolia	✓	2011		Lesotho	✓	2012	
Nepal	✓	2012		Mozambique	✓	forthcoming	✓
Pakistan	✓	2012	✓	* South Africa	✓	2008	✓ *
Philippines	✓	2008	✓	Swaziland	✓	2012	✓ *
Brazil	✓	2010	✓	Tanzania	✓	2012	✓ *
Colombia	✓	2008		Zambia	✓	2009	✓ *
Mexico		-	✓	Botswana		-	✓ *
Peru	✓	forthcoming	✓	Namibia		-	✓ *
Ethiopia	✓	2010		Malawi		-	
Ghana	✓	2009	✓	Zimbabwe		-	✓ *
Kenya	✓	2010					*Proposed

Table 1: List of countries considered as information sources

Note that all of the information considered is current as at the date that the studies used as input documents were published. It is beyond the scope of this analysis to update the latest developments in all the countries considered. In particularly important areas and specific cases, available updated information was used.

⁵ Regulations are classified as a 'secondary form of regulation' which have the legal force of law but are usually the responsibility of the supervisor (IAIS, 2012).

1. Introduction

This paper considers the various regulatory approaches implemented by insurance regulators and supervisors globally in order to achieve the objective of inclusive insurance market development. The primary question that this paper seeks to address is: *what is the optimal regulatory approach to be followed by a particular country to promote increased access to insurance in a particular product market or across multiple product markets?*

From the experience of the countries scrutinised as part of this synthesis process, five distinctive regulatory approaches to the promotion of access to insurance have been identified. These five regulatory approaches can be located on a continuum according to the level of state intervention in or direction of the market. Each of the approaches are defined and described in detail in Section 2.2. They are:

- **Public provision approach:** the state identifies the risk to be covered and either acts as risk carrier itself or directly and/or indirectly subsidises insurance to the population, often to achieve a public policy objective ancillary to the insurance sector, such as health or rural development.
- **Directive approach:** the state requires insurers to meet certain targets in terms of access to insurance. Regulatory tools are therefore used to leverage the market mechanism.
- **Concessionary approach:** this approach relies on creating market incentives rather than direct state intervention to achieve the desired objective of access to insurance. It does so by creating proportionate regulatory concessions to encourage provision of access-friendly products as defined in the local context.
- **Nudge approach:** the state creates an enabling environment for access to insurance and may lower the compliance burden for all insurers across the board to promote access, but there are no direct state intervention and no explicit concessions or regulatory framework for inclusive insurance.
- **Long-term market development approach:** this approach entails no direct state direction of the market, with the focus instead being on building market and state infrastructure and capacity over time, before access to insurance can be pursued as an explicit objective.

Note that the approaches are not necessarily mutually exclusive. Some may operate in combination for different product markets in the same country. The synthesis exercise furthermore revealed that not all regulatory approaches can be applied in all market circumstances. Particular approaches are more appropriate when certain market conditions apply, and inappropriate when those conditions are not present. The paper therefore sets out to identify the most important triggers, referred to as conditioning factors, that determine whether a regulatory approach is appropriate or not. Identifying these conditioning factors is intended to assist financial sector policymakers, regulators and supervisors to decide which regulatory approach is best suited to their circumstances.

The document is structured as follows:

- Section 2 defines what constitutes a regulatory approach, introduces and explains the observed regulatory approaches, including specific implementation considerations for each approach.
- Section 3 analyses the conditioning factors that have steered jurisdictions towards adopting specific regulatory approaches for particular product markets or across markets.
- Section 4 concludes to summarise the findings from this paper and position it within the overall synthesis project.

2. Regulatory approaches

This section considers the various regulatory approaches to the promotion of access to insurance, internationally, how they are defined and how they impact market development.

2.1. Defining a regulatory approach

Governments set out to achieve particular public policy objectives. Making laws and regulations (collectively referred to as regulation) and enforcing compliance with these through supervision are important tools at the disposal of a government to achieve its objectives. In addition to its regulatory function, the state in some instances pursues its objectives through fiscal tools or direct intervention, for example through provision by state-owned financial institutions, through subsidy programmes, by entering into public private partnerships, or by leveraging state infrastructure for distribution of financial services. There are different fiscal, regulatory and supervisory tools and different ways to deploy them. Some work under certain conditions and others under other conditions. Deciding which regulatory tools to deploy depends on the objectives to be achieved as well as the prevailing circumstances.

The fundamental objective of the state is to maximise the welfare of its citizens. Increasing access to insurance can increase welfare by mitigating the financial impact of risks faced by households. Thus, increasing access to insurance may be a policy objective in itself. Alternatively, it can be employed as a policy instrument that contributes to the achievement of broader social goals. For example, a government may set out to increase access to health insurance as an instrument to increase the general health of the population or may build access to agricultural insurance as part of a rural development programme or to achieve broader food security objectives.

Irrespective of whether promoting access to insurance is the primary policy objective or an instrument to achieve broader social objectives, country evidence reveals a standard set of regulatory approaches that can be deployed to promote access to insurance. These approaches differ primarily according to the extent of state intervention versus market orientation in the insurance market. The level of state intervention in or direction of the market, as opposed to allowing the market to develop of its own accord, is thus proposed as the key aspect to differentiate between discrete regulatory approaches to the promotion of access to insurance. Note that state intervention includes not only direct assistance, subsidy for the provision of insurance, or mandatory insurance stipulations, but also includes the

state creating, through regulatory and fiscal measures, specific incentives to private insurance providers to expand their provision of services into low-income market segments.

Based on the foregoing and for the purposes of this paper, a regulatory approach is defined as: **a specific combination of fiscal, regulatory and supervisory tools designed to achieve a series of policy goals via a specific level of state intervention within a defined product market or across a number of product markets to facilitate access to insurance.**

Figure 1 below illustrates how any regulatory approach is the result of a number of policy objectives and conditioning factors, and is implemented through a portfolio of fiscal, regulatory and supervisory tools:

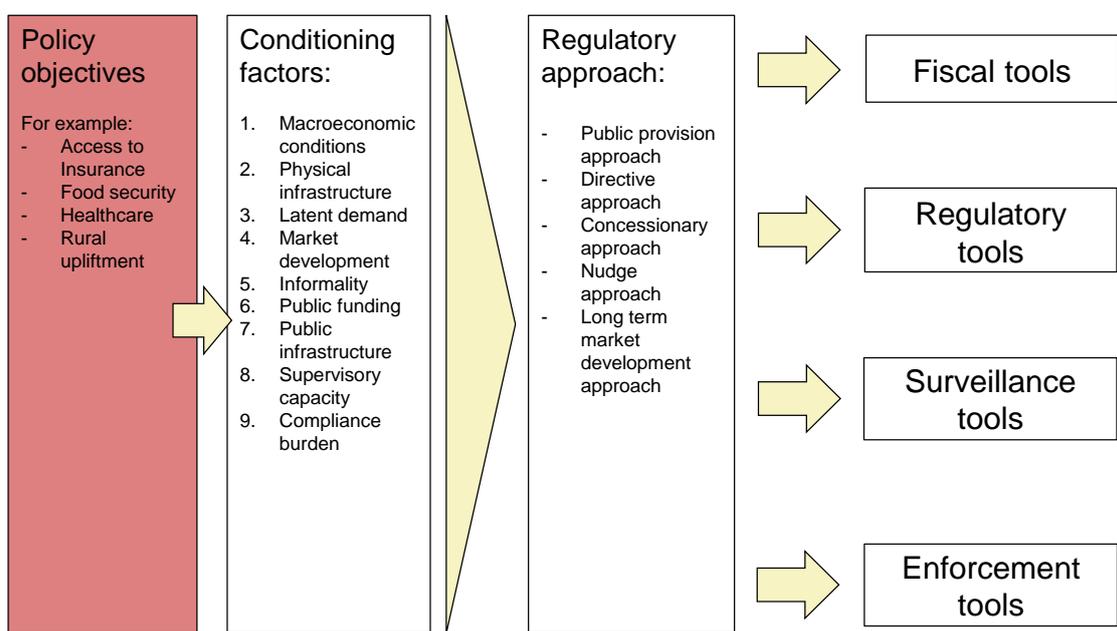


Figure 1: What constitutes a regulatory approach?

Source: Authors' own

Below, each element of the diagram is explained.

2.1.1. Policy objectives

The specific policy objectives adopted in a particular country are a key driver in defining the regulatory approach as they determine the extent and nature of the regulator's mandate.

2.1.2. Conditioning factors

To realise policy objectives through insurance will require the matching of products and clients through various models of distribution, entering into insurance contracts, and paying premiums and claims. The extent to which these actions can be performed in a particular country and market will depend on a number of factors. These factors determine or condition the feasibility of following a particular approach. For example, if a country lacks rural health facilities, implementing comprehensive national health insurance will be

counter-productive in rural areas. Or, if a country lacks sound life insurers, requiring insurers to sell a specific proportion of new policies to low-income households is likely to weaken rather than strengthen the overall life insurance market. Through the synthesis exercise, the following conditioning factors were identified, each of which is discussed further in Section 3:

- *Context factors:*
 - Macroeconomic conditions
 - Physical infrastructure
- *Latent demand*
- *Supply-side factors:*
 - Level of market development
 - Extent of informality
- *Public sector and regulatory framework factors:*
 - Availability of public funding
 - Public infrastructure
 - Supervisory capacity
 - Compliance burden

The choice of most appropriate regulatory approach for a particular market or across markets depends on the interplay between various conditioning factors. For example: a country that is very prone to natural disasters may wish to improve the risk protection for rural households against natural disasters. To do so, it may decide that earthquake or flood insurance should be promoted. Yet market research may show that there is no established demand for insurance amongst farmers. A purely market-based approach is therefore unlikely to succeed. However, if the state has sufficient fiscal capacity, it has the option of subsidising insurance provision to farmers.

2.1.3. Tools to implement a regulatory approach

The right-hand column of Figure 1 indicates the basket of tools through which the regulatory approach is implemented. A distinction is made between fiscal tools, regulatory tools, surveillance tools and enforcement tools.

Fiscal tools

Fiscal tools are utilised either to directly extend access to specific insurance products, or to incentivise market players to extend access to insurance⁶. The fiscal tools that can be deployed as part of a regulatory approach to stimulate access to insurance include both expenditure and revenue measures:

⁶ 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 generally not, unless incentivised or forced, simply jump over the next most profitable market to serve the poorest of the poor. The access frontier is the dividing line between those that currently use financial services and the next most likely market segment to be reached and served by the financial sector (Cenfri, forthcoming).

- *Expenditure measures*: Fiscal instruments can involve active spending by government to stimulate access to insurance. The commonest such tool would be subsidies. Subsidies can be both full, in which no premium contribution is required from the insured individual who is therefore typically automatically enrolled into the insurance scheme, or partial, where the insured is required to contribute a proportion of the premium. States can either subsidise the premium by paying the insurer on behalf of the insured individual, or can indirectly subsidise provision by performing certain insurance value chain services that would normally be covered by commercial insurers. These could include distribution or administration roles such as premium collection⁷, distribution through state entities⁸, conducting of risk assessments⁹, or even providing the underwriting vehicle¹⁰.
- *Revenue measures*: Revenue-based fiscal tools include tax concessions for insurers supplying the low-income market, particularly on indirect taxes such as VAT on premiums, but potentially also on direct taxes such as income tax for insurers. It can also entail reduced supervisory fees and levies for certain types or insurers or activities. The application of such fiscal tools can be differentiated across discrete markets. For example: life premiums may be exempted from VAT, whilst non-life premiums are not.

Regulatory tools¹¹

Regulatory tools include the full spectrum of legally binding rules - legislation, regulations, supervisory directives, etc. - which can be used by the state to structure its own participation in the insurance market and to set the framework within which market players are allowed to operate. These regulatory tools can be broadly categorised into: (i) preconditions for entry into the market; and (ii) on-going conditions for continued market participation. Below we briefly discuss those regulatory tools that can find particular application when seeking to promote access to insurance¹².

1. **Preconditions for entry** include three main regulatory tools: licensing, ownership restrictions and capital requirements. Of these, the first and the last have been used to promote access to insurance:
 - *Licensing* is the most basic form of entry restriction. A license gives the given entity permission to provide insurance products to clients. In order to receive an insurance license, the supervisor sets certain conditions that the entity must meet. Permitting entities that are cooperatives or mutuals to obtain an insurance operating license, for example, can be seen as promoting access to insurance.
 - *Capital requirements* include both minimum size requirements (aimed at ensuring that insurers have sufficient capital to support their contractual obligations to policyholders) and variable capital adequacy requirements (intended to absorb

⁷ For example in China the government assists commercial insurers with the provision of insurance to low-income rural households by collecting premiums through village committees.

⁸ For example: agricultural insurance in Brazil is distributed through a state-owned bank.

⁹ The state frequently assists in the provision of agricultural insurance by providing risk assessments for commercial insurers, such as in the form of indexation.

¹⁰ Examples of this include social health insurance in countries that do not procure the services of a commercial underwriter and third party vehicle insurance in South Africa, where 'premiums' are collected in the form of levies on fuel.

¹¹ The remainder of this section relies on Carmichael & Pomerleau (2002) for the theoretical underpinning and classifications of the discrete tools discussed.

¹² It is important to remain cognisant that each safeguard has a cost implication which the customer ultimately has to bear.

unexpected losses incurred by insurers). Both instances may be used as tools to promote access to insurance. For example: entry barriers may be set proportionately for insurers limited to providing certain defined microinsurance products and variable requirements may be scaled to the nature, scale and complexity of the risk.

2. **On-going conditions for continued participation** in the industry encompass a number of regulatory tools relevant for access to insurance, including¹³:

- *Market conduct rules* aim to ensure that markets are sound, orderly and transparent, that users of financial markets are treated fairly, and that markets are free from misleading, manipulative or abusive conduct. Market conduct regulation includes the regulation of the distribution and servicing of insurance products. It has been used in a number of instances to promote access to insurance, including: creating a microinsurance-specific category of intermediaries that can include entities such as MFIs, NGOs, retailers, mobile network vendors or other “client aggregators” outside of the traditional broker or agent space; reduced qualification and licensing requirements for intermediaries selling certain types of insurance; broadening of the range of functions that intermediaries may fulfil (for example including back-office administration functions and claims payment); or tailored commission structures to incentivise agents’ sales.

Market conduct rules in the inclusive insurance space may also relate to specific consumer protection safeguards, such as: placing conditions on the sale of compulsory credit insurance (for example, that the consumer must have a choice of insurance provider); imposing maximum periods for claims processing or requirements for what would be acceptable claims documentation; or stipulations regarding the contractual relationship between insurers, end-clients and third party administrators/client aggregators in the case of group underwriting. The latter can include requirements that a third party may not move the book without permission of a certain percentage of individuals, or that an individual certificate must be issued to each individual member stating for example the name of the insurer, the cover and premium obligations.

