The role of policy, regulation and supervision in

Making insurance markets work for the poor

The case of India • October 2008

By Christine Hougaard, Hennie Bester and Doubell Chamberlain. Based on the country report prepared by Sanjay Sinha and Swetan Sagar, M-Cril

micro insurance network

This document is focus note 4 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, as 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 India 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 Indian economic and financial sector context[1]

Economic context. With a population of around 1.1bn, India is the second-most populated country in the world and has the potential to reach significant scale in microinsurance. In recent years, India has achieved GDP growth averaging between 8 and 10%. Yet poverty remains high, especially in rural areas, in which 70% of the population still reside. The World Bank (2007[2]) estimates 88% of the rural population and 61% of the urban population to live on less than $2/day, reducing to respectively 40% and 20% for $1 per day.

Vibrant financial sector, mostly large institutions. The Indian formal financial sector is growing at 20-25% per annum. Stock markets are achieving growth and the demand for skills in the financial sector far outstrips supply. Historically, small and cooperative institutions have not performed well. This has resulted in a cautious regulatory approach that limits the players in the non-bank field to large cap institutions. These institutions are however less well equipped to operate in rural areas or work with micro clients.

Insurance sector only recently privatised. Government nationalised the insurance industry in the 1950s, monopolising it into one state-owned Life Insurance Company (the LIC) and four subsidiaries of one General Insurance Company (the GIC) on the non-life side. The insurance industry was liberalised in 1999 and though the state-owned insurers still dominate, there are currently 32 licensed insurers. Total insurance premiums represent 3.5% of GDP and have grown significantly in recent years. Life insurance premiums grew by an average of 25% per annum over the past few years, while non-life insurance grew by almost 18% per year.

Social assistance via the insurance industry. India is unique in that the government plays a proactive role in providing insurance through various social security programmes and highly subsidised insurance schemes to the very poor (those below $2/per day threshold). Amongst others, it provides life insurance to 10 million individuals below the poverty line and health and life insurance for 2-3 million artisans, as well as health insurance for organised sector workers. These programmes are however classified as social security rather than as microinsurance, as microinsurance is defined for the purpose of this study as provided by insurers via the market mechanism.

2 Salient features of the micro-insurance market

Usage. Though no figures are available on the exact size of the microinsurance market in India, a rough estimate would place it at around 14m individuals, or approximately 2% of the adult population[3]. Note that India is the only country for which this estimate includes health insurance[4]. The low take-up can be ascribed to a general lack of awareness of insurance as a financial product, even in the high to middle-income market (a factor that emerged strongly from the focus group findings). In addition a lack of rural financial services infrastructure for

1 Unless otherwise specified, all information and data quoted in this focus note stem from the unpublished Indian country report: M-Cril, 2008. Unpublished Indian 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 This figure is derived as follows: the main market for microinsurance in India is the MFI clients (clients of both privately run MFIs and the members of SHGs promoted under the Government's/NABARD SHG-Bank Linkages Programme). There are about 50m MFI clients, of which 30m are currently served. Of these, 30-40% are poor which means that there are about 10.5m credit life micro-insurance clients. There are about 5m clients served by community health schemes. However, there are some overlaps among the clients of private MFIs/SBLP and also the lives that are covered by credit life and social security schemes. Therefore, assuming an overlap of about 10%, the total number of low-income clients served by microinsurance will be around 14m. This estimation does not include micro-pensions. These figures would have increased by around 20-30% in 2008 as the Microfinance sector in India has grown at this pace for the last several years.

Note that this estimate differs from for example Roth, McCord & Liber (2007), where it is stated that in excess of 30m lives are covered by microinsurance in India. This can be ascribed mainly to the fact that the emphasis in this study is on the number of policy (insurance product) holders rather than the number of lives covered (more than one life may be covered per insurance product). In addition, this study did not count micro pensions (noted as an important product in Roth et al) as microinsurance.

