Emerging cross-country insights

Microinsurance business models, corresponding risks and regulatory responses

Stefanie Zinsmeyer, 12 November 2013
First Consultative Forum on business models, distribution and their regulatory implications
Jakarta, Indonesia
The Access to Insurance Initiative (A2ii)

The Initiative is a partnership between:

- International Association of Insurance Supervisors (IAIS)
- CGAP
- BMZ (Federal Ministry for Economic Cooperation and Development)
- FINMARK Trust
- ILO (International Labour Office)
- CDF

Hosted by:

- giz (Deutsche Gesellschaft für Internationale Zusammenarbeit)
Rationale of the Initiative

Unique partnership between:

- **international development agencies/ donors and**
- **the International Association for Insurance Supervisors (IAIS)**

Triggers the reforms in regulation and supervision required for the development of inclusive insurance markets.

**Our Mission/Vision:**
We are the implementing partner of the IAIS to increase access to insurance. We inspire and support supervisors to promote inclusive and responsible insurance, reducing vulnerability.
Introduction

• **A2ii synthesis process**: develop three thematic notes to synthesise trends and issues across countries on key microinsurance policy, regulatory and supervisory topics

• **Scope of notes determined by A2ii Technical Team**:  
  - *First note* - Evolving microinsurance business models and their regulatory implications  
  - *Second note* - Different approaches taken by regulators to catalyse microinsurance markets and their impact  
  - *Third note* - Input into forthcoming IAIS issues paper on market conduct, distribution and consumer protection in inclusive insurance markets
Information sources

- Brazil, China, Ghana, India, Mexico, Mozambique, Peru, Philippines, Ghana
- Botswana, Namibia, Pakistan, South Africa, Swaziland, Tanzania, Zambia, Zimbabwe
Evolving microinsurance business models and their regulatory implications:

1. How do we categorise the various business models?
2. What are they and how do they evolve?
3. Market dynamics distinctive to microinsurance business models
4. Risks, risk drivers and observed responses
Evolving microinsurance business models and their regulatory implications:

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Intermediation is the method of linking a buyer and a seller. A business model (generally i.e. for any business) is fundamentally about how to link a buyer with a seller. Hence intermediation is the main parameter by which we define discrete business models.

And from a supervisor’s perspective intermediation is the most definitive aspect due to the increased risks as a result.

The issue of intermediation is even more important in MI because of factors like difficulties in access, low premiums and values meaning high volumes needed etc.

Intermediation is particularly important in insurance because insurance is sold and not bought.
Business Models: value chain

Traditional insurance:

Players:
- Reinsurer
- Insurer
- Broker/agent
- Clients

Roles:
- Reinsurance
- Underwriting, Administration, Product development, Premium collection
- Marketing, Sales, Administration, Product development, Premium collection
- Insurance decision

Microinsurance: longer value chain

Players:
- Reinsurer
- Insurer
- Administrator
- Payments provider
- Broker/agent
- Aggregator
- Clients

Roles:
- Reinsurance
- Underwriting, Administration, Product development, Premium collection
- Administration, Product development
- Premium collection
- Marketing, Sales, Administration, Product development, Premium collection, Market-maker
- Sales, Marketing, Administration, Product development, Premium collection
- Insurance decision
Evolving microinsurance business models and their regulatory implications:

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8 discrete business models

1. Individual sales
2. Proxy sales force
3. Compulsory sales
4. Group decisions
5. Local self-help
6. Auto enrolment
7. Passive sales
8. Service-based sales
Model 1: Individual sales

Description:
- One on one active sales through fulltime insurance agents, broker or call centre
- No client aggregator involved.

Evolution:
- Traditional sales model that insurers extend down-market for MI in parallel to or before experimenting with alternative mass distribution channels
- Post-alternative distribution movement “back to the agent” where advantage of face-to-face interaction becomes apparent

Examples: SINAF Seguros, Grupo Villa (Brazil), Metropolitan REI (South Africa)
Model 2: Proxy sales forces

Description: Insurance sold by a non-insurance entity to existing clients, where the policy is marketed with the sale of another product.

Evolution, cross-selling:
- Instigated by the insurer, aggregator or 3rd party.
- Evolves from aggregators wishing to diversify income.
- For insurers, aggregator represents an easy existing contact point to the target market.

Embedded products:
- Evolves from the demand for the underlying product, most frequently credit, and the need to protect the default risk for the supplier.
- Often first product sold in microinsurance market.

Examples: Credit life; Bancassurance; Retailer sales: Casas Bahia (Brazil); Utilities: Codensa Mapfre (Colombia)
### Model 3: Compulsory

**Description:** Insurance required by regulation for certain categories of citizens.

**Evolution:**
- In response to specific public needs, e.g. protection of road users; health needs of employed population
- Often the "beginning" of asset insurance market

**Examples:** Third party motor vehicle insurance (most countries); Social health insurance for formally employed
Model 4: Group decision

**Description:**
- Members of a group become policyholders by virtue of being members of the group rather than individual decision.
- Collective negotiation.
- Either universal cover by virtue of membership of group or opt-in.