- *Disclosure requirements*: Though it forms part of market conduct regulation, regulation regarding disclosure of information warrants separate attention, as it is vital for the protection of consumers. Due to the crucial role information plays in insurance markets, inadequate or inappropriate disclosure creates the potential for market abuse. The role of information extends beyond market abuse. When parties to a transaction have inadequate information on which to base their decisions, there may be a loss of efficiency to the extent that the parties price the cost of uncertainty into their transactions. However, excessive or complex information can be counterproductive as it confuses customers and therefore reduces transparency¹⁴.

Disclosure requirements are used in a number of instances to promote access to insurance, including: the requirement that disclosure be in the vernacular, simplified

¹³ Competition regulation tools may also theoretically be used to address anti-competitive practices creating barriers to increasing access to insurance. However, as yet, there is no evidence of such tools being used to foster access to insurance.

¹⁴ Excessive provision of public information through disclosures from governments or market participants could crowd out potentially more precise private information, thereby reducing information efficiency, especially when such information is confusing.

disclosure requirements (for example stipulating that disclosure details during the transaction may be abridged, provided that full details are provided after the sale in the written policy or using any appropriate electronic medium, and that the abridged disclosure gives the prospective policyholder a clear appreciation of his or her financial commitments), requirements for simplified policy documents with minimum levels of summary information clearly disclosed, or stating in what way information should be explained to customers or what level of advice should be provided. Disclosure requirements can also be tailored to allow for electronic or telephonic communication, but with certain consumer protection safeguards in place, for example requiring that telephonic conversations be recorded.

- *Governance and fiduciary duties:* Governance provisions regulate the internal structures, controls, and procedures of financial institutions in an effort to ensure prudence, underpin trust, minimise conflicts of interest, and avoid consumer exploitation. Regulation and supervision supporting inclusive insurance markets may for example place minimum governance requirements¹⁵ on new institutional forms (such as mutual or cooperatives) allowed to underwrite microinsurance. Governance requirements are also particularly relevant where a country attempts to formalise entities that previously provided insurance on an informal basis.
- *Liquidity requirements* are designed to ensure that a regulated institution has the funds available to meet any undertakings it has made concerning the liquidity of its contractual obligations to consumers. Investment requirements included as part of a regulatory approach to facilitate access to insurance could include duration and asset-liability matching requirements (for example: where a concessionary regime defines microinsurance products to have a certain maximum term, liquid assets would be required to match the short-term contract obligations).

Surveillance tools

As well as establishing the rules for market operation through regulatory tools, regulators need to monitor the industry's compliance with these rules. There are three basic methods for monitoring compliance, namely consumer complaints mechanisms, off-site and on-site monitoring:

- *Complaints mechanisms.* Supervisors rely on complaints by consumers to identify regulatory breaches. Monitoring complaints is the least intrusive and least costly approach to surveillance. An ombudsman is the traditional recourse mechanism for insurance industry disputes. However, given limited funding and capacity in many lesser developed insurance markets, an insurance ombudsman may not (yet) be in place. Moreover, low-income clients may lack the skills and resources to submit a complaint to a distant ombudsman. In such cases the supervisor must receive and handle complaints directly, placing additional strain on already limited capacity. In response, some countries¹⁶ have expressly required insurers to establish a consumer complaints function. This can be much more suitable for low income clients since they should be able to access a complaints mechanism in the same place they bought the policy. Linked to the complaints mechanism, some supervisors have also introduced a set of minimum

¹⁵ This is for example the proposal in South Africa.

¹⁶ For example Pakistan, Brazil and Kenya.

requirements that insurers must adhere to for the resolution of complaints, also referred to as alternative dispute resolution requirements¹⁷.

- *Off-site monitoring* involves reporting requirements imposed on regulated institutions and the statistical and other reviews of such data by the supervisory authority. The general objective of off-site analysis is to detect deterioration in an institution's financial position by comparing its current position to its historical experience and to that of other insurers. In the inclusive insurance sphere it can also involve other objectives, such as monitoring client value through tracking claims ratios or commission levels and analysing data about customer complaints. In some instances, industry commits to targeting certain benchmark ratios¹⁸.

To be able to undertake the monitoring of the impact of access regulations, specific product categories can be defined as being targeted by the regulator for access purposes. A number of jurisdictions have developed or are in the process of deliberating such definitions.

Another relevant aspect in the inclusive insurance space is leveraging of regulated institutions to monitor activities or entities on behalf of the supervisor. For example: insurers may be made accountable to keep a register of their intermediaries and provide data in this regard to the supervisor on request¹⁹.

- *On-site inspections* entail a team of inspectors – either supervisory staff or outsourced professionals – physically visiting the insurer's premises to review areas of regulatory compliance. On-site inspection enables the supervisor to obtain information and detect problems that cannot be obtained or detected through off-site monitoring. However, it is a time and resource-intensive mechanism. It can be particularly difficult or expensive in the access environment, where there may be a number of smaller entities that capacity-constrained supervisors simply cannot all monitor. A number of supervisors are engaging with the topic of supervisory systems and processes as part of the inclusive insurance regulation and supervision challenge, considering a risk-based approach whereby high risk entities are targeted for on-site inspections²⁰.

Enforcement tools

Enforcement tools are the techniques available to regulators to resolve problems with regulated institutions. The IAIS Insurance Core Principles of 2011 state that, at a minimum, the supervisor should have the power to issue restrictions on business activities²¹, directions to reinforce financial position²² and other directions²³. Enforcement tools used in the inclusive insurance sphere include:

¹⁷ For example, the Philippines has developed an alternative dispute resolution mechanism (ADReM), implemented as part of the microinsurance regime.

¹⁸ For example the Philippines.

¹⁹ This is for example the case in Colombia.

²⁰ This approach is for example applied in the cooperative space in Thailand.

²¹ Such as prohibiting the insurer from issuing new policies, withholding approval for new business activities or acquisitions, restricting the transfer of assets, restricting the ownership of subsidiaries and restricting activities of a subsidiary where, in its opinion, such activities jeopardise the financial situation of the insurer.

²² Including requiring measures that reduce or mitigate risks, requiring an increase in capital, restricting or suspending dividend or other payments to shareholders and restricting purchase of the insurer's own shares.

²³ Such as arranging for the transfer of obligations under the policies from a failing insurer to another insurer that accepts this transfer, suspending or revoking the licence of an insurer and barring individuals acting in responsible capacities from such roles in future.

- *The threat of prosecution* is the main enforcement tool used by most regulators. The actions can include a restriction on business activities or the withdrawal of the insurer's operating license. The threat of prosecution has been used to promote access to insurance in at least two instances: by placing penalties on insurers not meeting access targets, and by imposing fines when microinsurance claims are not paid within a specific period. The latter is an example of the threat of prosecution being targeted at certain areas deemed critical for new markets to develop.
- *Pre-emptive problem resolution* entails the regulator picking up and rectifying regulatory breaches before the insurer becomes unable to honour its promises. This process is complicated by infrequency and inaccuracy of data reported. The most demanding level of problem resolution is where the regulator takes control of the troubled institution by installing an administrator or by forcing winding up operations. This may be particularly relevant where non-traditional or previously informal entities come on board as part of a regime to encourage access to insurance.
- *Graduated enforcement*. Recognising capacity constraints in formerly informal entities, part of the regulatory approach to promote access to insurance may be to allow graduation of compliance over time for newly formalised entities²⁴. This could for example entail first enforcing nominal registration, after which other elements of compliance are phased in. Such graduated enforcement can be accompanied by support programmes to build capacity²⁵.

2.2. Overview of regulatory approaches

The discussion in Section 2.1 shows how regulation and supervision can employ fiscal, regulatory, surveillance and enforcement tools to support inclusive insurance markets. Some of these tools are common across the five regulatory approaches identified in this paper. For example: all approaches may implement measures related to consumer protection in the low-income space (including requirements for consumer redress, the conduct of intermediaries and the information disclosed to customers). It is also common across several approaches to require that microinsurance policies are written in simple language and in the client's vernacular.

Some tools, however, are distinct to or more prominent in certain approaches. The analysis below will focus on the more distinctive tools in order to distinguish different approaches.

In Figure 2 below, the five identified regulatory approaches are depicted along a continuum based on the extent of state intervention in or direction of the insurance market. Moving left along the continuum entails increasing degrees of state intervention in the insurance market, while the three approaches on the right-hand side are market-based approaches:

²⁴ This has been applied in the Philippines and is proposed in South Africa.

²⁵ As was witnessed in the Philippines through the role of RIMANSI for mutual benefit associations, and as is proposed in South Africa.

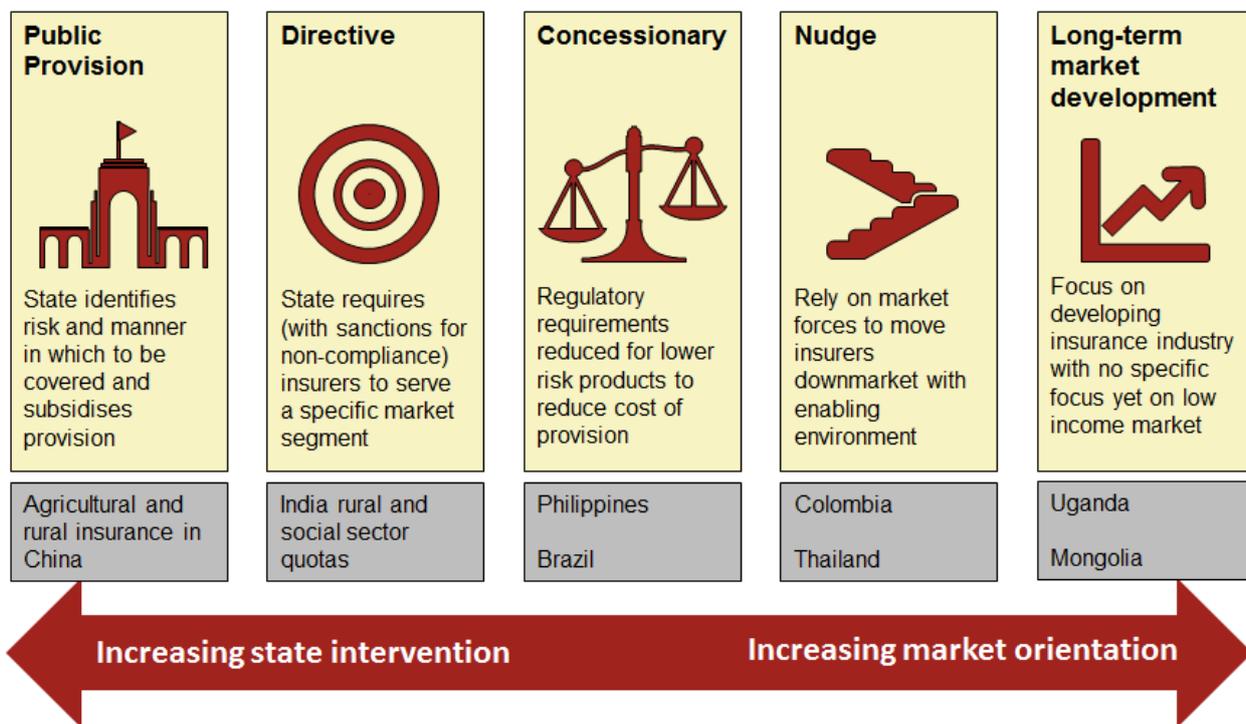


Figure 2: Continuum of identified regulatory approaches

Source: Authors' own

As Figure 2 illustrates, the five regulatory approaches each have a number of defining characteristics.

Countries can follow more than one approach. For example: India is the prime example of a directive approach through the rural and social sector quotas set for insurers, but also has a part-concessionary regime for microinsurance distribution, plus follows a public provision approach in some markets²⁶. Likewise, a country may, for example, follow a public provision approach in certain types of insurance, notably agriculture or health, while adopting a different approach (such as nudge or concessionary) more broadly, depending on the interplay between policy objectives. Generally speaking, health, agricultural or disaster risk insurance may lend itself more to public provision due to the fact that these may not be first-order products viably supplied to the low-income market by the private sector. Products which have become more commoditised, for example funeral insurance in Southern Africa or extended warranties in Latin America, may be more suited to a market based approach like the concessionary or nudge approach. There is no one rule of which approach is most feasible for which product market, as the approach adopted will depend on a combination of various other variables as outlined in Section 3.

Each sub-section below is structured as follows:

- Firstly, a definition or description of the specific approach is provided, followed by an overview of the public policy objective(s) that the approach seeks to achieve.
- This is followed by a number of relevant country examples of different embodiments of the approach.
- Next, each approach is described in terms of the fiscal, regulatory, surveillance and enforcement tools relevant to the implementation thereof.

²⁶ The same holds for South Africa, where the Financial Sector Charter access targets are characteristic of a directive approach, but the proposed microinsurance regulatory framework will represent a concessionary approach.

- Lastly, where relevant, additional considerations for the supervisor in the implementation of each approach are outlined.

2.2.1. Public provision approach

Description. The public provision approach entails the most direct state direction to promote access to insurance whilst maintaining a market context. The state identifies a specific risk to be covered, the manner in which it is to be covered and directly and/or indirectly subsidises the provision of the insurance product to the prescribed target market. The underwriting or risk management can either be done by the state itself under a pure public approach or by commercial insurers under a public private partnership. In all cases, though, the risk is managed on insurance principles, which distinguishes it from directly provided state welfare²⁷. The distribution of the products can be done through normal insurance distribution channels, but can also be supported by public institutions.

Public policy objectives. Virtually without exception, the public provision approach is used in order to achieve a strong public policy objective such as healthcare for the population, agricultural development/food security, or as part of a disaster risk management strategy. In products considered as critical to the national interest and which are costly for private insurers to administer and intermediate, the state therefore frequently steps in to subsidise the provision of insurance. This ensures that access to these risk mitigation products is substantially higher than it otherwise would be.

Box 1: Examples of the public provision approach:

Agricultural and rural insurance in China

Despite rapid growth in the commercial insurance market in China from the 1970s, the large rural population, effectively the primary microinsurance target market, went largely unserved by commercial insurance companies. The reasons were that their incomes are low, it is expensive to reach them, and their familiarity with insurance is very limited. The demand for insurance in this market was therefore very low. In response, the Chinese government launched a deliberate policy to stimulate the provision of insurance products by commercial insurers to this target market in 2004. These products had very limited success until the central government commenced with premium subsidies for agricultural insurance in 2007.

Similarly, the provision of property insurance for rural areas, especially for farmers, was catalysed by the provision of subsidies since 2006. Especially in coastal areas, the schemes were introduced to deal with typhoons and other natural disasters. By 2007, the policy was already introduced in 15 provinces. The premium is either fully or partially subsidised, depending on the province.

