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Institute of Microfinance (InM)

April 2010

Working Paper No. 2

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This paper is an outcome of this project. The authors are grateful to DFID's PROSPER (Promoting Financial Services for Poverty Reduction Program) project for providing funds for this project at the Institute of Microfinance (InM). However any opinions expressed and policy suggestions proposed in the document are the authors' own and do not necessarily reflect the views of either InM or that of PROSPER.

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Abstract

While both microcredit and microinsurance products in the developing world have essentially emerged in a regulatory vacuum, the general consensus appears to be that self-regulation may have thus far served the global microcredit industry adequately. The same premise is likely to be false when it comes to microinsurance since diffusion of the essence of insurance among the poor has proven non-trivial. The regulatory framework therefore has to target multiple goals such as to foster market innovations (in terms of product design and the institutional delivery mechanism), to protect the policy holder (i.e., achieving "cost efficiency" and "sustainability") and at the same time to ensure that insurance services remain inclusive and compatible with the needs of the poor. Accomplishing these goals within a single regulatory framework requires a fine balance. This paper deliberates on how to craft a set of regulatory statutes that would be relevant for the microinsurance industry in consonance with these goals.

JEL Classification Codes: G21, G22, G28, I30

Key Words: Microinsurance, poverty & vulnerability, prudential regulation, reporting standards

Toward an Efficient and Sustainable Microinsurance Market: The Regulatory Perspective[1]

Syed M. Ahsan, Shubhasish Barua and Jaimie Tax

1. Introduction

While both microcredit and microinsurance products in the developing world have essentially emerged in a regulatory vacuum, the general consensus appears to be that self-regulation may have thus far served the global microcredit industry adequately. Nurtured by a mix of microfinance institutions (MFI) and non-governmental organizations (NGOs) such as self-help groups (SHGs), the scale of operations and the diversity of products have flourished at a vigorous pace. The same premise is likely to be false when it comes to microinsurance. Products that are commonly claimed to be 'microinsurance', however, often turn out to be serving the interest of the insurer alone (e.g., in providing credit loss coverage), and does little to offer the insured household a real opportunity to overcome the impact of the loss. The obvious explanation would seem to be that in the case of credit, the selling part was easy; the extreme scarcity of capital is well-known to the poor (witness the historical rates charged by the proverbial village moneylender). But even when the implicit risk premium associated with informal or self insurance can be even more exorbitant (indeed, infinite), the awareness of the high cost of non-market insurance, and the associated concepts of pooling risks are poorly conceived by many unless they are provoked to do so. While idiosyncratic risk may be effectively pooled at a point in time so long as the 'pool' is large enough, systematic or 'covariant' risk often requires pooling across time. Diffusing the essence of insurance, namely to pool risks effectively and to share it among the insured, insurer and possibly the re-insurer, has proven non-trivial among the target groups. Hence, growth and development of the microinsurance market will not be as simple as that for microcredit. Can regulation pave the way?

By the term 'regulation', this paper will refer to a set of formal guidelines which are legally binding on the regulatee and for which there is a functioning supervisory authority. Self-regulation, by contrast, denotes a process where regulatory or supervisory guidelines are recommended by an agency controlled by the regulatees themselves (Christen, et al, 2003). The latter however will have no legal sanction. Examples would be the roles played by Sa-Dhan in India for the microcredit market there, while Palli Karma Sahayak Foundation (PKSF) in Bangladesh, which is a funding authority for a large number of MFIs (called partner organizations, POs, in this case), would come somewhere between self-regulation as defined above and formal regulation backed by legal authority.[2]

[1] The authors would like to acknowledge the constructive comments made by Salehuddin Ahmed, Suhel Choudury Franz Heidhues, Mahabub Hossain, Fazlul Kader, Baqui Khalily, Wahiduddin Mahmud, Joerg Schiller, Sohrab Uddin, and other participants at seminars held at the Institute of Microinsurance (InM, Dhaka), and Universities of Munich and Hohenheim.

[2] *Sa-Dhan* is described as an association of community development financial institutions, and is the largest apex body of MFIs in India. Its activities may be reviewed on the website (www.sa-dhan.org). The Bangladesh apex body is PKSF and in FY08, PKSF-sponsored POs disbursed BDT 82.5 billion, i.e., possibly about 40 percent of all microcredit funds advanced in the country (www.pksf-bd.org). PKSF set guidelines are binding on all member POs.

Returning to formal regulation, note that protecting the policy holder and fostering market innovations are generally put forward as the primary goals of a regulatory regime in the insurance context.[3] From an economist's perspective the policy holder's rights can be best served by ensuring that the industry remain competitive (thereby guaranteeing least cost and timely delivery of services) and financially solvent in the long run.[4] Market innovation as to product design and the institutional delivery mechanism is particularly important in microinsurance since lacking these, the task of rendering insurance services inclusive, cost effective, and compatible with the needs of the poor will remain elusive. Accomplishing both these goals within a singular regulatory framework would require a fine balance for the immediate import of regulation, as conventionally seen, is to restrain the activities or modalities of the regulatee. Consequently, the regulatee often looks upon regulation as inhibiting innovations. The primary objective of this paper is to lay down a framework illustrating that such a conflict need not necessarily arise in the delivery of microinsurance services.

Thus from here on the fundamental goals of regulation would be interpreted as requiring that the insurance market be 'efficient' and 'sustainable'. One may correctly reflect that in these broader terms the microinsurance market is no different than market for credit, general insurance and other financial (e.g., saving and deposits) services. However, the modalities through which these goals may be accomplished may well be different in the case of microinsurance, and further, be context specific. In any event, the principal purpose of this paper is to deliberate on how to craft a set of regulatory statutes that would be relevant for the microinsurance industry and fully in consonance with these goals.

The term 'efficiency' in this particular context, would describe an outcome where the services provided are meaningful to the poor (both in terms of product diversity and quality), are delivered in a timely fashion, and are offered at the least possible cost given the state of the technology and the institutional environment.[5] Products which are efficient by design would be sustainable if the cost is affordable to the poor, and if continuous innovations occur leading to the improvement of the range and quality of microinsurance services, which would be necessary in order to retain and augment the subscriber base. Thus, there is a possibility that some products, even if made available at least possible cost, would prove unaffordable in the absence of a subsidy; such a scenario would ordinarily be termed 'unsustainable' except where the needed shortfall in premium revenue can be built into the product design via the institutionalized mode of delivery.[6]

It ought to be stressed that this paper focuses on the microinsurance market as a whole, regardless of whether it is served by NGO/MFIs or commercial insurers, and when it refers to a regulatory authority, the latter is supposed to have the mandate to design, monitor and enforce the regulatory framework applicable to both segments of the market. While some countries do have a formal regulatory framework, as interpreted here (e.g., India or South Africa), many do not. Yet other countries have multiple regulatory bodies each with jurisdiction over only a segment of the market, which leaves the potential for mutual

[3] See for example Wiedmaier-Pfister and Chatterjee (2006).

[4] Bankruptcies become unavoidable in extreme circumstance. However, regulatory framework ought to be put in place to safeguard the interests of the insured. These issues are dealt with below.

[5] While the wording given goes beyond the requirements of the criteria for Pareto efficiency, note that the prerequisite of low cost provision can only be guaranteed under market competition.

[6] For example, the reinsurance fund may be committed up front by a third party (private, public or a multilateral entity).

inconsistency or incoherence. Hence an important goal of the paper is to develop a framework where even multiple regulators may coordinate their directives for the overall development of the industry.