**Evolution:**
- Evolves where there are existing groups which reduce distribution costs
- Insurers leverage the member database of the groups
- Groups offer value added services to members

**Examples:** Labour unions (Doves, South Africa), PASI (Brazil), China village model; cooperatives; Association of Tanzania bus drivers, Protecta partnership with educational institutions (Peru)
Model 5: Local self-help

**Description:** Group of persons pool own risks

**Examples:** Philippines MBAs; funeraria and cooperatives, burial societies

**Evolution:**
- Develops in the absence of appropriate/accessible formal alternatives or where people do not trust formal options or prefer own provision on the basis of solidarity.
- Strong community ties.

**Role**
- Underwriter
- Product development
- Premium collection
- Administration
- Insurance decision

If non-members allowed:
- Sales
- Marketing

**Non-Members**
Model 6: Auto enrolment

**Role**
- Underwriter
- Administration
- Claims payment
- Employees & agents used for communication and beneficiary identification
- “Market maker” administrator for loyalty schemes
- Prescribe product
- Procurement
- Subsidise premium
- Make claims

**Description:** 3rd party purchases insurance on behalf of a predetermined group of people.

**Evolution public provision:**
- Develops from a strong state mandate & social goals
- May be a response to market failures

**Loyalty benefits:**
- Value added service to reduce client churn
- 3rd party ‘market-maker’ such as innovative broker
- Opportunity for extending the reach of the insurance market in undeveloped markets

**Examples:** Health insurance in India (RSBY), state funded agricultural insurance (NAIS, India); disaster risk in rural China; Waseela BISP (Pakistan); MNO loyalty schemes: TIGO BIMA (Tanzania), TIGO (Ghana)
Model 7: Passive sales

Description: Individual purchases insurance without intervention of sales person.

Evolution:
- Particular insurance product has become "commoditised."
- Market familiar with the concept of insurance.
- Atypical in undeveloped markets.

Examples: Internet sales; Clientele hospital cash plan (South Africa), Pep/Hollard (South Africa)
Model 8: Service-based sales

**Role**
- Underwriter
- Product development
- Premium collection
- Administration
- Marketing
- Sales
- Service provider
- Insurance decision

**Description:**
- Securing a service to be rendered in the future through an insurance policy.
- Voluntary individual choice.
- The entity which sells the insurance is the same one that provides the service.
- May be underwritten by the provider or by an insurer.

**Examples:** Health insurance provided by health service providers; funeral assistance; funeral parlours in Colombia and Brazil

**Evolution:**
- Driven by strong demand for underlying service.
- Client cannot afford service without insurance.
- Does not require a well developed insurance sector to evolve.
### Scenarios of evolution

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Business Models</th>
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<tbody>
<tr>
<td><strong>Bottom up spontaneous development:</strong></td>
<td>• Service-based sales</td>
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<tr>
<td>Insurance evolves spontaneously on the back of</td>
<td>• Local self help</td>
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<td>underlying consumer needs and to fill gaps in</td>
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<td>formal provision.</td>
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<td><strong>External market catalyst:</strong></td>
<td>• Loyalty auto-enrolment</td>
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<td>A third party (e.g. broker or administrator ) sees</td>
<td>• Group decision</td>
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<td>the opportunities for market making and starts to</td>
<td>• Proxy sales force</td>
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<td>match insurers and groups.</td>
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<td><strong>State driven:</strong> The state provides this insurance</td>
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<td>in order to meet specific policy objectives</td>
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<tr>
<td><strong>Competitive Dynamics:</strong> market competitive</td>
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<tr>
<td>pressures and innovative players &quot;take on&quot; the</td>
<td>• Government auto-enrolment</td>
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<td>mass market challenges</td>
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<td><strong>Commercial non-insurance:</strong> used for one of</td>
<td>• Proxy sales force</td>
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<tr>
<td>three non-insurance commercial purposes: (i) to</td>
<td>• Service-based sales</td>
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<tr>
<td>mitigate financial risk; (ii) secure a market for</td>
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<td>the underlying service; (iii) additional revenue</td>
<td>• Passive sales</td>
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<td>stream</td>
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<td></td>
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**Consultation Draft**
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Market dynamics distinctive to microinsurance business models

**Business Models Dynamics**
- Involvement of multiple parties in delivering the insurance products
  - Longer value chain means more entities
  - Accountability of entities can be problematic
  - Proliferation of insurance agents/sales representatives
- Reduced skills and competence of persons selling insurance
  - Lack of insurance experience or qualifications
  - Lack of sufficient knowledge and skills for target market
- Misaligned incentives for sales persons or channel
  - The interests for the sales channel are primarily aligned to that of the third party, underlying service or group (e.g. need to mitigate credit default risk or build customer loyalty)

**Implications**
- Need for intra-agency coordination
- Need to make all entities functionally accountable
- Delegated supervision
- Balancing consumer protection with allowing new players to intermediate insurance

**Regulatory Consideration**
- Appropriateness of policy and/or interest in post-sales servicing (renewals)
- Information disclosure to client
- Delay of premium payments to the insurer
Market dynamics distinctive to microinsurance business models