The Chinese government also directly engages in providing key aspects of the intermediation chain, which can be regarded as a form of indirect subsidy. In the provision of rural housing insurance, the state aids insurance companies by assessing the damage to insured houses from natural disasters and accidents. In the provision of agricultural insurance through various pilot schemes, the government frequently plays an important role. Firstly, the government is responsible for raising premiums. For all

²⁷ An important differentiation should be made between insurance schemes administered under this approach and pure social security initiatives. To fall within the purview of the insurance supervisor, initiatives should be “managed based on insurance principles and funded by premiums. Premiums can be privately or publicly funded, or a combination of both (IAIS, 2012, p. 11).” Indications that a given insurance initiative is managed on insurance principles include:

- If the underwriting is done based on a risk pool
- If the premium is defined up front and paid over to the risk manager rather than an *ex post* compensation of the shortfall by the state or an open guarantee provided by the state.

types of agricultural insurance the state subsidises at least 50% of the premium, with as much as 80% in some cases. In addition, many insurance companies in rural areas do not have widespread marketing networks and rely on the government for premium collection. Secondly, claims survey and loss prevention are inseparable from the government's functional departments. Government departments assist with technical loss prevention measures advising farmers on planting and livestock. Thirdly, government agencies also assist with claims payment.

Source: Wei et al., 2014

PROAGRO-MAIS - Brazil

In 2004, the Central Bank of Brazil (BACEN) and the Ministry of Agrarian Development (MDA) designed and implemented a Farm Family Life Insurance product called PROAGRO-MAIS (PROAGRO-Plus). It is managed by BACEN and is aimed specifically at family farmers who are part of the mandatory enrolment agricultural funding programme of the National Agriculture Strengthening Program for Family Farmers (PRONAF), an important government initiative for agricultural development that includes subsidised credit provision. Qualification for PRONAF is restricted only to low income farmers based on various criteria, which includes limitations on the size of the farm, number of employees and annual income.

The programme charges a single, small premium across all farmers regardless of their area's particular risk profile. The proportion of the premium paid by farmers is determined according to what government deems to be farmers' capacity to pay, not according to risk principles. The shortfall is then paid by the state, meaning that this scheme is not technically run according to insurance principles²⁸. As of mid-2009, government had spent a cumulative total of R\$16.6bn (around US\$9.2bn) on the PROAGRO-MAIS program. As of 2010, about a third of family farmers were covered – c. 750,000 family farmers out of 2.5m eligible farmers (Bester et al., 2010).

Tanzanian health insurance

Many countries implement subsidised (national) health insurance schemes, including India, the Philippines and Tanzania. Tanzania subsidises health insurance through three different state schemes: National Health Insurance Fund (NHIF), National Social Security Fund - Social Health Insurance Benefit (NSSF-SHIB) and Community Health Fund/ Tiba Kwa Kadi (CHF/TIKA). In total, about 6 million Tanzanians are covered across the three schemes.

NHIF is compulsory for public sector workers and covers main members, their spouses and up to four children and/or dependents. Premiums are equal to 6% of a member's salary – 3% is deducted from a member's salary and remitted to the NHIF, and the remaining 3% is contributed by the member's employer, that is, the government.

NSSF-SHIB and CHF/TIKA are both voluntary schemes available to private formal sector employees and informal sector employees, respectively and working on a capitation rather than fee for service basis. In both cases the state makes a substantial contribution to the premium payments of the insured individuals.

In each instance, the scheme defines the benefits package, being a full range of services in the case of the NHIF, a broad range of services in the case of the NSSF-SHIB and only primary healthcare and limited hospital services in the case of the CHF/TIKA. The premium is deducted off the payroll and paid over by the state alongside its own matched contribution (subsidy) to the respective fund in the case of the NHIF and the NSSF-SHIB. In the case of the Community Health Funds, individuals make

²⁸ Despite this scheme not being technically run on insurance principles, it is included to illustrate the distinction between public programs not run on insurance principles, and applications of the public provision approach which is run on insurance principles.

nominal payments that are administered via the district government office, which supplements it with a matched government contribution through a so-called health basket fund. However, these contributions are not sufficient to cover medical costs and the district-level public healthcare system still relies on substantial government and donor funding.

The risk pool for the NHIF and NSSF-SHIB is managed by each fund, respectively, under the regulatory authority of a dedicated regulator, namely the Social Security Regulatory Authority. The CHF/TIKA is administered by the NHIF. The NHIF and NSSF are technically run according to insurance principles, as they do not merely entail blanket funding by the state. For the CHF/TIKA, the premium is only a nominal amount and does not relate directly to the risk, with services being funded by the state. It is therefore not directly run on insurance principles (Hougaard et al., 2012, p. 6 doc 6).

Fiscal tools. The public provision approach, unlike the other approaches, is characterised by the use of fiscal tools. Any one or more of the following tools can be utilised:

- Direct premium subsidies - either partial or full subsidies
- State entities can take responsibility for, and cover the cost of, one or multiple aspects of the microinsurance intermediation chain. These can include the distribution of products, for example through municipal/village-level structures, or the provision of technical support, especially in agricultural insurance.
- State entities can also be entrusted with the responsibility to manage the entire scheme.

State entities can furthermore provide subsidised *services* - such as in public health schemes whereby the state carries the cost of the service, such as a hospital. Whilst this may not be directly classified as a fiscal tool in the provision of insurance it is a related fiscal expenditure that indirectly results in lower premiums.

Regulatory tools. The regulatory tools which are commonly used in the implementation of the public provision approach include:

- *Regulation regarding the underwriters:*
 - An insurance entity can be given a statutory mandate to implement the scheme or to participate in it in a specified manner.
 - The extent of participation of commercial insurers can be regulated. For example, through public procurement processes and regulated public contracts.
- *Prudential requirements:* It follows the regulatory framework if commercial insurers are involved
- *Product requirements:*
 - Particular cover can be made compulsory.
 - The nature and extent of the cover can be prescribed in terms of which benefits are included and which are not. This is particularly important in the health insurance space.
 - The size of the premium/contribution is usually prescribed as well.

- *Policyholder requirements:* Under the public provision approach, the choice of who the policy holders will be is made *a priori*:
 - The nature of the insured individuals can be regulated, for example all the formally employed, all the public employees, all farmers with land holdings below a certain size, etc.
 - It can be specified that the insured individuals and/or their employers must make compulsory contributions to the cover.

Surveillance tools. Since the public provision approach involves subsidies, a high degree of surveillance may be called for. Surveillance tools include:

- The full spectrum of public expenditure controls, including scrutiny by the legislature;
- The state may establish a dedicated supervisor for a particular insurance (such as health insurance) or delegate the supervisory role to the relevant government department, such as the ministry of agriculture or the ministry of health;
- The responsibility of the insurance supervisor may be absent, or be limited to oversight of the prudential soundness of the scheme or intermediaries, with other aspects reserved for the relevant government department²⁹.

Enforcement tools. The enforcement tools observed in the public provision approach include all of the generic enforcement tools. However, as the public provision approach entails the use of public funds, the level of enforcement may be at a higher level than in the other approaches. Prosecution, in the event of non-compliance, may be pursued directly by the state rather than by the insurance supervisor and the application of criminal sanctions is more likely. However, the converse may also manifest in that weaknesses are overlooked due to bureaucratic mismanagement and/or the state being unwilling to admit failure.

Implementation considerations. The implementation of the public provision approach raises a number of considerations which do not arise in the other approaches:

- *Financial sustainability:* The financial sustainability of implementing this approach is a key consideration, particularly if substantial fiscal support is required to maintain the scheme. Publicly provided schemes or public-private partnerships can be intended to be temporary - in the hope that the private insurance market will grow - or they can be permanent where the state takes a view that the target market is unlikely to afford any commercially provided alternatives, or that the industry is unlikely to be able to viably supply into the identified market.
- *Crowding out private provision:* The impact that this approach has on private or commercial provision within a particular product market is a further factor to consider. For example, in the case of health insurance, a state subsidy often catalyses private top-up provision and can thus assist to catalyse wider private insurance growth in that market. On the other hand, an ill-conceived public provision scheme could crowd out private provision. In such instances, the state will forego the opportunity to leverage private investment to achieve its goals.

²⁹ Note that where this is the case, it may be that supervision is not in line with internationally accepted insurance supervisory systems.

- *Policy awareness*: Since the public provision approach usually does not require an individual decision by the policy holder or insured to purchase insurance, how beneficiaries are made aware of their coverage and when and how to claim are important considerations. Without these elements, it is unlikely that the target market will reap value from the scheme and the underlying social objective or goal may hence be undermined.
- *Policy coordination* between the primary ministry that deals with the particular area (e.g. health or agriculture) and the ministry of finance and the insurance supervisor, as well as between different levels of government such as national, federal/provincial and district level, is usually important to ensure the success of publically provided schemes.

2.2.2. Directive approach

Description. The directive approach is the insurance equivalent of a directed lending policy³⁰. It involves the state requiring private insurers to provide insurance to a specific segment of the population, such as explicitly defined low-income or rural groups. The insurance is therefore provided by private insurers as a requisite to the on-going maintenance of their operating license, or in order to qualify for incentives or avoid penalties. The state determines which target market should be covered and effectively forces commercial insurers to extend cover to this market. The state may also design and define the parameters of the insurance product to be distributed to this defined target market.

Public policy objectives: Governments with a strong social inclusion focus or a strong rural development emphasis may adopt this approach so as to extend access to insurance to these groups. The state aims to force insurers to not only cherry pick the most lucrative clients, but to extend cover more broadly³¹. Broad based economic empowerment objectives³² or indigenisation may be another reason to adopt this approach.

Box 2: Examples of the directive approach

India

Under regulations promulgated by the Insurance Regulatory and Development Authority (IRDA) in 2002, Indian insurance companies must procure insurance business on a quota basis from pre-defined rural areas and social sectors. Insurers must adhere to the following obligations:

- During the first five financial years of operation, life insurers must increase the total proportion of policies directly written in the rural sector³³ from 7% in the first financial year to a minimum of 16% in the fifth year.
- General insurers must earn at least 2% of total gross premium income written direct in the

³⁰ This insurance approach is effectively the equivalent of the directed lending approach in credit markets, for example the US Community Reinvestment Act (CRA) of 1977, which sought to channel credit to low-income communities in the USA. The CRA was intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, particularly low- and moderate-income neighbourhoods. To enforce the statute, federal regulatory agencies examined banking institutions for CRA compliance, and took this information into consideration when approving applications for new bank branches or for mergers or acquisitions. Many other countries have since adopted similar measures. Belarus, for example, relies on directed lending to selected, strategic sectors (mainly agriculture and some particular branches of industry).

³¹ As in India

³² As in South Africa

³³ According to IRDA (2002): "Rural sector" shall mean any place as per the latest census which meets the following criteria--

(i) a population of less than five thousand;

(ii) a density of population of less than four hundred per square kilometer; and

(iii) more than twenty five per cent of the male working population is engaged in agricultural pursuits.

first financial year, 3% the following year and 5% thereafter in the rural sector.

- All insurers must cover a minimum of five thousand lives in the social sector³⁴ in the first financial year, rising to a minimum of twenty thousand lives covered in the social sector from the fifth financial year.

Companies failing to fulfil these targets face financial penalties and in the event of repeated violations, the insurers could lose their license.

South Africa

Since democratisation in 1994, the South African government has promoted a strong drive towards black economic empowerment. As part of this process industry, labour and other stakeholders within the financial sector in 2003 negotiated and signed the Financial Sector Charter as a commitment by the formal industry to implement black economic empowerment. The Charter was renegotiated and gazetted under the official Broad-Based Black Economic Empowerment Codes of Good Practice in 2012.

The charter targets include specific penetration targets regarding the extension of financial access to the low-income market (defined since 2012 as all those earning below the tax threshold).³⁵ It also commits government to provide a facilitative regulatory framework for the achievement of the charter targets and goals. “Effective access” is defined in terms of the distance to the nearest service point, the range of products and services available, their appropriateness to the needs of the low-income market, and whether they are affordably priced as well as structured and described to customers in a simple and easy to understand manner. In addition, industry is committed to spending a proportion of post-tax profits on consumer education.

In response to the charter targets, both the short-term and the long-term insurance industry developed so-called *access product standards*. Products that comply with these voluntary product standards would then qualify for charter points. A 2011 review of the initiatives found that, in addition to catalysing a set of products that comply fully with the standards, the standards process also catalysed a set of near equivalent products. This is due to the narrow definition and often strict standards associated with the “official” access products. Nevertheless, by catalysing innovation beyond the required standard of access, the standards ultimately did serve the purpose of the Charter.

Source: Sinha & Sagha, 2008; Bester et al., 2008; Hougaard & Chamberlain, 2011; Financial Sector Charter 2012

Fiscal tools. The directive approach does not rely primarily on fiscal tools as it compels insurers to provide access to insurance, thereby reducing the need for direct public expenditure to promote access to insurance.

³⁴ “Social sector” includes unorganised sector, informal sector, economically vulnerable or backward classes and other categories of persons, both in rural and urban areas” (IRDA, 2002).

³⁵ The access targets for insurance initially required that 6% of the low-income population have effective access to short-term and 23% to long-term (life) insurance by 2014. This equated to 1.2m short-term and 4.5m long-term policyholders (FinScope, 2006). In 2006, the Department of Trade and Industry (DTI) promulgated the Broad Based Black Economic Empowerment (BBBEE) Codes of Good Practice to monitor, develop and evaluate various industry charters, such as the Financial Sector Charter. Therefore, a process to realign the DTI codes with the Financial Sector Charter began in 2007. The Financial Sector Charter was gazetted with effect from 1 January 2012. The gazetted standards were revised to broaden the definition of the low-income market to all those earning below the tax threshold and to set more granular long-term and short-term access targets, as well as to double the percentage of post-tax profits to be spent on consumer education to 0.4%

Regulatory tools. A number of regulatory tools have been observed in the implementation of the directive approach, including:

- Negotiated (and regulated) codes of conduct/practice which entails the government expressing its policy objective and then expecting the industry to propose the best way to achieve this objective.
- Clear targets to be achieved by insurers in terms of increased access to insurance. This may take the form of a mandated proportion of the insurer's clients required to fall within the defined target market.
- Product standards or codes as part of a form of directed insurance. This may entail explicit maximum and minimum amounts of cover for specific products, or even a standard microinsurance product.
- Delineation of the categories of policyholders to whom policies must be sold to comply with the directive insurance targets.
- Allotment of specific geographical areas in which insurers need to focus their distribution to the low income market. For example, a specific proportion of their specified low income clients may be required by the supervisor to be from a specific state or province, with lower registration requirements for intermediation to the targeted population³⁶.