With the above paragraphs serving as the introduction, the rest of the paper proceeds as follows. In section 2, the key regulatory benchmarks of a universal nature are reviewed, which may guide the operationalization of the twin goals of efficiency and sustainability of micro insurers. Next in section 3, we briefly describe the structure of the existing microinsurance market in Bangladesh and draw parallels to other developing countries. Section 4 examines the scope of the nascent regulatory regime in the Bangladesh context and cites its key shortcomings. A set of regulatory statutes and supervisory guidelines is then proposed in section 5, where we also explain how these directives may each apply to the different microinsurance regulatory agencies operating in a given context. Section 6 concludes the paper.

2. Regulatory Benchmarks

This section develops several regulatory 'benchmarks' of a universal nature which purport to lay down how the twin goals of cost efficiency and long-run sustainability of the micro insurance market may be achieved in a typical developmental context. These set of criteria are framed in the context of regulation; therefore broader aspects of the design of microinsurance products and the crucial issues of how to combat adverse selection and guard against the excesses of moral hazard are only touched upon insofar as these can be approached within the framework of a regulatory regime.

(a) Formal vs. self-regulation: Given the premise that microinsurance is intended for relatively low-income and poorer individuals who may not fully understand the modalities of pooling and shifting of risks, the issue of consumer protection becomes even more important than otherwise. Further in view of evident market failure, regulation ought to enhance the poor's access to insurance. Therefore, designing a workable regulatory framework for the microinsurance industry is an urgent task. As reviewed earlier, the goals of efficiency and sustainability of the microinsurance market would be hard to attain in a regulatory vacuum. The question is: Can self-regulation suffice?

The standard arguments in favour of binding regulation are to (i) guard against opportunistic behaviour, (ii) make it easier for the insurer to deal with covariant risks, and thus (iii) help attain long-run sustainability. This paper argues in favour of a formal scheme with appropriate legal status, although it is recognized that in view of weak administrative capacity of government regulatory bodies in many contexts, compliance verification and effective supervision will be hard to achieve. This suggests that the regulatory directives should be compliance friendly, be implemented in incremental phases, and pave the way for constructive innovation along the way.

Claim settlement process is another area where anecdotal information reveals uneasiness (in terms of delay, paper work, costs and indemnity) among the insured. Here regulation has the potential of significant improvement by requiring communication of transparent contract terms and enforcing expedient claim verification and time bound settlements.

Commercial insurers by and large are a regulated lot, though in practice, the weak capacity of the authority may significantly compromise the goal. Many MFIs, however, appear to prefer the informality route if at all available, and lament the possible loss of social welfare orientation brought on by regulation. There may well be room for innovation. For example, if an NGO is offering subsidized health services, and they mislabel that 'insurance', regulatory framework need not apply to such an activity. For this reason, among others, it will be prudent for the regulator to articulate what it may characterize as 'microinsurance' (see section 5 below).

Financial reporting standards provide another good example. Requiring all micro insurers (commercial or otherwise) to use a uniform template (see below) to report their performances need not inhibit innovation as to product design and delivery. However, a regulator's edict, as to the definition of a 'family' or laying down rigid sharing rules of premium between the insurer and the agent (as required by the Insurance Regulatory and Development Authority, IRDA, of India), may be considered as examples of heavy-handed regulation.

(b) Prudential vs. non-prudential regulation: Within the formal framework, there arises the further issue of prudential or non-prudential regulation. In principle, safeguarding financial soundness of each deposit taker and/or each insurer would contribute to system-wide stability, it may not however be practical to extend prudential regulation to each MFI engaged in deposit mobilization or insurance services. The consensus among different stakeholders seems to be that one needs to balance the demands of protection of the vulnerable with the goal of allowing wide access to the poor. Hence, the regulatory framework should not be unduly stringent, though allowing adequate monitoring on behalf of policy holders who are themselves not equipped to carry it out. Christen et al (2003) suggest that prudential regulation should only apply to certain transactions undertaken by an MFI rather than to the organization itself (i.e., relating to all their activities).

The thrust of this argument is that perhaps insurance services may call for prudential regulation and supervision, but not necessarily the credit operations of an MFI, even though both activities bind the members into a fiduciary relationship with the service provider.[7] MFIs offering credit services generally welcome members' deposits, and even encourage them to save, which in turn are used for on-lending. Likewise in the insurance context, subscribers deposit the premium revenue, typically at the start of the contract period, which ought to be invested prudently since the built-up fund serves as the source of indemnity payments, reserves and reinsurance premiums, if any. Therefore cautious and gradual progress toward prudential regulation would appear to be the way to go, at least for the larger MFIs with a significant ratio of average premium income to annual average payout (or, for that matter, a high ratio of member savings to the amount disbursed).

It ought to be clarified however that the framework of prudential regulation and supervision of micro insurers need not be at a level comparable to that applicable to deposit money banks (DMBs) or non-bank financial institutions (NBFIs). The task involved in identifying the agency that ought to be in charge of such supervision is a non-trivial issue in today's world of regulatory turmoil. Further details relating to capital requirements, reserves and reinsurance funds are discussed in section 5 below, where we review more specific guidelines for the regulatory regime.

(c) The primacy of financial transparency: Even when a non-prudential regulatory regime is opted for, one area where the regulatory process may enhance the efficacy of insurance and other financial services offered by any agency is the financial transparency norms.

[7] The term fiduciary duty can be described as a legal relationship of confidence or trust between two or more parties, most commonly a fiduciary (or trustee) and a principal (or beneficiary).

Needless to say, none of the cost, revenue and risk projections can be credible unless these are drawn up in a fully professional manner with the help of actuaries trained in the microinsurance business. Otherwise, the eventual sustainability of a project cannot be ascertained. The lack of non-comparable data leads to many difficulties, some of which are reviewed below.

(i) Financial Reporting Standards: Relative efficiency of service providers can only be judged if their financial statements are presented in a uniform way. In case of insurance marketed by NGO/MFIs, the emergence of a large number of such insurers with heterogeneous capacity (e.g., initial capital) and a diverse base (e.g., regional, urban, rural etc.) without much of a regulatory and supervisory mechanism have allowed them to report financial statements of, and at, their own convenience. The situation became even more complicated by the diverse range of activities (including social services) conducted by MFIs, where apportioning the overhead and other lumpy expenditures are often difficult to disentangle in spite of the best of intentions. However, this is a vital task since sound competition in all dimensions of financial services is the key to improving the efficiency of the industry.

(ii) Cost-Effectiveness: The reporting uniformity cited above is of critical importance since the lack of comparable information would prevent an assessment of how the cost structure of microinsurance and related services evolves over time, so that the issue of sustainability can be judged. Uniformity is also necessary in order to examine how a service can be made more cost-effective to compete globally in order to attract venture capital or reinsurance services from international entities. In the absence of a uniform code of accounting practices, the important goal of lowering the true operating cost of services would be compromised.

(iii) Product Design & Reform: The lack of credible financial information in the market would invariably lead to suboptimal product design. For example, in the absence of reliable data the true cost structure cannot be known, rendering it difficult to forge ahead with reforms. One also does not have a precise idea of the extent of possible cross-subsidization across the range of services, say between diagnostic tests and surgeries, or that between members and non-members.