### Business Models Dynamics

- Reduced bargaining power of insurer vis-à-vis new intermediaries in the distribution chain
- Increased distribution costs

### Implications

- Aggregator ‘owns’ the clients
- Longer value chain, more entities and enhanced bargaining power may lead to increased distribution costs and lower relative value for the clients

### Regulatory Consideration

- Traditional insurance regulatory framework most often is tailored to relationship between the insurer and the client, not the intermediary distribution channel
- Challenges tracking and controlling levels of remuneration along value chain
- Inflated premiums or disproportionality low claims ratios
Market dynamics distinctive to microinsurance business models

**Business Models Dynamics**

- Increased reputational risk
  - The insurer is no longer a driver of the client interface
  - Potential for miss-selling from the intermediary

- Enhanced consumer protection concerns due to nature of target market

**Implications**

- Limited knowledge and skills to make informed decisions
- Reduced bargaining power of client
- Clients have fewer resources to access consumer recourse mechanisms

**Regulatory Consideration**

- Linking the brand of the insurer with the brand of the channel
- Some cases not an issue if the aggregator has a strong interest in the channel

- Ensure that the sales process and the information disclosed take into account the realities of the target market
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6 discrete microinsurance risks

Prudential Risk
Policy Awareness Risk
Aggregator Risk
Payments Risk
Sales Risk
Post sales risk
Regulatory responses

Risks

Identify the risk

Risk Drivers

Understand what drives the risk

Observed Responses

Respond appropriately
Prudential Risk

Risk that insurer is not able to keep its promises and deliver the benefits to the beneficiaries

Risk Drivers:

- Capacity of the underwriter
- Lack of supervision of the underwriter
- The underwriter is too small
- Inadequate corporate governance

Observed responses:

- Product restrictions
- Regulatory approval for products
- Concessionary capital req. for micro insurers
- Simple and regular reporting to the supervisor
- Min. threshold for size of risk pool
- Separate insurance business from other lines
- Min. corporate governance req.
The risk of reduced client value and inappropriate products being sold to clients when an insurer accesses the aggregated client base of a non-insurance third party to sell its products through that channel.

- Power imbalance
  - Cost disclosure
  - Commission caps
  - Contract disclosure

- Financial interests of aggregator
  - Claims and expense ratio reporting
  - Public disclosure of partnership agreements
Sales Risk

Risk that the salesperson will misrepresent the product to the client or sell a product that the client does not need.

Risk Drivers

1. Insufficient knowledge and skills
2. Incentives are misaligned
3. Inadequate accountability

Observed responses

- Min. qualification and training requirements
- File and use requirement for marketing materials
- Insurers held liable for intermediaries
- Permit uncapped commissions
- Incentivise post-sale behaviour
- Code of conduct
- Product simplification req.
- Statutory cooling off period
- Explicit disclosure req.
- Mandatory complaints resolution procedure
- Explicit registration req.
- Insurer held liable for intermediaries
Regulatory responses: Policy Awareness Risk

Risk

Risk Drivers

The absence of a specific sales action

• Require a small contribution from consumer

“Tick box” sales process

• Require post-sales communication
• Require choice for mandatory product lines
• Statutory cooling off period

Low level of client financial literacy

• Consumer education/awareness campaign

Policy Awareness Risk

Risk that the insured is not aware that he or she has an insurance policy and is therefore unable to lodge a claim should the risk event occur.
Regulatory responses: Payment Risk

Risk

Risk Drivers

- Intermediary who can delay premium payment
- Seasonal or irregular income of clients
- Mandatory payment system req.

Observed responses

- Max. period for intermediary to pay to the insurer.
- Require financial soundness of intermediaries
- Require that the receipt of the premium by the intermediary is imputed as the receipt of the premium by the insurer.
- Statutory grace period
- Req. more flexible premium collection/payment methods
- Regulate the structure of payments
- Allow in cash or non-bank payment systems premium payment

Payments Risk

Risk that the premium will not reach the insurer, that the premium will not be paid on the due date or that the cost of collecting the premium is disproportionate.
Risk Drivers Observed responses

Risk that clients face unreasonable post-sale barriers to maintain their cover, change products, make enquiries, submit claims, receive benefits or make complaints.

• Consumer awareness/education campaigns
• Require client recourse systems
• Complaints in first instance directed at insurers
• Clear communication of available recourse mechanisms to the client
• Document standards for settling claims
• Register and train salespersons
• Structuring of commissions
Risk Drivers Observed responses

Risk

Post sales risk
Risk that clients face unreasonable post-sale barriers to maintain their cover, change products, make enquiries, submit claims, receive benefits or make complaints.

Unscrupulous insurer
• Require insurers to provide an option for a monetary benefit instead of an in-kind benefit (service based-sales)
• Prohibit or limit deductibles in microinsurance policies
• Max. periods for claims processing and claims payments

Group underwriting approach
• Prohibit selective cancellation of individual cover within a group policy.

Monopolistic insurance provision
• Liberalise the insurance market to increase competition and options for clients.
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Risk profiles of the different business models.
Questions and discussion
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