Surveillance tools. Surveillance tools include requiring insurers to submit an annual report detailing an account of progress in meeting the directive requirements. By requiring insurers to serve a specific target market, this approach creates an incentive for insurers to report inflated information regarding their provision of insurance to the defined target market. Insurers may also have an incentive to provide limited value to customers. Thus it is important that the supervisor is able to verify that the information it receives is accurate. An independent body can be created to oversee surveillance by conducting reviews and monitoring the implementation of the required targets/quotas. This can include:

- receiving, considering and approving annual audits from each institution
- confirming that these institutions meet the directives
- issuing guidance notes on the interpretation and application of the requirements
- accrediting agencies to perform audits
- engaging with government, public sector institutions and other regulatory agencies to promote the implementation of the requirements

Enforcement tools. Sanctions under the directive approach may include direct sanctions such as fines or the de-licensing of an insurer that continually fails to meet the targets. Indirect sanctions observed, particularly in the case of consensual targets, include exclusion from public procurement for companies that do not comply with the regulated directive requirements.

³⁶ This is detailed in India's 2012 exposure draft on a standard product for rural and social sector. This remains in draft form and has not yet been gazetted.

2.2.3. Concessionary approach

Description. The concessionary regime is based on the proportionality principle³⁷, namely the recognition that “supervisors need to adjust certain supervisory requirements and actions in accordance with the nature, scale and complexity of risks posed by individual insurers”³⁸. The concessionary approach to the facilitation of access to insurance creates exceptions to or changes in the standard regulatory requirements so as to create an incentive to provide certain products, often called microinsurance. These products are normally targeted at lower income market segments and are thus defined to be simpler, offer smaller benefits at lower premium values, and cover less complex risks. In return for the limited operations and specific market conduct requirements or product standards associated with providing these simpler products, the concessionary approach provides regulatory concessions in one or a combination of three ways:

- In a limited number of instances observed so far, prudential requirements are tailored to the nature, scale and complexity of the risk associated with microinsurance provision, thus creating a second tier insurance licence or dedicated microinsurance license.
- In most observed cases, intermediation regulation is adjusted to allow alternative distribution channels and other intermediaries than those allowed for in the traditional insurance regime to enter the microinsurance distribution space, to broaden the functions that may be performed by such intermediaries, and/or to reduce the qualifying criteria that intermediaries must meet.
- In some instances, the institutional form that a microinsurer may take is broadened beyond joint stock, public or private companies to also accommodate appropriately regulated mutual, cooperative and other community-based organisations.

In this way, the concessionary approach seeks to elicit one or both of the following responses from market players:

- Commercial insurers are encouraged to enter or expand their reach into a market segment that they would otherwise not be able to serve in a cost-effective manner, or would not have the incentive to serve;
- Where a concessionary approach involves creating a prudential tier, current informal providers of insurance are encouraged to enter the formal market through licensing or registration and place themselves under formal insurance supervision (a process referred to as formalisation). At the same time, new, smaller entrants are encouraged to enter the market. The regulatory approach can also include an institutional concession to entice cooperative, mutual and other community-based entities into the formal regulated space.

³⁷ Note that the concessionary approach does not entail “free for all” concessions, but rather concessions in return for meeting certain conditions, notably product definition limits and certain market conduct standards as described in this section. However, there has to be some incentive for insurers to want to write their products under the regime, hence the reference to “concessionary” approach. Though this approach is the prime example a proportionate regime applied to inclusive insurance markets, the principle of proportionality is also applicable beyond this approach or outside of the inclusive insurance sphere. For example: a country pursuing either of the approaches may simultaneously be implementing a proportionate broader insurance regime in line with the Insurance Core Principles. Proportionality is therefore an umbrella term of which the concessionary approach as described is one instance.

³⁸ IAIS, 2012: 4.

The lower compliance burden is associated with a variety of restrictions aimed at limiting the associated risk (thereby justifying a proportionate response). These may include a limited product offering, premium and benefit limits, term limits, etc. As an entity grows, it may start to find these limits restrictive, which provides a natural incentive to graduate to compliance with the full insurance regime – in return for not being subject to these limits anymore³⁹.

Public policy objectives. The public policy objective pursued through a concessionary approach generally is access to insurance as a form of financial inclusion, which in turn serves broader social inclusion goals. Some governments leverage the concessionary approach to pursue specific stated goals such as empowerment of small businesses or consumer protection through formalisation of informal practices. Whatever the stated objective, this approach involves the state explicitly choosing to leverage the market mechanism, which speaks to market development and facilitation as an objective or orientation. By opening up a carved out space to a variety of players to compete in offering insurance services to the low-income market, the objective is to create a level playing field, with proportionate regulation, that will facilitate financial inclusion.

Box 3: Examples of the concessionary approach

The concessionary approach can take various forms, spanning prudential, institutional and/or intermediation aspects. The Philippines (see below) is a prime example of a country that has adopted elements of all three aspects. South Africa has also published a detailed proposed regulatory framework along all three lines, though it has yet to be enacted. Similar plans are underway in Swaziland. Examples of countries opting for a part-concessionary approach include: Brazil, India, Mexico, Peru, Ghana, Tanzania and Zambia (proposed), where the emphasis is on the intermediation component, as well as Ethiopia, where a regulatory concession was only made with regard to the provision of microinsurance by microfinance providers.

Philippines

The Philippines was amongst the first countries globally to implement a concessionary approach to microinsurance, with the first microinsurance circular dating back to 2006 and allowing for dedicated microinsurance providers in the form of microinsurance mutual benefit associations.

Coordinated by the National Credit Council of the Department of Finance, stakeholders adopted the National Strategy on Microinsurance in January 2010 and have been pursuing various activities towards its implementation since then. As part of the subsequent implementation phase a regulatory framework for microinsurance has been adopted that has seen the issuance of several new Circulars and Circular Letters, including on performance indicators and benchmarking, opening up the microinsurance distribution space, approval of training programmes for microinsurance agents, and incorporating previously informal activities into the insurance regulatory net.

See Appendix 1 for detail on each of the Memorandum-Circulars issued under the microinsurance regulatory framework.

Brazil

Brazil has been engaging with the topic of microinsurance regulation since 2008. Throughout, government has followed a consultative approach with industry in the development of the framework. At the end of 2011, the Brazilian National Council for Private Insurance issued a

³⁹ For a full exposition of proportionality in the context of inclusive insurance, see the 2012 IAIS *Application Paper on Regulation and Supervision Supporting Inclusive Insurance Markets*.

Microinsurance Resolution that created a new category of microinsurance agents and correspondents and allowed for special rules for microinsurance provision. The resolution formed the basis for the drafting of rules and standards to flesh out the details for the microinsurance regime. Once again, a consultative approach was followed: various working groups comprised of supervisory staff and industry representatives were formed to determine the exact regulatory positions.

In mid-2012, the process resulted in the publication of a set of six circulars, with two more in the pipeline at the time of writing. The initial six circulars cover various topics including the conditions for microinsurance authorisation, the definition parameters for microinsurance and the conditions for distribution through microinsurance correspondents and brokers, respectively. Various requirements are imposed, including benefit limits, detailed stipulations regarding allowable excluded risks, deductibles and grace periods and the need to submit a microinsurance product plan to the supervisor. The main concessions provided in return relate to the fact that microinsurance may be distributed through the pervasive network of banking correspondents, through a new class of non-bank microinsurance correspondents, as well as through microinsurance brokers meeting significantly lower qualification requirements than traditional brokers. This significantly opens up the distribution space in a country traditionally characterized by a weak bargaining position of insurers in the mass or affinity market vis-à-vis brokers and large client aggregators such as retailers and utilities.

See Appendix 1 for an overview of the main tenets of each of the six circulars.

South Africa (proposed)

The origins of the planned microinsurance regime in South Africa date back to 2003, when the South African government heard parliamentary testimony of abusive practices prevalent in the informal funeral insurance market. Parliament then requested the National Treasury as financial sector policymaker, and Financial Services Board (FSB) as supervisor to propose regulatory reform that would better protect vulnerable consumers, especially those in the lower income segment. In parallel, the drive for financial access under the Financial Sector Charter described under the directive approach as well as competitive market forces catalysed interest in the low-income market by traditional insurers. Thus the regulatory plans were extended to microinsurance also beyond funeral insurance in order to prioritise market development and facilitate access to insurance. What followed was a consultative regulatory review that resulted in a policy discussion paper in 2008 and a final policy document in 2011 describing the intended regulatory framework.

The policy document defines microinsurance according to a number of product parameters that are set to limit the risk associated with microinsurance underwriting and to ensure simplified distribution. Regulatory requirements are then tailored to the low-risk nature of the product in a proportionate way, including by creating a separate prudential tier and dedicated licence for microinsurance provision, opening up the institutional requirements to allow cooperatives to obtain a microinsurance licence, as well as revisiting the fit and proper, including qualification, requirements for microinsurance intermediaries.

See Appendix 1 for further details.

The plan was originally to develop a standalone microinsurance act, but in 2013 the decision was taken to incorporate microinsurance in planned new market conduct and prudential insurance legislation. Such legislation was under development at the time of writing.

Source: Access to Insurance Initiative, 2012; Philippines Microinsurance Roadmap and various Insurance Commission Circulars 2011/12, Brazil Private Insurance Superintendence 2012, South African National Treasury 2011

Fiscal tools. Tax concessions are the main fiscal tool available under the concessionary approach. The following tax concessions have been applied or are under consideration by some countries:

- A tax amnesty or compliance path provided to informal entities which are formalised under the concessionary approach in order to aid the transition to formality
- A reduced tax burden in the form of VAT exemptions on premiums.
- Some countries have proposed additional fiscal incentives for microinsurance through reduced income tax for microinsurance providers, though it has proven challenging to convince government to forego revenue in this way.

In addition to or instead of tax concessions, supervisory fees and levies may be reduced for microinsurance operations, representing an indirect fiscal tool.

Regulatory tools. Proportionate regulatory tools are used to implement a tiered concessionary regime. The most prominent regulatory tools contemplated to date include:

- The adoption of a regulatory definition of microinsurance – be it stated at a conceptual level, in terms of the target market or in terms of defined product parameters. Some countries move beyond a definition to adopting more detailed product standards (for instance limiting permissible exclusions, no waiting periods or grace periods to be granted to facilitate consumer protection) or even standard product templates that insurers can tailor.
- Legislation or subordinate legislation providing for revised licensing and capital requirements for dedicated microinsurers. Some technical requirements, such as the need for an actuary, may also be adjusted.
- Legislation or subordinate legislation allowing for new institutional types of microinsurance providers (such as mutuals and cooperatives) and setting governance requirements in this regard⁴⁰.
- Legislation or subordinate legislation creating new categories of microinsurance-appropriate intermediaries, including so-called “third party client aggregators” or correspondents such as other financial service providers, retail outlets, microfinance institutions and NGOs, and specifying the entry and ongoing requirements that they must meet. Such legislation includes stipulations regarding the nature of the relationship between the insurer, the third party and the client.

The configuration of regulatory tools applied differs, depending on whether a country opts to apply a full or part-concessionary approach and what the specific public policy objectives are that it wants to achieve.

Surveillance tools. Effective surveillance is vital to the successful implementation of any regime, including a concessionary regime. It allows the supervisor to monitor the

⁴⁰ The IAIS Application Paper on Regulation and Supervision Supporting Inclusive Insurance Markets recognises the potential for a proportionate response where the regulation of mutual, cooperatives and other community-based organisations (MCCOs) is concerned. It states the following: “In comparison to other insurers, MCCO board members may be representative of the policyholder/member body, will usually feel a stronger link and obligation to policyholders, and be less subject to types of conflicts of interest between shareholders and policyholders. To this extent, these issues could be less of a supervisory concern provided the democratic process works effectively. ... As organisations become very large the processes may be less effective. This requires constant scrutiny from the supervisor.”

implementation of the regime, the compliance with its provisions and the value provided to customers (that is, whether the space created for microinsurance is delivering on the stated objectives). The key surveillance tools used in the implementation of the concessionary approach include:

- The design and implementation of offsite reporting requirements able to deal with the complexities presented by a tiered regulatory regime, that is, a clear differentiation between products marketed under different business classes and incorporating of key performance indicators needed to calculate ratios indicative of microinsurance performance and client value, including claims ratios, expense ratios, lapse ratios and claims processing ratios.
- Adaptations to the on-site supervisory system, including provisions in supervisory manuals, to investigate microinsurance related business.
- The design and implementation of supervisory reporting systems and tools that allow the supervisor to effectively monitor and analyse reported data, with the findings feeding into the supervisory response.
- Monitoring of consumer complaints, with a focus on low-income consumers

Where a concessionary regime entails an expanded number of supervised entities, including intermediaries, a form of delegated supervision or self-regulation is sometimes adopted whereby insurers are required to keep registers of intermediaries and oversee their compliance with regulatory requirements.

Enforcement tools. Various countries implementing a concessionary approach are grappling with the challenge of how to ensure effective enforcement. It requires dedicated capacity within the supervisory authority. It can also require cooperation and a strategic enforcement plan across multiple public agencies, such as revenue authorities, local authorities, the supervisory agency for cooperatives, etc. This is the case where a concessionary approach entails formalisation of previously informal operators, where new microinsurance entrants are incorporated from other economic spheres (such as funeral service providers, credit providers or cooperatives) or new types of intermediaries are accommodated that do not necessarily have insurance as their core business (such as retailers, utilities, microfinance providers, NGOs, community-based associations, postal networks or mobile network operators). In such instances, co-ordinated enforcement is required across various regulatory authorities to ensure that all entities still conform to regulatory requirements.

Another enforcement tool is to allow for graduated compliance: for example to first require nominal registration, thereafter phasing in compliance requirements. Proactive formalisation support for entities operating informally (see the discussion below) can also be leveraged to promote enforcement.

Implementation considerations. It is important to take both intended and unintended consequences of regulation into account. Specifically, consumer protection objectives need to be balanced with the associated costs of providing these products to new target markets. By requiring stringent consumer protection measures to protect vulnerable low-income households, for example, regulation may actually discourage rather than encourage the provision of insurance to the low income market. For example, a requirement for onerous qualifications of agents may cause insurers to dispense with the agent model and distribute

insurance through other channels which may actually have a substantially inferior sales process. Part of the aim of a concessionary regime is therefore to explicitly take note of and mitigate such unintended consequences.

As part of a concessionary regime, the supervisor may detail standardised product features or parameters to be offered to the market, or may set certain product standards. By keeping products simple and promoting it industry-wide, the supervisor can commoditise the product, meaning that individuals do not require the same level of skills to engage with the product as compared to a more complex version. Promotion of product standards by the supervisor would also complement a concessionary regime by building awareness and demand for the insurance product in the market. However, too detailed product specifications without sufficient incentives attached to the provision of the product may cause the industry not to write products under the specific category at all.

The concessionary approach requires significant skills and resource capacity from existing industry players to branch into new operations, as well as from new entrants (be they new players or informal entities coming into the formal fold). The supervisor can support the industry by providing support to revamp the insurance industry's processes and technologies. It could also consider capacity building support for formalising entities, for example support to develop business plans or complete the registration process. Similarly, a concessionary regime has significant capacity implications for the supervisor itself – requiring surveillance systems, scaled enforcement and supervision of new providers and/or intermediaries.

