The role of policy, regulation and supervision in

Making insurance markets work for the poor

The case of Colombia • October 2008

By Christine Hougaard, Hennie Bester and Doubell Chamberlain. Based on the country report prepared by Monica Caceres (PrimAmerica) and Sandra Zuluaga (Fedesarollo)

micro insurance network

This document is focus note 3 in a series of 12 produced as part of a five country study on the role of policy, regulation and supervision in making microinsurance work for the poor. See page 7 for further details.

Introduction

Access to insurance may be an important strategy for reducing poverty. Financial markets, and particularly insurance services, can help poor people manage critical risks such as death in the family, illness, or loss of income or property. Despite the growing importance and expansion of microinsurance services geared to low-income people, microinsurance penetration remains limited, leaving the vast majority of poor people without adequate protection.

This focus note explores the state of microinsurance in Colombia and the factors that influenced the development of this market, specifically considering the impact of policy, regulation and supervision. The individual country reports and summary findings can be accessed at www.cenfri.org.

Table of Contents

1 Colombian economic and financial sector context[1]

Economic context. Colombia is a lower-middle-income country with a population of almost 47m, 57% of which reside in urban areas. Poverty is relatively low compared to many other developing countries, with 19% of the population living on less than $2/day and 8% on less than $1/day. Adult literacy is very high at 93% (World Bank, 2007[2]). Yet the informal economy is estimated to contribute at least half of GDP and to employ almost 60% of the work force.

Liberalisation and crisis. Colombia underwent an economic liberalisation process in the early 1990s. This included legislation aimed at opening up the economy and achieving financial liberalisation. The central bank's monopoly on foreign exchange transactions was broken and it became an independent entity.

At the same time, the public sector was rationalised, the transport infrastructure improved, business renewal programmes were implemented and a general framework for foreign investment was defined (Uribe, 2000[3]). This laid the foundation for an average growth rate of 5.7% between 1991 and 1995. The subsequent imbalance created on the current account, along with a fiscal deficit and other factors, however saw Colombia experience a financial sector crisis at the end of the 1990s, triggered by the Asian financial crisis. As a result, GDP contracted by 4.2% in 1999.

Effects of the financial sector crisis. Between 1998 and 2000, the banking sector lost almost 40% of its equity. In the insurance sector, the impact was less severe and no insurers failed as a result of the crisis. Post-crisis, government undertook a clean-up process of the financial sector and strengthened financial sector regulation, including for financial cooperatives. In 2006, a new financial regulatory agency, the Financial Superintendence, was formed by merging the agencies in charge of supervising financial institutions and securities.

Financial sector outreach limited, but increasing low-income market activity. In 2007, a National Banking Association survey estimated formal financial services to reach at most 34% of the population[4]. Yet the Colombian banking sector has recently experienced a distinct move down-market, with more and more commercial banks entering microfinance. This trend was catalysed by financial liberalisation, which prompted commercial banks to enter lower-income markets (including microfinance) in search of new markets and in light of increased competition and a reduction of margins in traditional segments of the market. The positive experience of NGOs, MFIs and in particular financial cooperatives, and the realisation that there is a large untapped market segment further reinforced this move.

Insurance sector dominated by non-life, but life share growing. Insurance premiums in Colombia amount to 2.4% of GDP (the same as the Latin American average), though premium per capita, at $69, is still significantly below that of Latin America ($126). Life insurance accounts for only 11% of total premiums. It is suggested that this low figure is at least in part due to the fact that high-income individuals tend to obtain insurance abroad (partly the result of financial liberalisation, partly due to fears instilled by the crisis).

During 2006, life premiums however grew by 24.4% (versus 12% growth for non-life). This was largely driven by the growth in credit life insurance premiums, amounting to almost 24% for the year. Credit life growth, in turn, is the result of the quest for micro-credit expansion by formal financial service providers, a movement spurred by government's Opportunity Banking Policy.

1 Unless otherwise quoted, information and data in this report stem from the Colombia Country Report: Caceres, M. & Zuluaga, S., 2008. Unpublished Colombian country report. IAIS/MIN JWGMI study on the role of regulation in the development of insurance markets.