(iv) Regulatory Consensus: Radcliffe and Tripathi (2006) have argued that once the transparency norms are standardized, the scope for consensus-building on many regulatory issues widens considerably. For example, the cost structure may require a certain co-payment norm to be sustainable, which may be counter to the hypothetical regulatory guidelines, and in this case, all insurers would benefit from being able to lobby from a position of consensus among them.

(d) Diversity of delivery channel: IRDA stipulates microinsurance to be sold only by registered commercial insurers through their appointed (and duly registered) agents, where NGO/MFIs may be engaged as agents. Thus it effectively encourages the partner-agent model since it would be too costly for an insurer to engage traditional insurance agents to canvass the diverse poor and rural clients, whereas the NGO/MFIs already have a functioning network that these clients value and trust. While perhaps lacking in technical (e.g., actuarial) expertise, NGOs/MFIs and other grassroots level operators thus possess an advantage over the formal insurance companies in their capacity to deliver financial services in rural areas in a cost efficient way. It may also be anticipated that the cost of bringing a new product to the market would also be comparatively lower for them (IAIS, 2007). Indeed, to the extent unfamiliarity with insurance products and their modalities stand in the way of membership growth, and there are evidences behind this claim, Pauly has commented that "community-based insurance or insurance combined with other trusted financial organizations can be a way of generating trust" (2008, p.1018).

However the partner-agent delivery mode is not the only viable model; alternatively, many smaller MFIs may together form a microinsurance company to better serve their combined subscribers through a new entity, or they may partner with a national level MFI to jointly operate a microinsurance program. Besides, large MFIs (e.g., those with million plus subscribers) may serve as insurers themselves (preferably through a new corporate entity, see below). Different structures may each be appropriate in different contexts. Full service or the provider type of arrangements may all be open for experimentation by micro insurers.

In any event, the patronization of a single model by IRDA is viewed by some as too narrow since it does not encourage alternative delivery modes (Wierdmaier-Pfister & Chatterjee, 2006). The partner-agent model may well be efficient where MFI/SHG intermediation is deeply entrenched among the poor; however for IRDA to pre-judge the issue would appear to have exceeded the bounds of its competence and responsibility.[8]

In order to widen the scope of microinsurance, many experts therefore call for agnosticism in the organizational structure of the microinsurance industry to allow experimentation so that markets can offer a variety of products and modalities to clients (McCord, 2008). Churchill puts the idea rather succinctly: "functions - including marketing, sales, premium collection, policy and client management, policy administration and claims payment -- could potentially be conducted by various entities that have a comparative advantage vis-à-vis the low-income market (2007, pp409-10). It is therefore important that regulations do not unduly hinder such experimentation. Some authors further insist on community participation in choosing the insurance contract (Dror et al, 2007).

(e) Adverse selection, risk pooling and cost-efficiency: For microcredit delivery, a relatively small size may not affect the loan repayment behaviour, a feature that has been well recorded in many contexts. Indeed the small size may allow better supervision and lower overhead as the monitoring and recruitment of dedicated branch workers needed to service the pool of borrowers may become more manageable. The entrepreneurial resources are not overextended in the process. By contrast, when it comes to insurance unless the membership is wide, effective risk-pooling cannot be achieved thereby defeating the purpose. This is true for any insurance scheme, even for the minimalist MFI-run credit insurance (Khalily et al, 2008). What can regulation accomplish here?

Generally, it is the case that some degree of compulsion is an effective means of overcoming adverse selection in the insurance uptake, and regulation may often stand in the way. Hence regulatory directive may allow (even encourage) wide risk-pooling by various innovations on the part of the provider (e.g., requiring all borrowers to sign up for health insurance, requiring family as opposed to individual as the insured unit). There is also a need to establish likely threshold ranges for each type of insurance coverage for effective risk pooling, and if the number of subscribers fall short, the actuarial calculus will need to be adjusted to reflect this. Clearly at this stage of market development, no such firm threshold can be known with any degree of precision; only experience and experimentation can lead to that knowledge. However, regulatory authorities may undertake consultation with practitioners elsewhere in establishing working benchmarks. Cost-efficiency may also be advanced by the regulator, among other, by regulating the premium structure, requiring all

[8] However consultation with microinsurance practitioners and advocacy groups reveal that IRDA has so far turned a blind eye to various forms of experimentation currently underway at the behest of NGO-MFIs, some of which fall outside of the regulatory stance, and it seems that this benign indifference on IRDA's part may continue indefinitely.

risk-carriers to post their premium and policy description online, and by promoting competition in all aspects of the insurance process.

(f) Sustainability and the design of a subsidy regime: Sustainability for credit (or credit-cum-life), life and livestock risk coverage is primarily a function of being able to reach a wide pool of clients since these are essentially idiosyncratic risks. Regulatory directives should therefore encourage low-cost provision of service, which, for example, may be facilitated by a variety of institutional modalities as to product design, marketing, provision and risk bearing as cited above.

However, in most discussions of non-life products such as health or agricultural risks, sustainability is not merely a function of scale. Most analysts believe that even if the product design and delivery channel are optimally determined, thereby ensuring lowest possible unit cost, such costs may still be unaffordable to the majority of the poor and the very poor, which is a classic case of market failure. However, given the positive externality effects on society, say of being able to meet health shocks and thus prevent a relapse into poverty on the part of many, a subsidized micro health insurance (MHI) program may be a net welfare enhancing intervention.

The regulator has a significant role to play here, both in helping design a viable subsidy regime as well as in forensic supervision capacity to discourage products which do not promise eventual sustainability. It is recommended below (section 5) that the insurance regulator outline what a microinsurance product is and at the same time require simple approval procedure of products before these are allowed to be marketed under such a name. Further, these products would be posted on a real time basis on its web for immediate dissemination. One test for the approval process would be an examination of the viability of the financial model and its actuarial basis. Since some products (e.g., in the health area) are unlikely to break even without a subsidy, the latter's design becomes a critical element of the regulatory process.

The Micro Insurance Academy (MIA) rightly argues that demand (e.g., premium subsidy) and supply (e.g., underwrite provider costs) based incentives are not sustainable. Hence it proposes arrangements to subsidize the reinsurance costs and improving the capacity of the service provider, which would ultimately lower the costs of provision. The present authors hereby propose a key criterion that any subsidy regime must respect, namely that the provider fully retain the incentive to minimize the cost of service delivery to better match the affordability of the poor, which rules out any provision for direct premium subsidy for an indefinite period.

Capital subsidy (e.g., provision of hospital infrastructure and equipment) is another area that calls for analysis. This paper however endorses such an initiative so long as the donor or like funds are utilized for true capital costs only. In such an environment, major donors such as the Gates Foundation may be persuaded to open a facility of this type, where it will donate 'capital funds'(or, equivalently, offer an interest-free loan say for a 10-year period) to selected MHI programs in the developing world.

(g) Regulatory Coordination: How many regulators? While India has chosen to regulate microinsurance under a common rubric, this is unlikely to emerge as the common practice. In other words, in most contexts it will be necessary to address how to coordinate the regulatory directives applicable to micro-insurance activities of commercial insurers vis-à-vis those operated by NGO/MFIs. In such a context, while a variety of institutions may provide microinsurance services, the regulatory/licensing guidelines, if they exist at all, may be uneven, or may only relate to one segment of the market. In the absence of a coordination process, the simultaneous provision of service by heterogeneous insurers may ultimately undermine the protection of the policy holder and thwart market development. How can regulations relevant to activities of different types of organizations be coordinated?