2.2.4. Nudge approach⁴¹

Description. The nudge approach relies predominantly on market forces to move insurers downmarket and increase access to insurance. The state plays a facilitative role in providing the environmental enablers such as requisite infrastructure or signals of policy support to allow insurers to successfully supply insurance to the low-income market. The state can also apply moral suasion. The difference between the concessionary and nudge approaches is that the nudge approach takes the view that the overall compliance burden applicable to insurance providers and intermediaries is not high enough to warrant a concessionary regulatory framework and the corresponding supervisory capacity implications, but that the public policy objectives can be achieved through other market-based means.

Public policy objectives. The public policy objectives under a nudge approach are similar to those outlined for the concessionary approach, that is to serve as many citizens as possible with private insurance. Similar to the concessionary approach, the nudge approach differs from the public provision and directive approaches in that the regulator holds the view that financial inclusion objectives in the insurance market can be achieved without the need for state subsidy or direct intervention.

Box 4: Examples of the nudge approach

Colombia

⁴¹ This approach takes its name from the book by the same name: *Nudge: Improving Decisions about Health, Wealth, and Happiness* (2008) by Richard Thaler and Cass Sunstein. The book argues that positive reinforcement and indirect suggestions to try to achieve non-forced compliance can influence the motives, incentives and decision making of groups and individuals alike, at least as effectively – if not more effectively - than direct instruction, legislation, or enforcement.

To date there is no dedicated regulatory framework for microinsurance in Colombia, despite many insurance companies in Colombia providing products to low income people. A relatively open regulatory stance as well as a generally low compliance burden, especially on the intermediation side, has meant that the market rather than regulatory forces have been the definitive driver of microinsurance development.

Instead of creating a microinsurance regulatory framework, Colombia has created a facilitative environment for financial inclusion more broadly through its Opportunity Banking Policy. Launched in 2006, the policy seeks to provide access to financial services, including payments, transfers, savings, loans, insurance, pensions and remittances. It does not place any regulated inclusion objectives on private financial institutions, but signals government's commitment to financial inclusion and establishes the overall policy framework that guides public and private players to extend access to financial services. Amongst others, the government has amended banking regulations to allow the establishment of non-bank agents (named "non-bank correspondents") to extend the formal banking network into previously unserved areas. As of June 2007, there were 3,508 non-bank correspondents and between 2006 and 2007 the new channel enabled almost 1m Colombians to access formal credit for the first time. Although non-bank correspondents are not currently allowed to sell insurance they may collect premiums. The expansion of microcredit also paves the way for the growth of credit life insurance.

Thailand

Thailand follows a nudge approach with regard to market players alongside a public provision approach. Risk mitigation for low-income households in Thailand is provided primarily by the state and community-based entities, though commercial microinsurance is rising. As part of its second Financial Sector Master Plan, the Royal Thai Government sought to encourage commercial insurers to extend their services to low income households. To implement this policy, the Office of the Insurance Commission in 2011 issued a Microinsurance Framework after consultations with the private insurance industry. The Framework defines what constitutes a microinsurance policy, placing ceilings on benefit levels and premiums. It further requires, amongst others, that microinsurance policies should have simplified wording and claims processes. Although the Framework does provide for microinsurance agents, the provision has not been utilised to any significant extent by insurers as it entails very limited concessions. Thus it is categorised under the nudge rather than the concessionary approach. As of 2013, approximately 20 000 policies were issued under the Framework by private insurers.

Sources: Caceres & Zuluaga, 2008; Microfinance Services, forthcoming

Fiscal tools. As the approach takes the view that direct state intervention is not required to promote access to insurance, no fiscal tools are utilised as part of this approach.

Regulatory tools. The following observed regulatory tools aid the implementation of a nudge approach:

- A strong policy approach in favour of financial inclusion sends a signal to the market, highlighting the importance of increasing access to insurance.
- Creating a regulatory framework for microinsurance products, but without incorporating any significant concessions on the regulatory requirements applicable to insurance

products in general. This could include consumer protection measures, including dispute resolution, that are particularly adapted to the low-income market.

- Regulation to promote financial inclusion in other related fields, for example non-bank agents or payment systems, may make it easier to distribute insurance, although these regulatory actions are not directly related to insurance.

Surveillance tools. An important role for the supervisor under the nudge approach is to monitor the actual extension of private commercial insurance to the target market. In this way, the on-going effectiveness of the approach in increasing access to insurance is evaluated in order to determine whether not directly intervening remains the optimal approach for the state to achieve its goals.

Enforcement tools. Although this approach entails the state taking a hands-off approach towards the development of the industry, enforcement of existing regulation remains important to ensure that consumers are not exploited and that industry players remain financially sound and able to honour their contractual obligations. Thus the generic enforcement tools would all be applicable under the nudge approach.

2.2.5. Long-term market development approach

Description. The long-term market development (LTMD) approach applies where the focus of the policy-makers and regulators is to establish an insurance industry with the necessary skills, institutions and market presence, and to grow their own supervisory capacity, before specific focus is turned to growing retail insurance specifically for low-income households. Thus a longer-term view to increasing access to insurance is taken, with the primary focus being on developing the industry at large. This approach is generally found in under-developed insurance markets. It recognises the importance of the sequencing of development and that regulation designed for developed markets could have unintended adverse consequences if applied in a blanket way to less developed markets without consideration for the specific characteristics and financial sector development priorities of that market. This approach then indirectly benefits access to insurance over the longer term by building capacity and support infrastructure.

Public policy objectives. The LTMD approach recognises that the limitations⁴² in the existing state of the market make it unfeasible – and an inefficient use of resources – to pursue increased access to insurance for low-income households as an explicit objective in the short-term. Thus the overriding objective is the establishment or capacitation of the market. This does not mean that access and the welfare benefits that it promises is not an important public policy objective – just that pragmatism comes into play when determining the actual regulatory and supervisory priorities. Countries with this approach may officially have a financial access development mandate, but this does not automatically signify that such mandate is actionable or that steps are actively being taken to achieve it.

Box 5: Examples of the long-term market development approach

Southern and Eastern Africa

A number of countries in Southern and Eastern Africa, including Uganda, Tanzania, Zambia and

⁴² Such limitations can for example relate to capacity constraints (including skills and systems), market structure or competitiveness.

Swaziland, are characterised by a history of state-owned insurance monopolies in the post-colonial period. Many countries liberalised their insurance industries in the mid-1990s, seeing the entry of private and foreign players. Along with liberalisation, new insurance legislation was introduced and autonomous supervisory authorities established. Thus, supervisory authorities are still young and have had many important priorities to pursue as part of the set-up phase, the most important being implementing new legislation, establishing own systems and capacity and ensuring prudential soundness and appropriate market conduct in a growing insurance industry. As many of these markets are characterised by a dominance of general insurance focused on corporate clients, another imperative has been nurturing and overseeing a budding retail life insurance market.

As markets and supervisory authorities are becoming more established, the attention in a number of these jurisdictions is now starting to turn more explicitly towards access, with a number of countries transitioning out of the LTMD approach into a part-concessionary approach. This is for example witnessed in an ongoing Southern African Development Community (SADC) initiative to harmonise insurance regulation across the region, including regarding access to insurance, where the proposal is to apply the guidance set out in the 2012 *IAIS Application Paper on Regulation and Supervision Supporting Inclusive Insurance Markets*.

Mongolia

The commercial insurance market is still at a nascent stage in Mongolia. For many years, the Mongolian Government was the sole and direct provider of insurance. This has changed over the past two decades with the privatisation of the government insurance entity and the emergence of new entrants into the market. Currently, the insurance industry accounts for only 0.9% of the total assets in the financial sector and gross written premium amounted to only 0.4% of GDP in 2010.

The Financial Regulatory Commission (FRC), Mongolia's insurance supervisor, was only formed in 2006 and has very limited staffing capacity. Mongolia does not have specific microinsurance regulation, and the insurance regulatory environment does not specifically consider microinsurance clients, providers or intermediaries specialised in microinsurance. Rather, the focus is on building up the requisite underlying infrastructure, processes and supervisory capacity to help enable the growth of the insurance sector as a whole.

Source: Chamberlain et al., 2014; Rendek & Wiedmaier-Pfister, 2011

Fiscal tools. The LTMD approach entails fiscal expenditure to invest in underlying infrastructure and processes such as the establishment and building of an insurance supervisor and related systems, training insurance professionals, building actuarial skills, etc.

Regulatory tools. The regulatory tools applied as part of the LTMD approach are primarily aimed at helping to establish the market, rather than regulating for inclusive insurance markets *per se*. They include:

- A broader financial sector development framework
- Market liberalisation (where this is not already the case)
- Putting the basic insurance regulatory framework in place, including drafting of subordinate legislation and guidance

- Compelling individuals to have certain insurance products, for example by requiring third party vehicle insurance or workers' compensation insurance. Such tools can be instituted to meet societal needs but also to help kick-start the insurance market.

Surveillance tools. Where surveillance is concerned, the focus under the LTMD approach is on creating the relevant surveillance tools for the market as a whole, including:

- Establishing basic reporting frameworks
- Creating a database for the supervisor and building supervisory systems and skills for analysis
- Building up knowledge of the market and how it evolves

Enforcement tools. In a nascent market, enforcement capacity is grown as supervisory capacity and surveillance tools are being built up. Enforcement tools typically focus on prudential supervision and market conduct of existing players and the enforcement priority may be to build the necessary supervisory systems in this regard. Other considerations are the establishment of consumer redress channels, such as the creation of an insurance ombudsman.

Implementation considerations. A number of considerations need to be taken into account when implementing a LTMD approach:

- The public policy driving force for financial access is unlikely to lie primarily with an insurance supervisor. Rather, another financial sector authority like the Central Bank or the Ministry of Finance will typically be the custodian of the country's access priorities. This requires coordination.
- The insurance supervisory authority is likely to struggle with resource constraints as it is being established. The funding model for the authority, be it through state (tax-funded) resources or industry levies, may still be under consideration. This will have implications for the operations of the supervisory authority and what agenda it can take on.
- In a nascent market, private insurance is likely to be dominated by non-life insurance rather than life insurance. Yet the latter is where microinsurance usually evolves. Thus the normal market development curve must take its course before access can become a feasible priority.

3. What leads to the adoption of specific regulatory approaches?

The previous section described the observed regulatory approaches as well as the policy and regulatory instruments used to implement them. But what approach is most appropriate in a given market? The answer will depend on the contextual and market factors present in a country.

This section identifies nine interrelated conditioning factors which have been observed in markets where specific approaches have been adopted. In practice, countries may adopt approaches prematurely without taking these conditioning factors into account. The analysis attempts to identify linkages between prevailing conditions and specific regulatory approaches as a basis for consideration by insurance regulators and supervisors. It represents a first attempt at making sense of the way that approaches manifest across

countries and regarding the interplay between various conditioning factors, based on country evidence emerging to date. As the history of approaches described is still recent, the conditioning factors identified here are based on limited observations to date. Ongoing research and tracking across countries is required to arrive at more conclusive findings.

The table below lists the main conditioning factors identified. They are grouped according to the country context, the demand for insurance, the insurance market (supply-side angle), as well as aspects relating to the public system or regulatory framework, respectively:

Category	Conditioning factors
Context	<ul style="list-style-type: none"> • Macroeconomic conditions • Physical infrastructure
Demand	<ul style="list-style-type: none"> • Latent demand
Supply	<ul style="list-style-type: none"> • Level of market development • Informality
Public sector/ regulation	<ul style="list-style-type: none"> • Availability of public funding • Public infrastructure • Supervisory capacity • Compliance burden

Table 2: Identified conditioning factors

Each of these is discussed in more detail below, considering:

- the nature of the conditioning factor;
- the relevance thereof for insurance;
- the ways in which it influences the choice of regulatory approach; and
- where relevant, what the supervisor could do to influence the conditioning factor itself.

3.1. Context factors

3.1.1. Macroeconomic conditions

What do we mean by macroeconomic conditions? Macroeconomic conditions refer to the overarching state of the economy insofar as it affects the development of the insurance sector and access to insurance. Macroeconomic conditions can include pervasive macroeconomic concerns such as hyperinflation or a fiscal crisis, or the effect of GDP growth on incomes and thus insurance.

Relevance for insurance. Macroeconomic conditions can substantially impact insurance. Overarching macroeconomic conditions determine the environment in which the insurance market operates and thus the ability and incentive for insurers to expand. Macro factors such as inflation can also impact on the value proposition of insurance to the market or impact on consumer trust and perceptions (hyperinflation erodes insurance value, which typically undermines trust in the insurance sector). Low GDP growth rates and income levels would influence the take-up of insurance as low income levels constrain affordability amongst the low-income target market. Conversely, strong GDP growth and rising income levels can be a natural driver of the creation and growth of insurance markets.

Implications for regulatory approach. The ruling macroeconomic conditions will, alongside other conditioning factors, affect which regulatory approach is most appropriate. For example:

- A country with significant macroeconomic concerns such as hyperinflation or a fiscal crisis will have more pressing priorities than increasing access to insurance. Hence the long-term market development approach may be the most appropriate – or indeed only feasible – option until the overriding macroeconomic issues are resolved. Countries that have suffered from hyperinflation have found that it takes a number of years before the confidence of the market in particularly life insurance - the utility of which requires relative stability in the currency - returns.
- Severely low income levels within the economy could push the supervisor towards a public provision or long-term market development approach if they undermine affordability to the point of precluding an approach that relies on market forces. Low income levels could also entail low income tax revenues, thereby restricting the capacity of the state to provide insurance. Therefore a public provision approach would only be viable in the event that the state earns substantial revenues from alternative sources.

How could the supervisor influence macroeconomic conditions? The insurance supervisor has limited scope to address macroeconomic conditions. Rather, the macroeconomic context can largely be regarded as a “given” within which supervisors must find the most appropriate approach.

Box 6: Examples of the impact of macroeconomic conditions

Zimbabwe- hyperinflation

Until 2009, the Reserve Bank of Zimbabwe regularly printed money in order to fund the budget deficit. Zimbabwe consequently experienced stagflation until 2009, with negative growth rates complemented by rampant hyperinflation. Zimbabwe’s insurance industry shrank significantly during this period (Microinsurance Agency Holdings, 2007), but has since recovered somewhat. However, the sector’s contribution to GDP remains low (Madera , 2011).

The retail insurance sector has been particularly affected. Life industry premium volumes account for only 29% of total premiums in Zimbabwe, substantially lower than most other SADC countries (Mpfu, 2010). This has restricted the scope for Zimbabwe to pursue access to insurance as a stated goal. The first priority was to address the impact of hyperinflation and to re-establish trust in the value of insurance (Chamberlain et al., 2014).