4 As agreed in the methodology for the country studies, health insurance would be outside the scope of the study. Due to its important role in the low-income market, India is however the one country for which an exception was made.

distribution purposes, as well as a lack of actuarial data[5], inhibit the development of the microinsurance market.

Players. Though the state-owned insurers still have the largest market share, there are now a total of 32 licensed insurers. A feature that sets India apart from other countries is the fact that microinsurance is mostly provided by large, corporate insurers. This is due to a cautious regulatory approach – in response to the fact that small and cooperative financial institutions have not performed well historically – that limits the players in the non-bank field to large cap institutions. The cooperative/mutual sector therefore does not feature as a provider of microinsurance, though corporate insurers use it as a distribution channel. Informal insurance is virtually exclusively the domain of formal entities such as health insurance schemes not registered for insurance purposes, rather than community risk-pooling groups, and is estimated to only comprise 20% of the market.

Products. Microinsurance in India is for the most part driven by compulsory credit life insurance on the back of microfinance. Due to the limited reach of the public health system, there is also a high natural demand for health insurance. Many MFIs therefore provide a package of compulsory insurance cover to their clients that is credit-linked – this includes life, asset as well as health insurance. The cover is for the term of credit (usually 1 year). Health cover provided in such packages is not comprehensive and it covers only certain listed diseases for which hospitalisation is required. Accident cover is a rider on life insurance and is a fixed payout. India is therefore fairly unique in that compulsory insurance cover extends beyond life cover.

It is estimated that only 10% of microinsurance policies are sold on a voluntary basis. Of these, up to 90% are endowment products rather than pure risk products, indicating a preference among the low-income population for financial products that provide some payout regardless of whether a risk event has occurred.

Health insurance (by Yeshasvini and a few other schemes) largely account for the informal part of the microinsurance market. The health insurance cover in this case is quite comprehensive (unlike in credit linked policies) and covers a number of illnesses as well as out-patient costs. The lack of adequate health care facilities in rural areas however undermines micro-health insurance.

Distribution. Distribution is an important part of the microinsurance landscape in India. Regulations were issued in 2005 to create a microinsurance agent category for the dedicated distribution of microinsurance. Currently such agents however only distribute about 20% of all microinsurance. Instead, distribution mainly takes place through MFIs who either do not qualify as microinsurance agents under the regulations or who find the regulations too restrictive, as partners or agents of formal insurers.

The key features of the microinsurance market can be captured as follows:

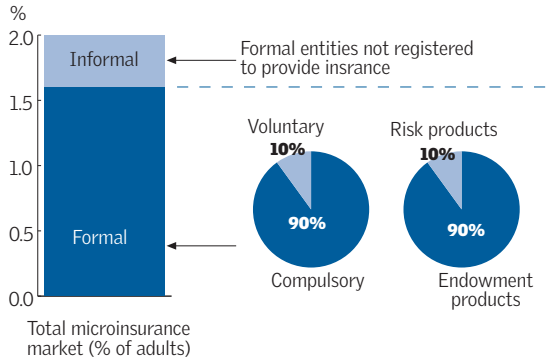

Figure 1. Composition of the Indian microinsurance market.

Source: M-Cril estimates (2008), unpublished India country report.

3 The insurance policy, regulation and supervision landscape

Insurance in India is regulated under the Insurance Act of 1938 (as amended). Concomitant to the liberalisation of the insurance industry, the Insurance Regulatory and Development Authority (IRDA) Act of 1999 established IRDA as the regulator and supervisor. As its name indicates, IRDA has two explicit mandates: regulating the industry for stability purposes, but also promoting industry development.

Prudential and institutional regulation. The Insurance Act, 1938 defines four categories of insurance – life, fire, marine and miscellaneous. IRDA

5 As private insurers are still young, they have not been able to accumulate enough pricing data.

licenses two categories of insurers – life and general (covering the last three product categories). Applicants have to be registered companies. Cooperative insurers are also allowed but must comply with the full regulatory load and minimum capital requirements[6].