The Bangladesh example is a good one in the sense that there are at least two types of organizations who claim to provide microinsurance services, where to date there has been little regulation and supervision, prudential or otherwise. First there are the commercial insurers, many of whom offer products targeted to the poor, which are generally referred to as 'microinsurance' services. While nominally these companies have been under the supervision authority of the Controller of Insurance, this agency has had very little impact due to a lack of will and expertise (Ali, 2002). Recently, a new law creating an Insurance Regulatory Authority (IRA) is in the process of being adopted by the parliament. IRA will be the new regulator, which is intended to be staffed by professional rather than career bureaucrats only. Draft statutes of the IRA mandate all insurers to offer 'life' or 'non-life' products (though not together) to the 'rural and social sectors', without specifying the latter as microinsurance per se.

As elsewhere, MFIs have hitherto been unregulated in Bangladesh. However, an entity called the Microcredit Regulatory Authority (MRA), created in 2006, recognizes microinsurance as a legitimate activity of MFIs. Indeed, most MFIs offer some microinsurance services, typically some variation of life-cum-credit as cited already. Again, these regulatory provisions are in the design stage.[9] Draft MRA guidelines authorize MFIs to offer 'microinsurance' to 'borrowers and their families', but otherwise offer few additional details. Many programs in operation however deliberately extend insurance coverage to non-borrowers as well, typically at a higher premium rate than borrowers. Some even think of this strategy as one means of cross-subsidizing the borrowers who are presumably poorer than the non-borrowers.

Regulation of the industry may appear difficult due to the fact that the orientation of commercial insurers (profit-driven) and that of NGO/MFIs, who operate under a variety of social objectives, differ markedly. However, the key criteria proposed above, namely efficiency and long-run sustainability, are equally applicable to both sets of institutions. Given that both IRA and MRA operate under the Ministry of Finance (MoF), and that the present ordinances pertaining to each appear near empty insofar as microinsurance regulations are concerned, it would be opportune for MoF to promulgate a fresh set of common statutes (call it, Microinsurance Regulatory and Supervisory Directives) relevant to the industry regardless of whether insurance is offered by commercial insurers, MFIs, or, in collaboration with each other. Section 5 proposes some key elements that such an ordinance may contain. Supervision and implementation of these directives will remain respectively with IRA and MRA as appropriate. In cases where both a commercial insurer and an MFI are jointly offering a program (e.g., in the partner-agent mode), each may be supervised in terms of fulfillment of their respective parts of the contract.

A somewhat similar initiative is underway in South Africa to create a dedicated regulatory framework for microinsurance, which will issue licenses to all eligible sellers. The aim is to stimulate the low-income market activity by (i) bringing down regulatory

[9] Conceivably, this still leaves out NGOs, who lack credit operations, but may have ventured into various insurance type services, e.g., in the health area. Strictly speaking, such entities are outside of MRA jurisdiction, and by the draft regulations, are unauthorized to offer insurance services.

unit costs in order to facilitate formal insurers' access to the lower income market, and by (ii) providing formalization and graduation modalities for the current informal providers.[10]

3. A Brief Overview of the Microinsurance Market in Bangladesh

(a) Who are the micro insurers? Microinsurance providers in Bangladesh can mainly be divided into two categories: (i) mainstream insurance companies (e.g. Delta Life Insurance Company), and, (ii) NGO/MFIs (e.g., *Grameen Kalyan*, GK, and *Sajida* Foundation). Among NGO/MFIs some specialize in the provision of healthcare, e.g., GK, while others provide a range of financial services as well (e.g., BRAC and *Shakti* Foundation). In spite of some efforts and possible ongoing overtures, unlike India and elsewhere, a framework of collaborative implementation of microinsurance between an MFI and a dedicated risk carrier, namely the partner-agent model, is yet to take root in the country, though the International Network of Alternative Financial Institutions (INAFI) is in the process of initiating some steps in this direction.[11] This is an area where suitably crafted regulatory directives may succeed in fostering institutional innovations, an issue that is further dealt with in section 5 below.

While *Gano Shasthya Kendra* (GSK) started to offer some form of health coverage as early as 1978, microinsurance in Bangladesh is popularly known to have commenced in the late 80s with the Delta Life Insurance Company, a registered insurer. Similarly, many MFIs began informally offering micro insurance products (typically credit type) to their clients at this time. Bangladesh has even higher rural population density compared to its neighbours, which allows for coverage of a large number of policyholders within a rather limited geographic area, and thus offers the scope of implementing a good sized program without a large administrative set-up. Out of approximately 30 million microfinance clients, about 69% (or, 20.69 million, mostly women) were covered by some form of microinsurance products (Khalily, 2008).[12] A survey conducted by INAFI office in Bangladesh (hereafter Hasan, 2007) reported that 92 NGO/MFIs offer insurance services either in the name of 'microinsurance' or in the guise of a variety of saving products.

The commercial insurance sector in Bangladesh has shown strong growth in recent years reflecting the development of new products and innovation, and the change of the government's policy stance to enable the insurance sector to emerge from a traditional structure of state-owned companies to a more liberalized and competitive market (Uddin, 2009). There are currently 62 registered companies, including 2 public sector corporations operating in Bangladesh, of which 44 offer non-life insurance in the formal sector. Among 18 life insurance companies in the country, a majority offer what may be termed as products targeted at low net-worth households.[13]

[10] The proposed framework is envisaged to facilitate active selling of microinsurance products putting an end to the current heavily segmented market between low-end and regular insurance services. At the same time the removal of the strict demarcation between life and non-life policies should allow providers to bundle life and non-life products as they see fit (Bester, H. et al., 2008).

[11] INAFI is reportedly in the process of developing pilot schemes (life and non-life) where a registered insurer would team up with a consortium of MFIs.

[12] Among the largest providers are the top lenders, namely ASA (5.7 million), Grameen (5.58 million), BRAC (5.50 million) and Proshika (1.94 million), where the figures in brackets denote the size of their membership, respectively.

[13] While Hasan (2007) claims that only 13 offer micro life insurance, the up to date figure is 16 according to Uddin (2009).

(b) What type of microinsurance products do they offer? Microinsurance generally includes many specific products that are adapted to the needs and demands of low income households to cover specific risks: life, health, disability, property, livestock, micro enterprise and crop insurance. The available evidence shows that MFIs have introduced microinsurance programs to minimize institutional risk, to partly mitigate the risk of borrowers and, since the premium income exceeds the claim settlement, they gain access to a revolving loan fund (Khalily et al, 2008). A good number of MFIs use microinsurance as a mandatory requirement for receiving microcredit from their institution as a safeguard mechanism for their lending activities.

Though the type of insurance tends to vary depending on the size of the MFI, the main product offered by MFIs is credit life insurance which generally covers the outstanding loan balance, disability and provides, in some cases, an additional one-time monetary benefit to the client's designated beneficiary. Smaller MFIs tend to offer only term life insurance due to their limited capacity. Conversely, large MFIs tend to offer both credit risk and endowment type insurance products. The INAFI survey cited above found that of the 81 MFI-run products (offered by 62 organizations), 57 dealt with loan, 13 with life, 5 with health, 4 with livestock, and 2 with property insurance (Hasan, 2007). The contract terms and conditions vary by product and MFI. The contract term for insurance products marketed by MFIs is typically yearly so as to harmonize with the loan term (Khalily et al, 2008), which is a constraining feature of this type of coverage.