2 World Bank, 2007. World Development Indicators. Poverty statistics and other data extracted from: http://iresearch.worldbank.org/PovcalNet/jsp/CChoiceControl.jsp?WDI_Year=2007 (accessed March 2008)

3 Uribe, JD, 2000. The banking industry in Colombia: competition, consolidation and systemic stability. BIS Papers, no. 4. Available at: http://www.bis.org/publ/bppdf/bispap04d.pdf (accessed April 2008)

4 Note that this figure may be overestimated, as it is not clear that the actual number of account holders, rather than accounts, was measured. There may be some duplication of accounts per person.

2 Salient features of the micro-insurance market

Usage. An estimated 19% of Colombian adults are microinsurance clients. There are about 2.74m[5] formal microinsurance policies (9% of the adult population). Informal microinsurance (most notably funeral insurance provided by so-called funeral entities) also plays an important role. Industry sources estimate the informal market to reach up to 3m clients (10% of adults), making it slightly bigger than the formal market (at 52% of the total microinsurance market).

The salient features of the Colombian microinsurance market can be represented as follows:

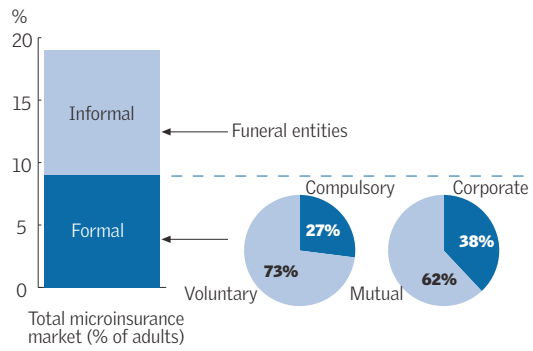

Figure 1. Estimated composition of the Colombian microinsurance market.

Source: Compiled from Cáceres & Zuluaga, 2008

Players. There are 43 registered insurers in Colombia. Of that, 41 are corporates and two are cooperatives. Though 17 insurers provide some form of microinsurance products, the two insurance cooperatives, La Equidad and Solidaria, are the microinsurance pioneers and remain the largest players in the microinsurance market. With their 1.7m insurance policyholders, they are estimated to account for 62% of the total formal microinsurance market. This is however still significantly below the total cooperative membership of 3.7m, implying scope for further cooperative-based microinsurance expansion.

5 This may be a slight overestimation of policyholders, as some people may have more than one policy.

Products. Voluntary microinsurance plays an important role in Colombia compared to international experience. Compulsory credit life insurance is currently estimated to account for only 27% of all microinsurance clients, though it is growing strongly on the back of credit expansion.

The most popular life microinsurance products are funeral insurance, followed by credit life insurance. Innovative new products are also increasingly marketed on the non-life side, including motorbike insurance, insurance tailored to cover the stock of small businesses, repatriation insurance for migrant workers, products providing benefit pay-outs in the form of grocery vouchers or education fee coverage, and cell phone insurance. Fasecolda (the insurance industry association) estimates property insurance to comprise 60% of the microinsurance market. This category is in turn largely made up of cell phone insurance. 30m Colombians (about 64% of the population), 72% of whom are classified as lower income, now own a cell phone.

Distribution. Traditional broker and agent distribution channels do not feature prominently in the microinsurance market.

Instead, microinsurance is distributed largely through cooperatives, as well as through micro-credit NGOs requiring compulsory credit life insurance. Direct sales[6], bancassurance and distribution through utilities[7] are also emerging as important intermediation channels:

Distribution channel	Share in total distribution
Cooperatives	22%
NGOs specialised in microcredit	18%
Direct sales	18%
Bancassurance	11%
Utilities	9%

Table 1. Microinsurance distribution channels in Colombia.

Source: Cáceres & Zuluaga, 2008. Unpublished country report

6 "Directs sales" refer to insurance products sold directly by the insurer without tied agents or brokers, for example through telemarketing, direct mail, or call centres. Sometimes this involves insurers selling products through their employees without such employees being considered agents or brokers. This is allowed under Art. 5 FLFS and Art 2 Decree 2605, 1993.