Thailand – banking crisis

The 1997 Asian financial crisis saw an increased focus on the stability of commercial banking operations in Thailand. As a result, the focus for all commercial financial institutions shifted strongly in favour of maintaining financial stability and reliance was placed on state-supported entities to achieve financial access objectives. The focus for the insurance industry, as part of the financial system, was on stability as opposed to access. This meant that no direct attempt was made to increase access to insurance via the private insurance industry. Rather, the state moved strongly to provide risk mitigation through its budget and through state-owned financial institutions. As far as private insurance is concerned, it reverted to the long-term market development approach. Only once it had been ascertained that the stability of the sector had been fully re-established, was access to private insurance once again pursued as a discrete policy objective. This was highlighted in 2011

with the issuing of the Microinsurance Framework (Microfinance Services, forthcoming).

3.1.2. Physical infrastructure

What is physical infrastructure? This conditioning factor refers to any relevant infrastructure required to effectively administer or distribute insurance, including payments infrastructure, financial sector infrastructure, electricity, internet connectivity and mobile network coverage.

Relevance for insurance. The existence of physical infrastructure is crucial to the administration and distribution of insurance. For example, without efficient payment and settlement system mechanisms in place, it may be substantially more difficult and more expensive for insurers to collect premiums on a regular basis and to pay claims. Likewise, limited internet connectivity or unreliable electricity networks undermine communication and integration of systems between branches and head office, and limited financial sector infrastructure could mean that the ability to sell insurance on the back of other financial services, or to leverage their geographic footprint, is limited. Uptake of insurance will also be determined by the state of development of the real sector, for example: take-up of health insurance will depend on the level of development of state hospitals and clinics and the efficient supply of agricultural index insurance is dependent on the availability of reliable meteorological data and the existence of appropriately equipped weather stations.

Implications for regulatory approach. In an environment with limited infrastructure, a more market-based approach, notably the concessionary and nudge approaches, could result in private firms only targeting those sectors that they can easily reach with the existing infrastructure. Where there are severe infrastructure constraints, for example in the deep rural areas of many countries, a public provision or directive approach could leverage state support and infrastructure to compensate for constraints to private provision⁴³.

How can the supervisor influence infrastructure? Investment in physical infrastructure falls beyond the realm of the insurance supervisor's influence. However, a proactive supervisor may coordinate with relevant ministries (for example through a financial or social inclusion inter-governmental policy group) to advocate for greater investment in key infrastructure, such as the development of IT transaction platforms, and to open up financial sector infrastructure. For example: in a number of countries, mobile payments platforms are seen as potential mechanisms to overcome the limitation that financial payments networks are restricted to cities and larger towns. The insurance supervisor can advocate for such networks to be leveraged for distribution of other financial services.

Box 7: Examples of the role of physical infrastructure in insurance market development

Uganda

Uganda has limited infrastructure available for the distribution of insurance. Banking networks are limited and there is no extensive, formalised retailer network. This is a major obstacle to increasing access to insurance. At the time of the country study, the lack of available physical infrastructure for the distribution of insurance was identified as a primary reason for the supervisor's inability to

⁴³ This is for example witnessed in China, Peru and India.

directly target access to insurance in the immediate term, as it first needed to focus on developing the underlying infrastructure (Smith et al., 2008). The country's approach to its insurance industry would therefore be classified under the long term market development approach.

Tanzania

The Tanzania diagnostic indicated that (i) limited internet connectivity between branches and head office, (ii) dips or downtime in mobile network coverage and electricity and (iii) poor road infrastructure all challenge insurance market development. The first two elements make it difficult to move beyond the current paper-based systems used by most insurers. The latter impacts on distribution. In addition, limited access to electricity and piped water are indications of a development gap that may challenge especially the rural target market in becoming viable insurance clients and the absence of a well-developed formal retailer network means that one of the emerging alternative distribution channels, internationally, is not available (Hougaard et al., 2012).

The agricultural sector provides a particular window into the insurance market challenges created by poor infrastructure: a 2010 study⁴⁴ demonstrated that agricultural infrastructure such as transport, communication, storage facilities, marketing facilities, risk management, quality standards as well as marketing research and information are underdeveloped in Tanzania. According to the AgFiMS survey results, lack of infrastructure, electricity, transport and markets all limit the growth of agricultural businesses. Poor infrastructure and distance to the markets hinder agribusinesses' integration into commercial supply chains. Underdeveloped infrastructure in the agricultural sector also means that there are few agricultural value chain entities (for example well-capacitated processing facilities, extension service networks, input suppliers with a broad reach, or market systems or farmers' cooperatives) that can serve as aggregators of smallholder farmers for insurance distribution purposes.

Along with poor electricity, piped water and road coverage in rural areas, poor agricultural sector infrastructure therefore creates a rural-urban divide that will be very difficult to cross for insurers wishing to penetrate the unserved market. This implies that insurers will have to be particularly innovative in the design of distribution and premium collection strategies.

Brazil

Brazil provides a counter-example: the country's well-developed financial sector, on-grid, urbanised population and wide-reaching physical infrastructure via the municipalities combine to form a strong backbone for financial sector development. It provides insurers with a large network that can be used to place their products within reach of the bulk of the population, though challenges remain in some deep-rural areas such as the Amazon. The existence of an efficient payment network, through the ubiquitous banking agent network in every one of the more than 5000 municipal areas, is fundamental to making the microinsurance market work as the target market often has a preference for transacting in cash. This well-developed infrastructure contributes to the feasibility of the concessionary approach adopted in Brazil (Bester et al., 2010).

3.2. Latent demand

Whether there is latent demand for risk mitigation in certain product areas or defined target markets is a primary factor determining the approach adopted.

⁴⁴ As quoted in: Temba, P. (7 May 2012). *AllAfrica* [Online]. Available: <http://allafrica.com/stories/201005171654.html>

What is latent demand? Demand refers to actual intention/willingness to purchase an insurance product or pay for suitable risk cover at a suitable price. In the event that there are insufficient insurers to meet this demand or that products are not distributed in a manner that will realise the demand, it will remain latent and will frequently manifest in the development of informal risk pooling mechanisms. Note that a lack of demand does not necessarily mean there is no underlying *need* for the product. Even though individuals or households may have insurable needs, some consumers may simply not have enough income to find insurance affordable or may not be aware that insurance is an option to deal with their need.

Relevance for insurance. Latent demand means that people are aware of and will be prepared to pay for the insurance product. Without latent demand there can be no voluntary sales of insurance policies and thus no private commercial market.

Implications for regulatory approach. Latent demand is a prerequisite for market provision. If there is no latent demand, although an existing underlying need, then a public provision approach will be the only viable option to increase access to insurance. Thus, in a hypothetical hierarchy of conditioning factors, latent demand may be one of the most important.

How could the supervisor influence latent demand? The supervisor can indirectly impact latent demand by undertaking targeted financial education initiatives, including on the benefits of insurance from regulated rather than non-regulated providers, or by requiring insurers or the industry to do so. In the absence of latent demand, public provision may be the only short-term option to directly increase access to insurance. However, if financial education is effectively implemented together with a public provision approach, latent demand may be catalysed over time and other approaches, such as the directive or concessionary approach, may become feasible. Furthermore, the supervisor could promote the formation of demand by allowing the bundling of products so that product elements or features for which there is latent demand can be bundled with products for which there is not yet a latent demand, but indeed a need or a strong public policy imperative.

Box 8: The role of demand

Capitalisation and “benefits in life” – Brazil

The Brazilian microinsurance market is characterised by a strong demand for a sweepstakes component – called capitalisation bonds – that is a unique feature of the Brazilian insurance landscape. Capitalisation bonds are a type of savings vehicle that includes a lottery prize. In the microinsurance space, insurers buy the bonds and cede the associated prize to policyholders. They therefore get entry into the lottery draw as a free add-on to the policy, without the savings component. Capitalisation is such a strong driver of demand that it is an add-on to virtually all insurance offerings to the low-income/mass market.

Another strong demand feature revealed by focus groups in the Brazilian market is the need for “benefits in life”- that is, some benefit to a life policy that is provided while the person is still alive. In response, a number of product offerings bundle in tangible in-life benefits, ranging from food hampers to pharmacy discounts (Bester et al., 2010).

Both of these features were taken into account when the concessionary regime for Brazil was designed.

Funeral insurance – South Africa

According to the 2010 FinScope⁴⁵ survey data, almost half (49.7%) of South African adults had some form of risk cover, of which funeral cover accounts for 89.2%. This equates to more than 16 million South Africans covered by funeral insurance. The demand for funeral cover is driven by the need for a dignified funeral under traditional custom, as well as the everyday reality of death (Smith et al., 2013).

South African insurers have identified this strong latent demand as an important driver of growth in the South African funeral insurance industry with the traditional maxim that ‘insurance is sold and not bought,’ being reversed for funeral insurance. In one notable example, funeral insurance has been successfully sold in large numbers ‘off the shelf’ as part of a partnership between an insurer and a low-income clothing retailer, despite no active sales process (Thom et al., 2014). Strong latent demand for funeral insurance also underlies the pervasive informality found in the funeral insurance market in South Africa. Along with other conditioning factors, as will be discussed below, the strong demand for funeral insurance has prompted the policymaker and supervisor to design a concessionary regulatory response.

Health insurance - China

Focus group discussions conducted for the China access to insurance diagnostic indicated that health is considered a major risk by participants, with only the cost of education considered a greater risk to their finances. Despite widespread state-provided health insurance, commercial insurers still successfully sell medical expense insurance – often as a form of top-up insurance. This substantial underlying demand for health insurance has prompted the China Insurance Regulatory Commission (CIRC) to include health insurance under the concessionary dispensation created for micro personal insurance under a new Rule published on 12 June 2012 entitled the *Concept for Comprehensive Roll out of Micro Personal Insurance* (Wei, et al., Forthcoming).

3.3. Supply

The attention now turns to those conditioning factors related to the operation of the market. Sections 3.3.1 to 3.3.2 consider the market “reality check” on what approach will be feasible in a particular market, namely: (i) the level of market development; (ii) the impact of market failures; and (iii) the presence of informality.

3.3.1. Level of market development

The level of market development is comprised of three elements: breadth, penetration and financial soundness.

Market breadth

What is market breadth? The breadth of the insurance sector refers to the access of the population to a wide range and choice of products and providers.

Implications for regulatory approach. A concessionary or nudge approach is enabled by a market with existing breadth. As the market is already providing good choice, it may just need to be nudged into increasing access. Similarly, the concessionary approach is premised on the assumption that there are insurers in the market ready to roll out products if a proportionate space is created. At the same time, the concessionary approach also aims to

⁴⁵ A nationally representative demand-side survey of financial inclusion conducted by FinMark Trust. See www.finscope.co.za.

increase breadth by creating a space for more players (including the formalisation of informal players), thereby expanding clients' options for formal providers and products. In the same vein, the nudge approach aims to increase breadth by triggering more product options for the low-income market.

A lack of breadth, alongside various other conditioning factors, may imply that the market is unable to increase access to insurance with its current resources. In such instances, government may need to “take matters into its own hands”, pointing towards a directive or public provision approach, neither of which requires breadth. If breadth as well as state capacity is limited, the long-term market development approach may be the most appropriate.

How could the supervisor influence market breadth? As part of a long-term market development approach, the supervisor may embark on various initiatives to support market infrastructure development within the insurance sector in an effort to promote breadth, for example modernisation of insurers' system platforms. Other actions that can support breadth include: liberalising a former state-owned monopoly to permit local and foreign players to enter; permitting a wider range of products and bundling options; implementing regulatory measures aimed at generally reducing the cost of delivery; or building expertise to develop new products, for example through data collection and actuarial analysis or bringing in foreign reinsurers.

Market penetration

What is market penetration? The penetration of an insurance sector is defined as the size (in terms of turnover or revenue) and the state of development of the insurance sector as measured in assets or premiums relative to GDP.

Implications for regulatory approach. A reasonable level of market penetration is important for the nudge approach and to a lesser extent for the concessionary approach, as these approaches rely on market forces to move insurers downmarket. Reasonable penetration would also be an advantage for the directive approach, as a better developed market would be in a better position to extend insurance to the unserved when compelled by the state. The public provision approach may be a response to low penetration alongside other conditioning factors. Similarly, very low penetration may indicate that a long-term market development approach is called for rather than a direct access emphasis.

How could the supervisor influence market penetration? The supervisor increases market penetration with all the same efforts as market breadth - barring the specific product regulations. In addition, penetration may grow in a scenario where, for prudential reasons, the supervisor encourages mergers and market consolidation to create larger, better capitalised insurers.

Financial soundness

What is financial soundness? In the insurance sphere, financial soundness or health is an equivalent term for solvency. It refers to the “[ability] of an insurer to meet its obligations to policyholders when they fall due. Solvency includes capital adequacy but also involves other aspects of a solvency regime, for example, technical provisions, qualitative aspects (such as

would be addressed in an enterprise risk management framework), supervisory review and supervisory reporting⁴⁶. Financial soundness is intricately linked to the stability of the insurance sector.

Implications for regulatory approach. Financial soundness is important in all approaches other than the public provision approach, where insurers can be supported by the state. However, it is particularly important in the directive approach as insurers need to be able to absorb the increased costs related to offering insurance to specific groups that they may not have found viable clients otherwise.

How could the supervisor influence financial soundness? All prudential regulation is fundamentally aimed at ensuring soundness and stability, regardless of which regulatory approach is adopted. Specific considerations include risk based regulation, actuarial pricing and reinsurance requirements.

Box 9: Examples of how the level of market development can influence the regulatory approach

Breadth and depth

The role of breadth and depth in shaping which approach is feasible can be unpacked by contrasting the examples of South Africa, Nigeria and Kenya:

South Africa has the third highest insurance market penetration⁴⁷ in the world, with insurance premiums accounting for 12.9% of GDP (Swiss re, 2012) – indicative of significant depth. Furthermore, South Africa had 154 licensed companies in 2012 serving a total population of approximately 51 million (World Bank, 2013), indicating a high level of market breadth. South Africa has been pursuing a directive approach for a number of years and is now moving towards a concessionary approach.

In contrast, **Nigeria** ranks 86th in the world for insurance penetration, with the insurance market accounting for 0.6% of GDP (Swiss re, 2012). In 2012, Nigeria had a total of 61 registered insurers serving a total population of about 169 million (Dias, et al., 2012). Survey findings indicate that only 1.5% of the Nigerian adult population has an insurance product (de Vos et al., 2011). Such low breadth and depth suggest that much headway is still to be made in the market at large. The 2013 Access to Insurance Initiative diagnostic found that: “[considering] the challenges and opportunities posed by the broader Nigerian context, the industry dynamics, the findings of the demand side research, and the specific business needs of microinsurance operations, Nigeria will need a more enabling regulation, coupled with stricter minimum consumer protection and market conduct standards that are effectively enforced, to ensure the health of the system and the soundness of insurance companies, while protecting policyholders.” In parallel, it makes a number of recommendations for the creation of a concessionary approach.