Mainstream insurance companies offer insurance products for rural people in popular Bengali names such as *Gono Grameen Bima*, *Sharbojonin Bima*, *Islami Khudro Bima* etc, and which, in the absence of a regulatory guideline as to the definition, are generally termed 'microinsurance'.[14] Most of these products are in the form of life insurance covering death risk policies, where premiums are collected on a monthly basis by door to door campaign. A few of these products offer health benefits or accident claims subject to some additional premium payment. These products are claimed to be designed for low income households, earning less than $100 per month. While the size of the insurance coverage is seen to vary within a range of Tk. 5000 to Tk. 100,000, a majority of these are concentrated in the low end of the range (Hasan, 2007). It may appear that life coverage close to the upper limit stated here may not be a good example of policies that are of appeal to low-net worth individuals.[15]

The formal insurers however mostly offer endowment type life insurance schemes which encompass elements of saving, protection and investment. The basic difference between term life insurance and endowment life insurance is the saving element, where premiums become savings for the policy holder if death does not occur during the period of coverage. The non-life coverage by the registered insurers are practically absent in Bangladesh, except for items such as fire protection made available to micro enterprises.

The important area of micro health insurance (MHI) schemes in Bangladesh appears to be exclusively offered by not-for-profit NGO-MFI providers to serve the underprivileged. Most products at the pilot stage (with limited geographic coverage) strive to offer the available facilities at an 'affordable' price, and thus incur heavy financial losses.[16] A membership card

[14] These product names may be translated, respectively as 'rural public insurance', 'universal insurance', and 'Islamic microinsurance'.

[15] See section 5 below for a discussion on a useful quantification of microinsurance products for regulatory purposes.

[16] Ahmed et al (2005) report that in 2004, policy premium revenue covered a mere 36, 22 and 4 percent of total health insurance program expenses for GK, BRAC and Society for Social Services (SSS), respectively.

is the most common vehicle of marketing the product, where the card subscription fee serves as the premium income, and where the typical claims are settled in kind (e.g., by offering curative services) directly by the provider. Additionally, some preventative and educational health care activities on child health, maternity and related diseases are frequently conducted by MHI program employees (Ahmed et al 2005). However, these products are characterized by a very high rate of co-payment on the part of the insured. The coverage in effect offers modest discount (typically in the 10-25% range for medication and laboratory tests etc) or a fixed-sum contribution towards the cost of hospitalization and surgery. These stipulations suggest that 'insurance' may well be a misnomer to describe these products since the insurers only carry a modest risk and the bulk is borne by the insured, which need not be an efficient risk allocation. Even then there are major obstacles in running micro health insurance programs, namely the financial viability and the failure to provide an adequate range of services in a timely manner in some locations. Many micro health insurers struggle to meet their operational costs and find it exceedingly difficult to retain doctors and trained medical professionals in rural areas (Khalily et al, 2008).

4. The Regulatory Framework in Bangladesh

Many stakeholders including existing insurance companies as well as non-NGO private health service providers strongly believe that a comprehensive legal regulatory framework standardizing operational procedures and quality assurance, especially in health care provision, is a prerequisite for successful development of the industry (Ali, 2002 and Ahmed et al., 2005). Such views notwithstanding, to date the regulation of the insurance industry in Bangladesh has largely been rudimentary. The existing regulatory agency had been run by bureaucrats with little industry experience, and the agency has had little impact on either the structure of the industry, or the quality of the products marketed by them. Historically the regulators have enjoyed neither the capacity (witness its inability to produce a mortality table of policy holders in nearly 38 years of its existence) nor the operational independence of the administration. The new Insurance Regulatory Authority (IRA) Act currently being adopted, replacing the earlier Insurance Act of 1938 (amended in 1973 and in 1984), which promises to develop an autonomous entity, is however near empty insofar as microinsurance is concerned. The term is not used even once in the entire present form of the document.

The draft statutes of the IRA Act, like its predecessor, however, cover a large number of areas over which it commands jurisdiction such as terms for the cancellation of license/ registration, verification of the appropriateness of premium structure, full disclosure of financial accounts, actuarial audits, inspection, investigation and verification of records, examination of financial sustainability, mergers and acquisitions, compensation policy for directors, staff and agents, bonus/profit distribution, bankruptcy modalities, disciplinary and punishment regime etc. While some of the elements cited here would even call for prudential regulation, historically, little has ever been exercised. Given that commercial insurers are mandated to sell (micro) insurance in the 'rural and social sectors', one would presume that the directives, to the extent IRA is able to implement, would apply with equal force to these products as well.

Turning to MFIs, the Government of Bangladesh (GoB) enacted the "Microcredit Regulatory Authority Act, 2006" on August 27, 2006. Under the act, the Microcredit Regulatory Authority (MRA) has been established "which is empowered and responsible to monitor and supervise the microcredit activities of the MFIs" (MRA, 2006). Since the Act, no MFI can operate a microcredit program without obtaining a licence from MRA, and out of 4,236 applications, 401 institutions have been offered a license as of September 2008.[17]

Though the details are yet to be approved by the Parliament, the draft version of the guidelines consider insurance services of MFIs as a discretionary component of their activities beyond core activities such as micro lending and deposit taking services. Each licensed MFI however has the authority to "offer different types of insurance services …for the loan recipients and members of their families" (article 24). MFIs have to provide MRA with documents clarifying full details of insurance products, fees or premiums due in this regard, claims settlement as well as the status of their financial viability. Insurance clients will be responsible for timely payment of premiums as well as for the maintenance of records of such transactions. Members also have the right to receive insurance claims subject to the fulfillment of the stipulated conditions. The document also cites punishment of MFIs for failing to abide by the directives in terms of cancellation of the registration, or removal of its management or board -- much like similar provisions of the draft IRA Act. However, at what stage and to what extent the regulator will be able to exercise such discretion and judgment is another matter.

Given that most discussion relating to insurance in this document is rather vague and suggestive of promises of future directives, it would be fair to state that MRA has yet to develop any formal regulatory statutes guiding the fledgling microinsurance industry. In contrast, IRDA of India enacted a set of binding regulatory directives for the microinsurance industry in November 2005, some of which may be viewed as overly restrictive as reviewed below. It is in this vacuum, created by both the history of regulation in the country and the present development of the IRA and MRA Acts, that this paper calls for a new set of 'microinsurance regulatory and supervisory directives' (MRSD) along the lines suggested below.

5. Proposed Microinsurance Regulatory and Supervisory Directives (MRSD)

The guidelines enunciated below shall apply to both commercial insurers and MFIs, and the implementation and supervisory tasks are to be performed respectively by the relevant regulator (e.g., IRA and MRA) as appropriate. In spirit, these reflect the set of 'regulatory benchmarks' analyzed in some detail in section 2 above. While the earlier discussion was of a universal nature, the following elaborations apply particularly to developing countries with a comparable regulatory background as that in South Asia. The directives highlight the key goals of cost efficiency, financial viability, and inclusivity. They are also aimed at fostering innovations in product design and delivery. The compliance burden has to be kept at a low level so that smaller MFIs do not face undue hurdles thereby compromising the needs of the poor and/or impeding the growth of this emerging sector.

From the point of view of practicality, the elements reviewed below cannot be and need not be articulated by the regulator in one giant sweep of the wand; instead these ought to be gradually and sequentially enforced as the industry matures, with the prudential aspects to come in last.