7 With the insurance premium added as a separate item to a person's monthly utility statement

Additional channels such as hospitals, educational establishments, large retail outlets/networks and funeral homes could also become significant, though such distribution is not found at the moment, except for a recently launched initiative where life insurance is sold through cashiers at some supermarkets. The potential of cell phones to support distribution in the low-income market is of yet untapped.

3 The insurance policy, regulation and supervision landscape

Colombia has no dedicated insurance law. Insurance is incorporated with other financial activities under the Fundamental Law of the Financial System (FLFS) and its subordinate decrees and regulations. The Financial Superintendence (FS) acts as insurance regulator and supervisor.

Prudential and institutional regulation. Both public corporations and cooperatives may register as insurers. The minimum upfront capital requirement consists of a standard minimum capital component, as well as additional technical capital requirements per class of product provided. In 2006, the standard component was $2.7m for life and non-life insurers, $1.5m for credit and export insurers, and $11m for reinsurers. The technical equity required ranges from $0.3m to $1.2m, according to the type of product. Therefore the total minimum upfront capital requirement will depend on the combination of products provided by the insurer.

Apart from the FLFS, Law 79 of 1988 on Cooperatives is also of relevance. It establishes a framework to develop cooperative activities and allows cooperative insurers to provide insurance to non-members. There is no special dispensation for cooperative insurers and they have to adhere to the full set of regulatory requirements for insurers.

Product regulation. Upon registration insurers are authorised to provide various classes of policies (group life, health, vehicle, asset, etc). New products have to be submitted to the FS, but no product authorisation is required. Strict product demarcation applies only to individual life policies. Under Article 38 of the FLFS, insurers providing individual life policies must do so exclusively.

Any other life insurers may sell group life, collective life[8], health, personal accident, funeral or education policies, as well as annuities and non-life policies. Non-life insurers may sell collective life, group life and health insurance in addition to asset-based policies.

Market conduct regulation. In Colombia insurance may be distributed directly by the insurance company, through agents, insurance agencies or by means of insurance brokers. Under the Cooperative Law, insurance cooperatives may sell their own or another insurer's policies without the use of agents, brokers or agencies. The main difference between brokers and agents is that while agents are natural persons, brokers must be a limited company or public corporation. They must register with the financial superintendence and are subject to capital requirements. Agents do not have to register and the onus is placed on the insurers dealing with them to ensure that they are compliant and competent. Insurers must certify that they have trained their agents to ensure that they will be competent and must make their training programmes available to the FS. In practice, insurers implement this requirement jointly through courses presented by the industry association, Fasecolda.

The direct distribution and agency channels are interpreted quite broadly to accommodate new channels. New channels (for example bancassurance or distribution through public utilities) have also been regulated through subordinate regulation on an ad hoc basis. There is no price control on premiums or commissions. Market conduct provisions mostly relate to consumer protection measures such as the right to choose the provider in the case of credit insurance and the establishment of proper complaints procedures.

Financial inclusion policy. Financial inclusion is an important policy objective. Government, specifically the president, invests much energy in supporting the development of financial services for the poor. A key feature is the Opportunity Banking Policy that was launched in 2006. It seeks to provide access to financial services, including payments, transfers, savings, loans, insurance, pensions and remittances. It does not place any regulated inclu-

8 The only difference between group life and collective life policies is that in the former there is some relationship between the policyholders, for example they belong to the same union. Collective life would for example refer to the policies sold via the electricity utility.

sion objectives on private financial institutions, but establishes the overall policy framework that guides public and private players to extend access to financial services. Amongst others, the government has amended banking regulations to allow the establishment of non-bank agents (named "non-bank correspondents") to extend the formal banking network into previously unserved areas. As of June 2007, there were 3,508 non-bank correspondents and between 2006 and 2007 the new channel enabled almost 1m Colombians to access formal credit for the first time. Non-bank correspondents are not currently allowed to sell insurance (though they may collect premiums).