The level of market development in the **Kenyan** insurance industry is between that of Nigeria and South Africa. Total gross insurance premiums generated in 2008 were KSh55 billion (US\$ 730 million or 2.6% of GDP), of which gross premiums for general and long-term business consisted of KSh35 billion (US\$ 460 million or 1.7% of GDP) and KSh20 billion (US\$ 270 million or 0.9% of GDP), respectively. Voluntary insurance serves only 3.6% of the adult population, while only 1% of adults have life insurance Overall insurance penetration only increased marginally between 2006 and 2008 from a lower base of 2.5% to 2.6%, largely tracking GDP growth. Kenya has thus far followed a nudge approach to develop access to insurance. The Insurance Regulatory Authority has a legislated mandate to “promote the development of the sector.” This has manifested through *ad hoc*

⁴⁶ <http://www.iaisweb.org/index.cfm?pageID=47&vSearchLetter=s##>

exemptions for insurers and insurance distributors (Smith et al., 2010).

Financial soundness

The 2012 Access to Insurance Diagnostic in Tanzania found that the state-owned insurer, the National Insurance Corporation, has a poor claims payment track record and questionable solvency. This is damaging the reputation of insurance more broadly and needs to be taken into account when the optimal regulatory approach is chosen. In parallel to implementing a concessionary approach focusing mainly on the intermediation side, the Tanzanian supervisor has embarked on regulatory reforms to enhance prudential regulation in an effort to ensure solvency and promote consolidation in the industry (Hougaard et al., 2012).

3.3.2. Informality

What is informality? Informality refers to unlicensed schemes offering risk mitigation products – either in contravention of the insurance legislation, or in a grey area outside the official definition of insurance. High levels of informality in the insurance market with concomitant consumer protection concerns can harm the perception of insurance in general amongst potential (and existing) clients, thereby reducing client trust and the demand for insurance. At the same time, informal risk-pooling at community level (for example through burial societies or community-based health schemes) can provide solutions to risk management needs where the formal market fails to reach and can play an important social and financial role in the community.

Implications for regulatory approach. If high levels of informality in a market lead to consumer protection issues, an active regulatory and enforcement approach is required to formalise informal institutions – regardless of the regulatory approach adopted. Informal institutions may not have the capacity to comply with the full suite of regulatory requirements applicable to incumbents, meaning that they would opt to remain informal or, if formalisation is effectively enforced, will cease to exist. The latter may not be desirable given other policy objectives such as the empowerment of small businesses. Neither may their operations or products be as complex as that of formal insurers. Insurers operate outside of the law because it is beneficial for them to do so relative to the perceived costs of entering the regulatory fold⁴⁸. Therefore, in order to incentivise these entities to formalise the costs of doing so need to be reduced. A concessionary approach creates tiered regulatory requirements proportionate to the nature, scale and complexity of risks. It thus creates a dedicated space into which informal entities can formalise, making it the appropriate regulatory approach to address informality, provided there is sufficient supervisory capacity to implement it.

However, informality in itself may not be a major concern provided it does not result in consumer protection issues. In an undeveloped market, community-based risk pooling initiatives may arise due to latent demand and fulfil an important risk mitigation and social support need not being addressed by the formal market. In such instances, the long-term market development approach would be most appropriate in achieving formalisation over time. All of the other approaches may also implicitly facilitate formalisation by forcing, enabling or encouraging formal players to compete in the market space currently served by

⁴⁸ . Source: Heintz, J. 2012. *Informality, Inclusiveness, and Economic Growth: An Overview of Key Issues*. SIG Working Paper No.2, July 2012.

informal means, or by the state stepping in directly and thereby potentially crowding out informal provision.

How can the supervisor influence informality? Experience shows that addressing informality requires a coordinated approach amongst various public agencies. Where informality relates directly to the provision of risk mitigation products, the role of coordinating such agencies naturally devolves to the insurance supervisor.

Box 10: Examples of how informality impacts on the regulatory approach

Philippines

In the 2008 Philippines diagnostic it was estimated that over 1 million adults were engaged in informal insurance schemes. Approximately half of the 22,000 operational co-operatives in 2007 were estimated to be engaged in providing informal insurance services. As cooperatives are regulated by the Cooperative Development Agency (CDA), their activities were outside the sphere of influence of the Insurance Commission (IC). In addition, a number of pre-need companies regulated by the Securities and Exchange Commission (SEC) provided insurance benefits outside of the jurisdiction of the IC (Lanto et al., 2008). Since the schemes did not benefit from any actuarial input and had not undergone the review and approval process of the Insurance Commission, clients engaged in these are exposed to higher risks. Most of the pre-need companies subsequently failed, leading to a growing distrust amongst the low-income population in insurance. Thus the high level of informality in the market and the concomitant risks to consumers was one of the key triggers for the Philippines to implement its Microinsurance Regulatory Roadmap, which entailed revamping its concessionary approach (ADB, 2013).

It was recognised that informality could only be addressed through cooperation between regulatory authorities responsible for the institutional regulation of the various entities providing insurance informally. As a result, the IC, CDA and SEC jointly issued Memorandum Circular 01-2010 to define government's policy on informal insurance activities.

Southern African Development Community (SADC) countries

A 2012 study on insurance in 12 states in the SADC region found that many of the countries, including Botswana, Namibia, Swaziland, Zambia and Tanzania, are characterised by low take-up of informal risk cover. Low prevalence of informality reduces the imperative to move to a concessionary approach with a formalisation objective.

South Africa is a notable exception: the prevalence of informal provision of insurance in the funeral parlour industry and the consumer protection concerns that it gives rise to were the main initial driving force for government turning its attention to the regulation of microinsurance in South Africa.

Apart from informal funeral service providers, the 2008 insurance diagnostic in South Africa also highlighted the presence of an estimated more than 100,000 informal community-based risk-pooling groups called burial societies. These societies are mostly small and do not guarantee their benefits. They fulfil a valuable social role. In recognition of this role and due to practical supervisory considerations, the proposed microinsurance regulatory framework exempts all societies that do not guarantee their benefits and with a membership base of less than 2,500.

3.4. Public sector and regulatory framework

Four conditioning factors that relate to the public sphere emerge cross-country:

- the availability of public funding;
- the state of public infrastructure;
- supervisory capacity; and
- the overall compliance burden on the insurance sector.

3.4.1. Availability of public funding

What do we mean by availability of public funding? In the context of inclusive insurance, the availability of public funding simply refers to whether the state is able to afford the significant outlays required for state-supported microinsurance. It thus relates to the fiscal implications of the choice of regulatory approach. Donor funding is also considered a form of public funding.

Relevance for insurance. If public funding is available, the state is able to pay for premiums or to provide public resources to support other aspects of the insurance value chain.

Implications for regulatory approach. The availability of public funding is a prerequisite for the public provision approach, which relies on state-funded risk mitigation initiatives. For the other approaches, the availability of public funding for *implementation purposes* is not of direct relevance. However, other approaches also require funding, for example to create a concessionary regime, licence informal players, and improve systems and staff capacity.

How can the supervisor influence public funding? The supervisor does not have influence over central government's budget. However, by highlighting the relevance of improving access to insurance and requesting funding in a timely manner, the supervisor may be able to influence budgetary allocations. Furthermore, it typically generates revenue through licensing fees and industry levies, part of which could be dedicated to the promotion of inclusive insurance markets.

Box 11: The role of public funding

In 2010, China's government revenue per capita was USD \$504.9 per person. Kenya's revenue per capita for the same year was USD \$159.8 per person, whilst Ethiopia's was just USD \$35.1 per person (World Bank, 2013).

China is providing subsidised insurance products to large rural populations. Kenya provides partial subsidies for healthcare to employees in the formal sector, whilst Ethiopia's ability to provide insurance publicly is limited. Ethiopia however illustrates how significant donor funds can be leveraged for financial inclusion. Donor funds are often earmarked with a real economy link, for example for rural poverty alleviation/agricultural sector development, for which insurance is then regarded as a tool.

3.4.2. Public infrastructure

What is public infrastructure? Public infrastructure refers to the state's administrative capacity to implement policies and programmes. Supervisory capacity is excluded here as, due to its direct importance to the insurance market, it warrants separate discussion (see Section 3.4.3 below). Public infrastructure includes national, regional/provincial and local administrations.

Relevance for insurance. The ability of the state to make good on its promises is relevant for all sectors where the state could play a direct role as provider or enabler – including insurance. Examples in the insurance domain include health service networks that are able both to distribute health insurance and render health services, national and regional agricultural and meteorological departments that can be utilised to implement risk mitigation programs for agricultural insurance programs and even to undertake damage assessments on behalf of commercial insurers, or local authority structures that can collect and partly pay insurance premiums on behalf of their citizens.

Implications for regulatory approach. The implementation ability of the state is a key consideration when deciding whether a public provision approach is feasible. Different types of infrastructure will be necessary for different types of products. For example, a network of health service providers is necessary to implement a national health insurance scheme. To implement agricultural index insurance, adequate weather tracking infrastructure is required. This is a limitation to this type of publicly provided insurance in many countries.

How can the supervisor influence public infrastructure? Developing public infrastructure is largely beyond the influence of the supervisor, although effective coordination with relevant government departments may support implementation of insurance-specific programmes.

Box 12: Examples of the role of public infrastructure

Tanzania – health insurance

Tanzania subsidises health insurance through three schemes at national and community level, covering a total of about 6 million citizens. However, ineffective publicly provided healthcare and inefficient administrative systems challenge the success of the schemes. Focus group discussions indicated dissatisfaction with the national health insurance scheme, with some respondents suggesting that if the scheme were not compulsory they would not choose to join it (Hougaard et al., 2012). Thus it would seem that the public provision approach was implemented without the requisite public infrastructure, resulting in reduced effectiveness of the schemes.

China – rural housing and agricultural insurance

The Chinese state supports commercial insurers by performing certain key roles in the provision of insurance under its public provision approach. This leverages existing public infrastructure to support the distribution of insurance to low-income households. The roles performed by the state include: damage assessment of insured households in the wake of natural disasters or accidents; premium collection; marketing; and claims payments in many of the agricultural insurance schemes. Government departments also assist with technical loss prevention measures advising farmers on planting and livestock, thereby reducing the risk and cost to insurers (Wei et al., 2014).

3.4.3. Supervisory capacity

What is supervisory capacity? Supervisory capacity refers to the ability of the insurance supervisor to effectively implement regulations, monitor the insurance industry and enforce sanctions against misconduct. Funding is a key aspect of supervisory capacity as it allows the supervisor to attract and develop the appropriate capacity. The extent of its human resources, their technical skills and experience will determine the overall ability of the supervisor to oversee the national insurance industry. A newly formed insurance supervisor will likely be less effective in its roles than one with experience.

Relevance for insurance. The principal objective of supervision is to promote the maintenance of a fair, safe and stable insurance sector for the benefit and protection of policyholders (IAIS, 2011). The supervisor's role in defining and enforcing regulation is also important to market players, as a clear definition of the rules removes uncertainty, thereby paving the way for investment and other strategic market decisions.

Implications for regulatory approach. Certain of the regulatory approaches utilised to extend access to insurance require more supervisory capacity than others. In particular, the concessionary approach and, to a lesser extent, the directive approach require sufficient supervisory capacity to render them effective. Regulation which delegates certain aspects of insurance supervision to market players, for example by making insurers ultimately liable for all distribution and intermediation partners' actions, can help reduce the required supervisory capacity. The supervisory capacity demands differ as follows across the five approaches:

- *Public provision implemented by state, limiting demands on supervisory capacity.* The public provision approach is heavily reliant on public infrastructure (see Section 3.4.2 above), but does not necessarily place high demands on the insurance supervisor's capacity. The insurance is primarily implemented by the state and hence the role of the supervisor to monitor and oversee the private market becomes less important. More capacity will be required if private insurers are utilised to perform underwriting and/or distribution of publicly provided programs.
- *Extent of supervisory capacity for directive approach dependent on number of insurers.* The directive approach requires supervisory capacity as it falls within the ambit of the supervisor to ensure that the commercial insurers fulfil the state-provided access directive. However, in a market with a limited number of large commercial insurers the degree of supervisory capacity required to implement the directive approach is lower than in a scenario where a large number of smaller players need to be effectively monitored.
- *High supervisory capacity required for concessionary approach.* The concessionary approach requires the highest level of supervisory capacity as the adoption of this approach can result in a number of smaller players and/or additional numbers and new types of intermediaries entering the market. The concessionary approach also requires the supervisor to monitor more than one tier of regulation, making supervision more complex and requiring greater resources. The supervisory capacity requirements will be higher under a full concessionary approach spanning prudential and market conduct elements than when for example only the intermediation space is granted concessions.
- *Market focus of nudge approach has limited supervisory capacity requirements.* The nudge approach would normally not require more supervisory capacity than normal insurance supervision without any inclusive market focus.
- *Supervisory constraints a major determinant of long-term market development approach.* The long-term market development approach requires the least supervisory capacity as it does not call for new regulation and does not seek directly to expand the number of insurers or intermediaries. Indeed, one of the factors leading to its adoption may be severely constrained supervisory capacity.

How can the supervisor influence capacity? Supervisors continually strive to improve and expand their capacity, including by remaining up to date with global trends and research to

inform their decision-making. The capacity of the supervisor is strongly impacted by the level of funding extended to it by the state, as this determines the number and quality of technical staff it can afford to employ. Other means of enhancing supervisory capacity could be through delegated supervision or the use of self-regulatory organisations.

Box 13: Examples of the role of supervisory capacity

Supervisory capacity building is almost without fail a recommendation in access to insurance diagnostic studies⁴⁹. The Education Sub-committee of the IAIS's Implementation Committee plays a pivotal role in supervisory capacity building, as do other supervisory capacity building initiatives through, amongst others, the Financial Stability Institute⁵⁰ and the Toronto Centre⁵¹. The Access to Insurance Initiative plays an increasing role in building supervisory capacity and encouraging peer learning in its capacity as implementation arm of the IAIS with regard to inclusive insurance regulation and supervision.

Below, two examples of the role of supervisory capacity are highlighted.

SADC

Constrained capacity due to limited technical supervisory staff in countries within the Southern African Development Community (SADC) was identified by supervisors as a major risk to their respective insurance industries. Most of the SADC insurance markets currently fall within the nudge or long-term market development approaches. Despite a number of these countries having mooted a move to a concessionary regime for a number of years, only Mozambique has formally enacted a tiered insurance framework (Chamberlain et al., 2014). A lack of supervisory capacity implies that any plans to adopt an approach requiring greater supervisory capacity will face challenges.

India

The Indian Insurance Regulatory and Development Authority (IRDA) limited the scope for offering microinsurance to insurers that are deemed to have appropriate operational governance. These are corporate entities with substantial (>\$25 million) capital (Sinha & Sagar, 2008). The stringent entry requirements ensure financial soundness, but also limit the number of insurers to be supervised.

3.4.4. Compliance burden

What is the compliance burden? The compliance burden refers to the overall level, in terms of entry barriers and associated compliance costs, of regulatory requirements imposed by the existing body of insurance laws and regulations.