(a) Definition: It is critical to settle on a workable interpretation of the concept of microinsurance as distinct from the standard variety, and it is therefore proposed that the

[17] The minimum criterion for obtaining a licence is either a minimum balance of outsanding loan at field level of BDT four million or a minimum of 1,000 borrowers.

regulator determine if a product developed by a potential insurer would be eligible such that only eligible products may be marketed by a licensed micro insurer. The discussion in the literature points to the following key elements as characterizing the idea. 'Microinsurance' products are (a) targeted at low-net worth households, (b) designed to reflect pooling of risk faced by the insured, and (c) priced in keeping with the willingness to pay criterion as well as being proportional to the likelihood and costs of the risks involved (Churchill, 2006), (d) that all phases of the products be developed in close collaboration with the communities they are supposed to benefit (MIA, 2006), and (e) the products must be of substantive value to the poor in terms addressing the issue of vulnerability to poverty (Ahsan, 2009). In essence, therefore, *microinsurance services are those risk-shifting devices offered by insurers that are especially suited to the needs of low-income households and are affordable*.

In deciding on eligible products, attention should also be drawn to product variety and quality such that these contain significant value to the poor and are not simply dressed up as new opportunities for expanding the insurance business. Since different types of providers may propose different products, the eligibility criteria need to take into account prudent balance in diversity.

(b) Quantification: The conceptual definition cited above may not suffice for regulatory purposes if the goal is to encourage the development of a set of standard products. Among the advantages of standardization are that the potential beneficiaries may easily compare products available in the market, while at the same time, allowing insurers to operate the entire range or specialize to a subset of products depending on their expertise and circumstances. The Indian directive on this score is perhaps too precise. In order to allow innovations, it would be useful to offer a flexible structure by twinning the size of the indemnity to parameters of income distribution such as the average annual income, poverty line or the size of average annual microcredit. Thus, for example, for credit/life (term, endowment etc) type policies, the benchmark products may offer indemnity in a range of 1.5 to 5 times the average size of the annual microcredit loan, which as of March 2009 stood at about BDT 11,000.[18] A similar figure may be assigned to health coverage per family as well.[19] Setting the limits in this manner does in no way imply that the insured necessarily be a member of a credit group. Coverage below the threshold cited here can be presumed to offer little value to the average poor/low-income person since it would be inadequate to offer her a chance to overcome the vulnerability due to the loss. It would seem that a good portion of 'microinsurance' policies currently marketed by commercial insurers in developing countries are below the threshold of the quantitative guide proposed above, which will cease to be so defined if such a regulation is passed.

Products beyond the definition given above ought to be proposed to the regulator for prior and timely approval. As stated earlier, the approved products ought to be posted on a real time basis, and only these products may be marketed by an insurer or its agents.

(c) Simplicity of Microinsurance Products: The regulatory directives ought to require that each microinsurance product be described, as well as the contract be written, in plain

[18] This figure corresponds to the average amount of loans disbursed by PKSF partner organizations (POs), which is expected to be close to the industry average. For other South Asian countries, these figures may be interpreted in their national currencies.

[19] Other risks such as livestock and value of immoveable structures may be covered up to the average replacement cost. By contrast the IRDA definition is far more stringent. It specifies absolute figures typically in a range between 10 and 50 thousand Indian rupees (with additional specifications as to family size, individual vs. family coverage for health insurance etc) requiring revisions over time.

language where all benefits and documentary requirements for the time-bound claim settlement process are clearly stated.

(d) Eligibility for Insurance: Once the products are defined with low-net worth persons in mind, it does not really matter who subscribes to these, except what may be required to overcome adverse selection issues. For marketing purposes though, insurers would need to reach both the rural and urban poor. In this context, it would make little sense to prevent MFIs, as implied by draft Bangladesh MRA guidelines, from extending insurance service beyond their existing members. One can make the further point that there are poor (both urban and rural) who are not in need of new loans; instead, they would demand insurance if available in order to safeguard their savings against health and other shocks. What justification can be there to exclude them? The risk of adverse selection must however be guarded against, but that is primarily a design issue.

In practice MFIs working in the health area routinely offer membership to non-borrowers with a differential premium structure. Some even claim that this is one way of cross-subsidizing the poorer (members) by the less poor (non-members), although this runs the risk of picking up riskier clients. While borrowers may be encouraged to join en-masse, it would be hard to devise a scheme where non-borrowers (and, more so, non-members) can be signed up in large numbers except through village level participating modalities like "Choosing Health Plan Altogether (CHAT)", being implemented by the Micro Insurance Academy of Delhi, India.

(e) Duration of Coverage: The majority of 'microinsurance' products currently being offered by MFIs in South Asia is of the credit or credit/life type of coverage, which typically expires at the end of the loan term, rendering the 'insurance' a transient phenomenon. It is proposed that directives may be framed so as to require the insurer to offer a conversion of credit risk policies to equivalent life coverage once the borrower ceases to be one, and the insured will thus have a choice to continue the coverage or look for alternate plans. In terms of the premium rate structure, it is a standard practice to set the policy premium on an annual basis, and timely payment of the same is necessary for the continuation of coverage. However, demand for insurance, being a temporal phenomenon, would appear more appealing if insurers were to offer flat annual premium for terms for up to of 5 or even 10 years. This would be especially relevant for term life coverage as is routinely done in advanced financial systems. Regulatory directives may therefore be channelled to encourage the emergence of such long-term contracts, which however would require up to date actuarial projections for the premium determination. Such a measure would generate additional demand for the product since the insured would know the future cost of continuing the coverage.

(f) Life vs. Non-life Products: The historical demarcation as to carriers of life and non-life risk has been done away with in most developed financial systems. The IRDA statutes permit marketing of each other's products, but the carriers are required to remain distinct.[20] The Indian scheme in effect allows a life micro insurer to act as an intermediary for a general microinsurance company (and vice-versa) rather than as a risk carrier. Thus in the end, competition is curtailed and the poor may suffer as a consequence. Perpetuation of this dichotomy, also embodied in the new IRA guidelines in Bangladesh, makes little sense especially in microinsurance, since that may be one way of pooling risk across product

[20] Premiums for general microinsurance services can be collected by the life micro insurer either directly or through agents, which will be transferred to its general microinsurance partner, and vice-versa.

lines, and hence may allow an insurer, if socially deemed fair, to cross-subsidize some services by others (e.g., health by life). If a company/MFI were to specialize in one, nothing prevents it from doing so.

(g) Promoting Inclusivity: Some countries have targeted inclusivity and sought to expand the reach of microinsurance by requiring all insurers to serve the low-income market (as is the case in India). The IRDA requirements are that all insurers will have to attain a certain share of premium income from policies catered to 'rural areas' as well as 'unorganized workers, economically vulnerable or backward classes in urban and rural areas', and failure to achieve the targets may lead to financial penalties or even cancellation of the license (2002). Such a heavy-handed approach need not be productive at all times. For large, nationwide firms, this policy may be practical, but certainly not for the smaller entities. Even for larger ones, some may specialize in some niche market, and dilution of their business strategy may harm the goal of efficiency and sustainability. Though ICICI-Lombard and Tata-AIG have developed products in response to the new regulation, and have made strong strides in the microinsurance area, the overall industry impact is yet to be determined. For smaller insurers, such a law may force mergers, which by itself may be anti-competitive, and thus against the interests of the policy holders. Besides, these stipulations require extensive compliance efforts on the part of the insurer, as well as burdening the regulatory/supervisory authorities with additional duties.