4 Impact of policy, regulation and supervision on the market

As the FLFS makes no reference to microinsurance and there is no official microinsurance definition, the Colombian experience illustrates that microinsurance can grow even in the absence of any regulatory concessions to facilitate its development. However, this is only possible because general insurance regulation does not impose an unduly heavy burden on the intermediation of microinsurance; neither is it restrictive on underwriting:

- *Insurance provided by funeral entities unregulated.* Funeral entities serve a large part of the market and have also supported formal market development by increasing awareness and familiarity with the concept of insurance. A 2006 opinion by the FS (based on a 2003 constitutional court judgment) holds that the policies provided by funeral service providers fall outside the definition of insurance in the FLFS. These providers therefore operate on an unregulated and unsupervised basis. Though this "regulatory forbearance" has by and large served the development of the market, it could create the risk of consumer abuse if not carefully monitored by the supervisor.
- *Demarcation rules favourable to market development.* Market development in Colombia is supported by the fact that an insurer is allowed to provide health, non-life and group life policies under a single license.
- *Flexible market conduct regime.* The Colombian regulatory framework facilitates microinsurance intermediation in a number of ways: it accommodates new channels within the "direct sales" or "agencies" categories or through specific subordinate legislation as they arise. Furthermore, no price controls (in the form of commission caps) apply to the intermediation process. Cooperatives may sell insurance to non-members and may act directly as distribution channel. Lastly, the FS delegates supervision of agents to insurers. These factors combine to make Colombia one of the sample countries with the most flexible market conduct regime. This gives providers the confidence to pursue distribution innovation, as witnessed in the various new channels emerging.
- *Active government encouragement of low-income market activity.* To date one of the main impacts of the Opportunity Banking policy has been the introduction of "non-bank correspondents" as an intermediary category to support the distribution of financial services in poor and remote areas. The expansion of micro-credit in turn paves the way for credit life microinsurance expansion.

5 Key insights and lessons from Colombia

Impact of liberalisation and crisis. Colombia's experience of financial liberalisation and subsequent crisis contributed to shape the microinsurance market: liberalisation brought more competition for domestic clients and prompted a move downmarket by domestic insurers (partly in light of the fact that many wealthy individuals started to procure insurance abroad).

Voluntary sales still dominate microinsurance, but compulsion on the rise. Voluntary purchases rather than compulsion have thus far driven microinsurance in Colombia. Recently, credit life insurance has however grown rapidly on the back of microfinance expansion. Funeral insurance is the most popular insurance product, followed by credit life insurance. Non-life insurance, especially cell phone insurance, is proving increasingly popular among the low-income population. This bodes well for the expansion of access to insurance to low-income groups. Increasingly, products of relevance to this market segment are being found in the market, and distributed through increasingly innovative means.

Central role of cooperatives. The cooperative

sector has been central to the development of microinsurance in Colombia and accounts for more than 60% of all policy holders. The sector's role has been facilitated by the fact that the regulation of the cooperative sector was strengthened by the financial sector reform necessitated by the crisis.

Gaps in regulatory regime allow informal operation of funeral entities. The existence of funeral entities effectively providing insurance outside of the regulatory regime shows that gaps in legal definitions may facilitate risk pooling on the one hand, but may create an unlevel playing field and unnecessary risk for the consumer on the other hand.

Financial inclusion policy driving current trends. The Opportunity Banking Policy represents a significant push for financial inclusion by government, initially focusing more on access to credit, but in the process also stimulating the credit life insurance market.

Development without dedicated regulatory framework. The Colombian experience illustrates that microinsurance can develop where the regulator has a fairly open stance, even without a dedicated microinsurance regime. However, this can only happen if the overall regulatory burden imposed by regulation, particularly on the market conduct side, is relatively low.

But lack of intermediate step may undermine further development. Microinsurance is still largely driven by two large cooperative players who entered when regulatory requirements were lower. The current system may not provide the same process for new cooperative insurers, therefore prudential requirements mean that it remains difficult to provide microinsurance "from the bottom up", as no intermediate step or tier with reduced regulatory cost is available to new underwriters who want to enter the market providing microinsurance only.