No more than 26% of the issued share capital of an insurer may be foreign-owned. All insurers, regardless of type of product offered or institutional type, must hold Rs100 crores (approximately $25m) in minimum start-up capital.

Product regulation. One insurer is not allowed to offer both life and general insurance (unless it forms two separate companies for this purpose). Health insurance may however be provided under either a life or a general insurance license. New products are subject to a file-and-use approval approach. General (non-life) insurance premiums have traditionally been regulated, i.e. were subject to price control. In an effort to improve efficiency, IRDA however started to "detariff" the sector in 2007, with full premium liberalisation as of 1 January 2008. As a result property insurance rates are reported to have fallen by as much as 75-80%, though health insurance rates are expected to rise[7].

Market conduct regulation. IRDA recognises four types of insurance intermediaries: brokers, agents, corporate agents (that can for example include rural banks or MFIs) and microinsurance agents. Intermediaries have to undergo a minimum number of hours of training and (with the exception of microinsurance agents) have to pass an examination before they can register. From 2008, IRDA's approach has been to concentrate on solvency issues and to delegate market conduct supervision to self-regulatory insurance councils[8], for example in administering examinations of prospective insurance agents. Nevertheless, IRDA has set up a grievance cell/complaints office and works with insurers towards the expeditious disposal of complaints. Furthermore, it works towards the standardisation of concepts, simple application forms, acceptable accounting standards, transparency in business operations and disclosure of financial statements.

Financial inclusion policy and regulation. Financial inclusion is an explicit policy objective of the Indian government and various initiatives have been launched to that effect. India is one of only two sample countries currently to have a microinsurance regime in place. Of relevance to microinsurance are two sets of regulations issued by IRDA under its market development mandate:

Regulations regarding rural and social sectors obligations[9], 2002. These regulations oblige insurance companies to procure insurance business on a quota basis from pre-defined rural areas and social sectors, with the latter defined as "unorganised workers, (and) economically vulnerable or backward classes in urban and rural areas". The quotas are phased up over time:

- 5% of all life insurers' policies must be from rural areas in year 1, phasing up to 16% in year 5.
- For non-life insurers, 2% of total gross premiums underwritten must be from rural areas in year one, phasing up to 5% in year 5.
- In the social sectors, each insurer has to maintain at least 5,000 policies in year 1 rising to 20,000 in year 5, for both life and general insurance.

An insurer failing to reach the targets incurs a financial penalty. Repeated violations could prompt IRDA to revoke such an insurer's license.

Microinsurance regulations, 2005[10]. These regulations embody IRDA's commitment to extending the reach of the insurance sector. They create a specific category of microinsurance agents to distribute microinsurance products on behalf of registered insurers. Microinsurance products are defined to comprise both life and general insurance products. The definition is set according to minimum and maximum benefits, the minimum/maximum term of the insurance policy and minimum/maximum age of

6 Just one cooperative insurer, specializing in agricultural insurance, has been established so far.
7 Previously, health and property were combined in one product and property rates cross-subsidized health. With property rates falling, this is no longer feasible.
8 All insurers and provident societies incorporated or domiciled in India are members of the Insurance Association of India. It has two councils, namely the Life Insurance Council and the General Insurance Council, funded by industry. Both councils act as self-regulatory bodies by developing codes of conduct, setting disclosure standards, developing compliance programs, etc.

9 Full name: The Insurance Regulatory and Development Authority (Obligations of insurers of rural social sectors) Regulations
10 Gazetted in November 2005. Available at: www.irdaindia.org/regulations

Definition in terms of	
Benefit limits	Non-life: max. $740; min. $123 (exception family health and accident: $247) Life: max. $1230 (exception endowment and health: $740) ; $123 min. (exception of family health and accident: $247)
Age of entry	Life: >18, <60 Non-life: n/a (exception personal accident: >5, <17)
Term limits	Non-life: 1 year Life: >5, <15 years (exception health insurance: >1, <7)
Product features	Simplicity, available in vernacular language
Demarcation	Composite life & non-life MI products allowed, but separate insurers must underwrite the risk.
Institutional aspects	No prudential space for MI, only distribution through MI agents (non-profit entities)

Table 1. Definition of microinsurance in India[11].