The draft Bangladesh IRA guidelines appear to mandate each insurer to offer 'life' or 'non-life' products in the 'rural and social sectors' (article 6). In view of no further elaboration, however, it is unclear if this is a deliberate requirement of each, though the language reads so. While widening the access of the poor to insurance services is in public interest, it is worth debating if compulsion is superior to alternative incentive strategies such as tax reliefs in terms of reduced rates of corporate profit tax for insurers whose premium income from 'recognized' microinsurance business exceeds some pre-set threshold (say 10%) of total premium income. Though any provision of this type is fraught with bureaucratic wrangles that may unnecessarily use up scarce resources, the IRDA type edicts may lead to opportunism and market distortions. On balance, the tax incentive idea would appear to be of appeal to commercial insurers who may be able to develop expertise in designing and retailing microinsurance products (by themselves or in collaboration with NGO/MFIs). Even if these were not profitable in the short-run, they would enjoy lower tax on their net income. However, for such a policy to be functional at all, the definition of what goes by 'microinsurance' ought to be crystal clear.

While credit insurance would normally be regulated, in order to allow maximum access to the poor, one may exempt those MFIs from regulatory process who offer only credit insurance for self-protection, provided that no additional fees (premium) are charged of the borrower (i.e., the insurance service is offered as a fringe benefit financed out of annual overhead or profit or other internal source of funds).[21] However, if a premium fund (regardless of the label) is maintained to meet claims, in that case the investment of such a fund and its uses ought to be under the regulator's purview.

Bester et al (2008) suggest that in the South African context marketing innovations have played an important role in promoting inclusivity. These include the use of the cell phone as communication and sales tool and collaboration with retailer chains or sports clubs as distribution channels. Design features such as choosing the policy contracts using a "tick-of-the-box" approach have led to low transaction costs and the ability to reach a large pool of clients. It would be interesting to experiment how similar innovations may be adapted in other contexts.

[21] In such cases, the MFIs in question ought to state that the interest charge includes free credit insurance so that the former is made comparable across MFIs.

(h) Separation of Credit and Insurance Activities: The credit and insurance services ought to be separated for greater financial transparency, a point that has been cited earlier in the context of analyzing the appropriate delivery channel. It is therefore proposed that MFIs separate the microinsurance operations from all other activities, and receive a separate licence from the regulator to run the former line of business.[22] In the case of a registered MFI, once MRA is satisfied that the proposed products are eligible, it will automatically earn the insurance licence. This separation of credit and insurance is also justified since the separate activities of an MFI would in principle face different regulatory directives, especially when it comes to prudential matters. Such a step will therefore go a long way in evaluating the financial situation of each activity of the same organization, and all arms' length transactions will be put on a transparent perspective.[23]

(i) Reserves: In commercial insurance, reserves, typically an actuarially determined fraction of net premiums, are kept in a more or less liquid form in order to meet contingent demands which may be made upon it. In case of life policies, configuring a reasonable level of reserves presupposes the acceptance of a particular mortality table. In health policies, the demands are commensurately lower. However most MFIs appear to have neglected the important task of determining the size of adequate reserves against the temporal pattern of policy liabilities (Uddin, 2009). This is an area that the regulator may address forcefully without necessarily requiring full-fledged compliance with the prudential guidelines that may be made mandatory at some stage. Pauly goes on to argue that "regulations that assure adequate reserves … and protection of customers from arbitrary denial of benefits or rate increases are all important" (2008, p.1018).

It is therefore important that experienced actuaries be engaged to project the future liabilities of micro insurers. Attention may be drawn to the of Centre for Agricultural Research and Development (CARD) in Philippines, an NGO-MFI, which started to offer a pension plan in 1996 without any actuarial advice, but had to be stopped (in 1999) due to fast erosion of the fund. It has since then formed a separate entity, a mutual benefit association (MBA), known as CARD MBA, which has been successfully offering actuarially sound microinsurance products, which seem to be gaining solid popularity.

(j) Capital Adequacy & Related Prudential Guidelines: Determination of the required level of capital for micro insurers, which in principle reflects the shareholder equity (for publicly traded entities) or retained earnings (for mutual insurance companies), is far from an exact science. The primary accepted norm is that capital adequacy be linked to the riskiness of an insurer's business. Dwelling on the notion of risk-based capital (RBC), note that capital needed to offset the 'insurance risk' alone is often referred to as the solvency margin, which is not adequate for the overall risk scenario, but captures an important component.[24] The insurance regulator ought to deliberate both the appropriate standards, which may well deviate from the current Basel RBC guidelines for the banking sector, as well as what stage and to what extent such risk stipulations should apply to micro insurers.

In setting the capital requirement, it is relevant to recognize that the source of funds are

[22] The licensing may be of type-A and type-B, where the latter may permit operation of credit and saving products, while the type-A license is all purpose to include insurance services as well.

[23] As stated earlier basic (premium-free) credit insurance may remain outside of MRSD, and hence these MFIs need not form a separate entity to operate the scheme.

[24] Beyond the 'insurance risk', other important categories of risk include the (a) asset default risk, (b) asset-liability mismatch risk, (c) business risk, and (d) operational risk (Uddin, 2009). The latter author also proposes the solvency margins as a first step toward adopting a more comprehensive RBC down the line.

different between commercial insurers and NGO/MFIs since the latter do not have access to equity capital. Thus meeting the capital goals would be easy if smaller MFIs were to partner with national level MFIs or with commercial insurers in the provision of insurance services. The capital issue further reinforces our earlier remark that MFIs separate their credit and insurance services under distinct organizational structures. Hence the regulatory directives ought to consider that the scale necessary to successfully operate credit and insurance services need not be the same, and micro insurers may well face a higher capital requirement than if they restricted themselves to only credit and deposit taking activities. Nevertheless, many experts believe that the minimum capital necessary to achieve the threshold economies of scale in providing most types of microinsurance services need not prevent worthwhile initiatives by small but efficient MFIs.

In terms of actual practice, IRDA requires a minimum capital of $22 million to form an insurance company, which appears to be in the high side for a developing country. By contrast the Philippines set its level between 1 and 2 million dollars, depending on 'life' or 'general' companies. The latter however has a two-tier approach to microinsurance: commercial insurers and mutual benefit associations (MBA), the latter requiring a paltry initial capital of under $200 to register. Indeed, the Philippines Insurance Commission (PIC) has established a separate unit to supervise the smaller entities. However, significant differences in taxation between insurance companies and MBA's prevent many MBA's from transforming into commercial insurers. The latter are subject to minimum corporate income tax, business tax and documentary stamp tax, while MBAs witness tax-exemption due to their status as non-profit entities (KPMG 2008). In December 2004, the CARD MBA stopped its transformation to a first tier entity to avoid paying between 12.5% and 25% of the premium income in taxes. Accordingly, many entities register as MBAs in order to take advantage of the more favourable tax conditions, leading to regulatory arbitrage (Weirdmair-Pfister and Chatterjee, 2006 and GTZ, 2007).

Registered insurers in Bangladesh at this time require BDT 300 million to offer life coverage and BDT 400 million for non-life policies, which are significantly below the IRDA requirement cited above. However, mutual insurance associations set up by cooperatives can earn a licence with a much smaller sum of BDT 15 million as capital.[25] The only financial guideline for MFIs in Bangladesh is the outstanding balance of credit actually advanced (of BDT 4.0 million, i.e., about USD 58,000) in order to obtain a licence to offer microfinance services. However in order to offer insurance services, MFIs as insurers, ought to be required to adhere to capital requirements that respect the fiduciary and prudential goals of regulation.