Relevance for insurance. The nature of the compliance burden impacts the cost structure of insurers. High compliance costs increase per transaction intermediation costs for all insurance products sold by insurance providers, thereby negatively impacting on the ability of insurers to extend their operations to lower-premium environments. However, overly lenient regulatory requirements may also be detrimental to increasing access to insurance. Low barriers to entry have been observed to encourage multiple entrants to the industry. Whilst this may increase competition in the industry, too many insurance providers in a small market means that they will struggle to achieve sufficient scale to benefit from the economies of scale associated with a larger risk pool. Also, low entry barriers can allow

⁴⁹ Apart from the SADC examples below, these include, amongst others, Nepal, Mongolia, Ethiopia, Ghana and Nigeria

⁵⁰ <http://www.bis.org/fsi/aboutfsi.htm>

⁵¹ <http://www.torontocentre.org/>

financially unsound providers to enter the market and lead to market malpractices due to intense competition, eventually resulting in a break-down in trust when such insurers fail to deliver on their promises.

Implications for regulatory approach. Broadly speaking, the higher the regulatory requirements in the mainstream insurance market, the less likely it is that insurers will naturally progress down-market. Thus, if the compliance burden is not proportionate to the nature, scale and complexity of the risk, the state may be required to address access to insurance. For example, a high compliance burden can either prompt the regulator to opt for concessionary elements aimed at a proportionate compliance burden to allow smaller and more innovative players to enter and informal players to formalise, or can necessitate greater direct state provision as market players are unable to reach the target market. Alternatively, one of the aims under the long-term market development approach can be to improve efficiency and reduce disproportionate compliance requirements over time.

How can the supervisor influence the compliance burden? The supervisor can affect the compliance burden on insurers by increasing or reducing the regulatory requirements over which it has control⁵².

Box 14: Examples of the extent and impact of the overall compliance burden

The **Colombian** diagnostic found that the overall compliance burden on Colombian insurers is generally not overly onerous. Colombian regulators are therefore able to implement a nudge approach to encourage access to insurance (Caceres & Zuluaga, 2008). Similarly, minimum capital requirements are not perceived as prohibitive by new entrants in **Zambia** or **Swaziland** (Hougaard et al., 2009; Hougaard et al., 2011). Hence the concessionary frameworks being developed in Zambia and Swaziland do not focus on creating a new prudential tier, but rather on intermediation elements, as well as (for Swaziland) on opening up the institutional space for microinsurance.

In contrast, the minimum capital requirements and other licence conditions in the **Philippines** were found to pose significant barriers to entry for non-traditional providers such as mutual benefit associations. This prompted the Insurance Commission as early as 2006 to implement a concessionary regime for microinsurance (Lanto et al., 2008).

3.5. Interplay between the conditioning factors: determining the most appropriate response

No approach will be the result of only one conditioning factor: it is the combination of and interplay between various conditioning factors within a specific market environment that makes a given approach more appropriate to that environment.

The following matrix summarises the role of various conditioning factors observed across countries to date. Each factor can play one of four roles in each approach: (i) it can be a *prerequisite* to a given approach; (ii) it can be *important to* the implementation of a specific approach; (iii) it can *aid the adoption* of the approach; or (iv) it will *not be a particular determinant* of the specific approach or the pursuit of that approach is neutral vis-à-vis the particular conditioning factor:

⁵² Supervisors typically have the ability to set secondary regulatory requirements, for example through circulars or directives, but primary legislation is set by the legislature and the supervisor must conform to it.

Conditioning factors		Approach				
		Public provision	Directive	Concessionary	Nudge	LTMD
Context factors	No adverse macroeconomic conditions (hyperinflation, fiscal crisis, very low income levels) are present	✓	✓✓	✓✓✓	✓✓✓	
	Good existing physical infrastructure	✓	✓	✓✓	✓✓✓	
Demand	There is latent demand for a particular insurance product		✓✓	✓✓✓	✓✓✓	
Supply	State of insurance market development	There is reasonable penetration		✓	✓✓	✓✓✓
		There is significant breadth		✓	✓✓✓	✓✓✓
		Insurers are financially sound	✓	✓✓✓	✓✓	✓✓✓
	Substantial informality and associated consumer abuses				✓	
Public sector and regulatory framework	Public funding is available		✓✓✓			
	Public infrastructure is well developed		✓✓✓			
	Adequate level of supervisory capacity		✓	✓✓	✓✓✓	✓
	A high regulatory burden				✓✓	

Legend:

- ✓ The existence of this factor aids in adopting the approach
- ✓✓ The existence of this factor is important in order to adopt the approach
- ✓✓✓ The existence of this factor is required in order to adopt the approach

Table 3: Relationship between conditioning factors and regulatory approach

Certain conditioning factors may have a greater hierarchical 'importance' than others in determining the regulatory approach adopted in a particular country. For example, the first consideration may be whether there is latent demand for insurance among the target market. If this conditioning factor is present, the regulator may next ask itself what will be feasible to implement given the level of supervisory capacity and public infrastructure.

Below, we summarise the set of conditions that would seem to be conducive to the implementation of each of the approaches⁵³:

- *Public provision approach.* The public provision approach can be applied in an environment where public funding is feasible and where there is a sufficient existing level of public infrastructure. Where commercial insurers are involved, they should also be capable of delivering.
- *Directive approach.* The directive approach can be followed in an environment with a relatively low level of market breadth, but sufficient depth and financial soundness and at least some latent demand.
- *Concessionary approach.* The concessionary approach requires a reasonably developed market with existing latent demand and sufficient physical infrastructure. It may furthermore be desirable where there are high levels of informality, or where the insurance sector is already subject to a high existing compliance burden that makes insurance provision to the low-income market too expensive for current players. A full concessionary approach furthermore requires relatively high supervisory capacity in order to successfully supervise multiple entities under tiered regulation. The supervisory capacity requirements reduce considerably for a partial concessionary approach only focusing on the intermediation side, especially where insurers can be leveraged to register non-traditional intermediaries and be accountable for their actions.
- *Nudge approach.* Like the concessionary approach, the nudge approach is market-based and so is reliant on existing latent demand and a sufficient degree of market development and physical and financial sector infrastructure. However, in contrast to the concessionary approach the nudge approach will be most appropriate if there is a low current compliance burden. It is suited to environments in which the insurance market will progress down-market in an organic fashion and the state merely needs to fulfil an enabling and encouraging role.
- *Long-term market development approach.* The long-term market development approach is the default approach if other conditions are not favourable.

4. Conclusion

This paper identified five observed regulatory approaches to promote access to insurance observed across jurisdictions and across product markets. These approaches are classified along a continuum primarily defined by the level of state intervention, ranging from direct public provision, on the one hand, to gradually building market development, on the other hand. Several interrelated conditioning factors together determine which approach will be appropriate in each given market environment. As new country evidence comes on board, especially on the medium to long-term impact of different approaches, these conditioning factors can be adapted, expanded and refined. Similarly, emerging evidence will enable a refinement of the analysis of the approaches themselves.

⁵³ Note that these are sets of circumstances that *may* make a particular approach feasible and should not be regarded as specific recommendations. As further learning comes on board, these findings can be updated.

This paper builds on Paper 1 to present a fuller understanding of the factors that drive the development of microinsurance models: Paper 1 considers the various evolving microinsurance business models and the regulatory responses to them at a granular level. Paper 2 unpacks the overarching regulatory approaches followed that impact on microinsurance market development. In so doing, the papers aim to provide a greater understanding of the evolution and development of microinsurance markets and to present supervisors with a set of considerations when determining which general approaches and specific responses to implement in their particular market.

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6. Appendix 1: Detailed concessionary approach examples

Philippines

The main tenets of the Philippines microinsurance regulatory regime are:

- **Insurance Memorandum Circular 1-2010: Microinsurance regulation.** Microinsurance is defined as all products with guaranteed benefits of which the premiums do not exceed 5% of the daily minimum wage of non-agricultural workers in metro Manila and the maximum sum of benefits is not higher than 500 times the minimum wage for non-agricultural workers in metro Manila - per product, per policy. Bundled life, non-life and health policies may be provided by insurers, mutual benefit associations and cooperatives, as long as each component is underwritten separately. All microinsurance products must have easily understood contract provisions, with simple documentation requirements. The manner and frequency of premium collection should coincide with the cash flows of the insured and should not be onerous. Furthermore, a class of microinsurance agent or brokers is created that do not need to take the regular licensure examination, but that should undergo an approved and prescribed microinsurance training programme and undergo a related qualifying examination. Microfinance institutions and cooperative societies may apply to become microinsurance agents. Claims must be settled within 10 days upon receipt of complete documents.
- **Joint Insurance Commission (IC) -Cooperative Development Authority (CDA)-Securities and Exchange Commission (SEC) Memorandum Circular 01-2010 and 02-2010:** brings previously informal providers of insurance from the jurisdictions of the CDA and SEC under the jurisdiction of the IC for the purpose of insurance provision and prohibits any further informal provision of insurance. Another joint circular in 2011 extended the deadline for the termination of informal insurance and insurance-like activities.
- **Performance standards for Microinsurance:** determines various indicators and ratios relating to solvency and stability, efficiency, governance, understanding of the product by the consumer, risk-based capital and outreach. For each, a benchmark or target is set. Industry must report on these indicators and ratios in their returns submitted to the Insurance Commission.
- **Circular Letter 06-2011:** Guidelines for the approval of training programmes and licensing of microinsurance agents.

Brazil

The main tenets of the Brazilian microinsurance regime are:

- **CIRCULAR DOCUMENT, SUSEP Nº 439, JUNE 27, 2012:** Establishing conditions for the authorization of corporations and entities to operate with micro-insurance and other provisions. Main provisions include:
 - Existing insurers may be authorised to provide microinsurance in their field of operation, namely damages (asset insurance) or personal (life) insurance. The norms applying to insurance companies in general shall also apply to their microinsurance operation.
 - Insurers operating exclusively in microinsurance must set up an internal microinsurance ombudsman system to address complaints.
- **SUSEP CIRCULAR DOCUMENT Nr. 440, JUNE 27, 2012:** establishes mandatory parameters regarding micro insurance plans, defines forms of agreement, including through remote means, and other matters. Main provisions include:
 - Each microinsurance product plan submitted to SUSEP should state, amongst others, the target market for that plan, its objectives, the coverage offered, deductibles, grace period, forms of premium payment accepted, maximum period for paying claims, documents required for claims purposes and distribution channels used for marketing.

- The rest of the circular outlines various criteria for the definition of each of these aspects. Maximum coverage levels are set for various business classes, for example R\$24,000 (just under US \$10,000) for death, lender insurance, education insurance, total permanent disability insurance or serious illnesses, R\$4,000 for funeral expenses and R\$2,700 for personal accident insurance. On the damages (asset) side, limits include R\$30,000 for individual real estate and R\$40,000 for real estate for micro-entrepreneurs.
- Detailed stipulations are set regarding allowable excluded risks, deductibles and grace periods.
- The regulations also state that contracting may be done on the basis of policy proposals, individual certificates issued under a group policy or simplified “tickets”, and that contracting will be possible through “remote” (electronic) means.
- Furthermore, a microinsurance intermediary category called the microinsurance correspondent is created that opens up the intermediation space to a range of retail and other entities.
- A microinsurance plan glossary must comply with the definitions contained in the SUSEP portal and must use simple, easily understood terminology.
- **SUSEP CIRCULAR DOCUMENT NO. 441, JUNE 27, 2012:** Regulating the offer of micro-insurance plans through correspondents of financial institutions and other institutions authorized to operate by the Central Bank of Brazil. The Circular allows all banking or other financial service provider correspondents to distribute microinsurance, subject to an agreement between the insurer and the entity regulated by the central bank, which should contain certain prescribed elements, including a prohibition on compulsory microinsurance linked to a banking product as well as full and unrestricted access by SUSEP to the correspondent.
- **SUSEP CIRCULAR DOCUMENT Nº 442, JUNE 27, 2012:** Regulating the operations of microinsurance correspondents. Main provisions include:
 - Sets out the allowed functions of microinsurance correspondents, including supplying and promoting microinsurance, receiving proposals, collecting premiums, receiving and paying claims on behalf of the provider, including through remote means, as well as providing any administration on the policy
 - The insurer takes full responsibility for the actions of the correspondent and payment of premium to the correspondent is regarded as payment to the insurer
 - The insurer must enter into an agreement with the correspondent that meets certain stated conditions, including the prohibition of compulsory microinsurance linked to the other products of the correspondent
 - The insurance company must develop a plan to control the quality of services rendered by correspondents and must keep a register of all correspondents on its website; it must also report certain information regarding correspondents to SUSEP
- **SUSEP CIRCULAR DOCUMENT 443, JUNE 27, 2012:** Regulating the registration and activity of microinsurance brokers. Main provisions include:
 - Defines microinsurance brokers as natural persons exclusively active in intermediating microinsurance
 - Sets qualifying criteria for microinsurance brokers in the form of a course spanning 30 class-hours and covering the fundamentals of insurance, the concept and role of microinsurance, basic legislation, consumer rights, marketing strategies for microinsurance, ethics and trustworthiness in microinsurance.

- **SUSEP CIRCULAR DOCUMENT Nº 444, JUNE 27, 2012:** Regulating the assignment of rights to a cash-prize competing savings certificate as incentive to the acquisition of micro-insurance policies. Main provisions include:
 - Regulates the common Brazilian practice of adding a sweepstakes component to an insurance policy (called a capitalization bond) in the case of microinsurance, including disclosure requirements regarding the capitalization component and reporting of certain information to SUSEP
 - The capitalisation component shall also be contractable by remote means, as long as all requirements laid down in the specific regulation are complied with.

South Africa

The main tenets of the microinsurance regime are:

- Microinsurance is defined according to a number of product parameters, rather than according to the target audience. The parameters include that all products are to be underwritten on a first loss or sum assured basis; that no savings components are allowed (i.e. that microinsurance is risk-only); a benefit cap of a maximum of ZAR 50,000 (US \$5,000) per person, per insurer, for life policies and ZAR 100,000 for asset insurance, and a maximum renewable contract term of 12 months.
- These product parameters are set to limit the risk associated with microinsurance underwriting and to ensure simplified distribution. Regulatory requirements are then tailored to the low-risk nature of the product in a proportionate way, including:
 - Reduced prudential requirements for a dedicated microinsurance license including a reduction in minimum upfront capital from ZAR 10m for life and ZAR 5m for non-life to ZAR 3m for microinsurers; this amount may be built up over a period of three years; a simple reserving formula based on the previous year's net premiums will apply.
 - The microinsurance license will be available to any public or private company or cooperative. This opens up the institutional space, as only public companies are allowed to become insurers under the traditional regime.
 - Reduced intermediary qualification and other requirements
 - Uncapped commissions, subject to monitoring
 - Simplified templates and requirements for registration and tailored reporting templates and requirements that will focus on monitoring consumer value



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