Future of microinsurance in Colombia? The Colombian case illustrates two main trends: (i) a traditionally open approach by the regulator to new and low-income targeted market approaches, which illustrates how microinsurance can develop even in the absence of dedicated, tiered regulation; and (ii) a recent government drive for greater financial inclusion mainly through microfinance. The combination of an open regulatory stance and the recent financial inclusion policy therefore largely shapes the Colombian microinsurance market. However, some market aspects point towards limited access for new cooperative and other insurers imposed by the uniform regulatory regime, suggesting that it is inclusion policy more than anything else that drives the recent growth in microinsurance uptake (via compulsory credit life coverage on the back of microloans). Overall, microinsurance penetration however remains low. This begs the question whether a regulatory framework that makes no particular provision for microinsurance, even if fairly accommodating, can continue to unlock large-scale uptake of insurance among the low-income population. ■

The focus note series

Focus note 1: What is microinsurance and why does it matter? The rational for microinsurance from a regulator's perspective.
Focus note 2: The role of policy, regulation and supervision in making insurance markets work for the poor: Executive summary and emerging guidelines;
Focus note 3: The role of policy, regulation and supervision in making insurance markets work for the poor: The experience of Colombia;
Focus note 4: The role of policy, regulation and supervision in making insurance markets work for the poor: The experience of India;
Focus note 5: The role of policy, regulation and supervision in making insurance markets work for the poor: The experience of the Philippines;
Focus note 6: The role of policy, regulation and supervision in making insurance markets work for the poor: The experience of South Africa;
Focus note 7: The role of policy, regulation and supervision in making insurance markets work for the poor: The experience of Uganda;
Focus note 8: Risk it or insure it? Understanding the microinsurance purchase decision;
Focus note 9: Ensuring mutual benefit: The role and regulation of member-owned insurers;
Focus note 10: Informal insurance: a regulator's perspective;
Focus note 11: The impact of policy, regulation and supervision on the development of microinsurance markets; and
Focus note 12: Making a market for microinsurance: the success and failure of different channels of delivery.

About this document

To support the development of microinsurance markets, a project was launched under the auspices of the IAIS-MIN JWGMI[I] aimed at mapping the experience of five developing countries – Colombia, India, the Philippines, South Africa and Uganda – where microinsurance markets have evolved in varying degrees.

The objective was to assess how much regulation has affected the evolution of these markets and gain insights which can guide policy-makers, regulators and supervisors looking to support the development of microinsurance in their jurisdiction.

To disseminate the findings of this project, a number of focus notes have been written to highlight themes that emerged from it. This document is the third focus note in a series of 12 – six thematic focus notes and six notes summarising each country study.

The project was majority-funded by the Canadian IDRC[II] (www.idrc.ca) and the Bill and Melinda Gates Foundation (www.gatesfoundation.org), with funding and technical support from the South African-based FinMark Trust[III] (www.finmarktrust.org.za) and the German GTZ[IV] (www.gtz.de) and BMZ[V] (www.bmz.de). FinMark Trust was contracted to oversee the project on behalf of the funders. With representatives of the IAIS, the ILO, the Microinsurance Centre and the International Cooperative and Mutual Insurance Federation (ICMIF), the funders are also represented on an advisory committee overseeing the study.

I International Association of Insurance Supervisors (IAIS) and Microinsurance Network (MIN) Joint Working Group on Microinsurance
II International Development Research Centre
III Funded by the UK Department for International Development (DFID).
IV Deutsche Gesellschaft für Technische Zusammenarbeit GmbH.
V Bundesministerium für Wirstschaftliche Zusammenarbeit und Entwicklung - Federal Ministry of Economic Cooperation and Development

These focus notes and other material related to the project can be downloaded at www.cenfri.org.
For more information, please contact the project coordinator, Doubell Chamberlain: Doubell@cenfri.org

Centre for Financial Regulation and Inclusion,
University of Stellenbosch Business School Campus,
Carl Cronje Drive, Bellville, Cape Town, 7530, South Africa;
+27 21 918 4390; www.cenfri.org

www.microinsurancenetwork.org