As a final comment on capital requirement, note that even if the target set for MFIs appears moderate by registered insurer standards, such a stipulation may pave the way for self-selection of NGO/MFIs who essentially offer social services from those who actually offer 'insurance'. Social service providers would then be willing to re-label their products appropriately, and remain outside the purview of the regulatory regime, which may well be in the long-run interest of all. Apparently a reorganization of the industry along these lines occurred in Peru subsequent to the adoption of the insurance law in 1993 (Wiedmaier-Pfister and Chatterjee, 2006). A similar development is likely in the

[25] At the exchange rate of about BDT 69 to USD (April '09), the 3 capital requirements cited here would come to USD 4.35 million, 5.80 million and 217,000, respectively.

Bangladesh context since only a few hundred, out of several thousand NGO/MFIs are likely to obtain MRA licence by the deadline of December 2009.[26] Another significant dimension of the capital requirement is that it serves to ration the available regulatory and supervisory resources at the disposal of the authority (Christen et al, 2003).

(k) Design, Accumulation and Investment of the Reserve Fund: Guidelines would be necessary so that the regulator can examine the rationale of the chosen premium rate structure (i.e., their actuarial basis), the adequacy of the evolving reserve fund and hence the long run sustainability of the program. Regulatory directive would also be necessary to benchmark the permissible investment of reserve funds and rules regarding the build-up of excess funds and disposal thereof. A recent analysis of MFI run 'insurance' (typically credit or credit-cum-life policies) in Bangladesh revealed that, at least for large insurers, only 10% of the annual premium was used up in annual indemnity claims, which renders the actuarial basis totally suspect, especially where not many covariant events were being covered by these institutions (Khalily et al, 2008). Indeed the same survey reveals that, of those volunteering to publicly share the data, 85% use it as a 'revolving loan fund' accessed at zero interest, exposing the fund to the same risks that the insurance products attempt to guard against (Ahsan, 2009).

Investment of the funds should be generally guided by the need to match the time profile of investment returns with that of the stream of anticipated claims, an issue that is much more serious for life-based (e.g., term or endowment) policies than annual health or livestock insurance. The risk characteristics of the investment portfolio are another important dimension over which the regulator may provide guidance to the insurer.

It is conceivable that if an MFI insurer has actuarially determined 'surplus' in its fund, a portion of which may be loaned out for its other (e.g., credit) services, but in such an event there ought to be an explicit understanding of the terms of the loan and the collateral put up in support of the loan.[27] Moreover, in most regulatory guidelines, it is generally forbidden for an insurer to build-up excess funds not called for by the underlying actuarial calculus.

(l) Policy Delinquency: Microinsurance policies, like other insurance contracts, may be discontinued by the insured due to both voluntary and involuntary reasons. Regulatory directives would be essential to protect the rights of both parties and ensure fairness. In the case of registered insurers, the Bangladesh provision is that if at least two consecutive years' premiums have been paid, e.g., in endowment life policies, the policy qualifies for a surrender value (Uddin, 2009). The latter is typically less than the premium actually paid, but at least the entire payment does not go to waste as far as the insured is concerned. Of course if the 2-year cap is not met, the policy lapses with no cash value.[28] What would be an equitable benchmark in the case of microinsurance? On the presumption that successful programs (e.g., with NGO intermediation) would be low-cost operations, one would be tempted to suggest that surrender value should accrue after 12 months of consecutive payment for micro life products.

[26] It is unlikely that the actual number licenses to be issued would exceed 600, while there are about 6,000 MFIs presently engaged in some form of microcredit services.

[27] In other words, the insurer (being a distinct business entity from the credit provider) would loan the funds in question to the lending arm of the company under explicit terms.

[28] Uddin (2009) notes that while NGO-MFI run microinsurance offers no evidence of the lapse ratio, those offered by registered insurers are suggestive of high ratio of lapses, discontinuities and low surrender values. Such a scenario is not poor-friendly to say the least.

(m) Audit & Supervision: In the Bangladesh statutes, an external audit has been made mandatory for each MFI which is to be carried out by an eligible chartered accounting firm with experience in microfinance activities, and who must follow the Bangladesh Standard of Auditing (BSA) guidelines. Indeed the draft MRA Act goes beyond and suggests that it intends to issue a 'manual' at a future date detailing the modalities to be followed in establishing adherence to the Act and competence of the MFI by means of inspection, investigation and audit as necessary (article 21.10). With hundreds of licensed MFIs operating in the industry, it is unclear at what stage MRA will muster enough resources and experience to effectively implement the supervision tasks cited here.

(n) Reinsurance: As many writers have stressed microinsurance can only flourish when the risks carried by the domestic insurers (whether joint ventures or otherwise) are shifted further via reinsurance to global firms engaged in the business. As cited already, in order to attract reputable reinsurers into this market, it would be essential that insurers be fully registered entities in line with the regulations in force. Here the regulator may facilitate the process by encouraging smaller MFIs to choose a delivery mechanism compatible with scale efficiency as advanced in section 2 above. However, the regulatory statutes in turn must also be viewed as appropriate as outlined here. Any donor or state subsidy regime to promote reinsurance must also be well articulated as to its ultimate goal and be seen as sustainable in the long run.

(o) Educating the Regulator: Many developing country regulators do not have skilled manpower in the public service who would fully understand how the low income insurance market should function and what it may strive for.[29] The burden on available resources may be too severe, jeopardizing the very goals of regulation. Hence a road map would be necessary to impart and endow the regulatory authority with the required human resources and training on an on-going basis.

6. Conclusion

Given that diffusing the essence of insurance among the poor has proven non-trivial, it follows that growth and development of the microinsurance market will not be as simple as that for microcredit. Question is: can regulation pave the way? In the design of a suitable regulatory framework, a number of apparently conflicting principles are encountered. These include the issue of balancing the rigour of formal regulation and supervision which is legally binding on the regulatee with the idea that these do not inhibit innovations. Another fundamental goal is ensuring that the insurance market be 'efficient' and 'sustainable', which has to square with the issue of affordability of low-income households. Yet another concern is how to harmonize and ensure consistency of the regulatory guidelines to be enforced by multiple regulators, as for example that may arise if insurance is offered by MFIs and commercial insurers both serving as risk carriers. The paper puts forward a set of regulatory and supervisory directives illustrating that the conflicts cited above need not necessarily arise in the delivery of microinsurance services.

[29] Uddin (2009) cites the inability of the regulator in Bangladesh to devise even an elementary tool such as the mortality table as a serious anomaly. Many registered insurers instead use tables developed for other countries, which are often out of date.

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Institute of Microfinance (InM)

The Institute of Microfinance (InM) is an independent non-profit organization established primarily to meet the research and training needs of national as well as of global microcredit programs. Initiated and promoted by Palli Karma-Sahayak Foundation (PKSF) on November 1, 2006, the Institute is principally funded by UK Aid, Department for International Development (DFID) through its Promoting Financial Services for Poverty Reduction Program (PROSPER). InM has an excellent team of professionals in research, training and knowledge management. The regular core research group comprises well coordinated and dedicated researchers with extraordinary expertise. Besides, InM draws research scholars from reputed universities across the world. The major services that InM provides are research on poverty, microfinance, enterprise development, livelihood promotion, climate change; and impact assessment, evaluation, training need assessment (TNA), curriculum & module development, training on capacity building, training of trainers, scheduled and tailor made courses, training evaluation, consultancy, and program management.

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