Source: regulatory information as quoted in M-Cril (2008), unpublished Indian country report

entry, as well as certain simplicity requirements. The specifications vary according to the type of cover provided. See table 1.

Thus far, twelve life and eight non-life microinsurance products have been filed with IRDA. All sales of microinsurance products will count towards insurers' rural and social sector obligations (though rural and social insurance do not necessarily constitute microinsurance). Providers of such products do not receive any prudential or institutional concessions. The demarcation requirement between life and non-life insurance is relaxed for microinsurance in that the regulations allow for the bundling of life and non-life elements in one single product, provided that a life and non-life insurer must respectively underwrite the life and non-life risks underlying the product[12].

Microinsurance agent category. Microinsurance agents must enter into a "deed of agreement" with one life and/or one non-life insurer. Until recently such agents were limited to NGOs, self-help groups and non-profit MFIs with a minimum of three years experience in working with low-income groups. In March 2008 the category was extended to all non-profit entities13. For-profit entities such as rural banks and for-profit MFIs remain excluded (they are classified as corporate agents). Agent categories other than microinsurance agents may sell microinsurance but do not benefit from the concessions allowed for the microinsurance agents. However, a microinsurance agent cannot distribute any product other than a microinsurance product.

Concessions for microinsurance agents. While all types of intermediaries may distribute microinsurance, only microinsurance agents are granted certain concessions in doing so. Once registered as a microinsurance agent, lower training requirements apply (25 rather than 50 hours of mandatory training). Microinsurance agents may levy commissions of between 10% and 20% of premiums per year, depending on the type of product. These commission caps are more liberal than those applying to the rest of the industry (where upfront structuring of commissions is however allowed). Nevertheless, the general market sentiment is that commissions are still too low to make microinsurance sales viable. For group insurance products, the insurer may decide the commission subject to the overall limits specified by IRDA.

Other relevant regulation. The Reserve Bank of India (RBI) imposes stringent restrictions on the collection of "deposits" in any form. In 2002, it issued regulations stating that certain types of NBFCs (non-bank finance companies), including most MFIs, may not route any premiums through their books. The implication is that the NBFC intermediary must pay individual transactions over to the insurer, rather than processing all payments through

11 Exchange rates taken from www.oanda.com on 11 March 2008. Note: "MI" denotes "microinsurance".
12 This requires two such insurers to enter into a contractual relationship for the provision of the composite microinsurance product via a microinsurance agent.
13 Refer to www.irdaindia.org

their systems and making a single payment to the insurer. This introduces inefficiencies and increases cost. This restriction is however waived for registered microinsurance agents, enabling them to route premiums through their books. Furthermore, tax legislation is of relevance in that all insurance policies and commissions earned, with no exception for microinsurance policies or microinsurance agents, are subject to a service tax. The fact that insurers pay 12.36% service tax on microinsurance agents' commissions has direct implications for pricing and hence affordability of premiums. Submissions have been made to the Ministry of Finance for the removal of service tax on microinsurance sales, but no action has been taken in this regard yet.

4 Impact of policy, regulation and supervision on the market

High capital requirement undermines dedicated micro-insurance provision. The high minimum statutory capital requirement is a deliberate entry barrier imposed by IRDA. As there is no concession for dedicated microinsurance providers, this policy could impede the growth of the microinsurance industry since it precludes mutual groups and other community-based entities from formalising into registered insurers. Likewise, market conduct regulation, for example the price controls on commissions, increase the burden on insurance provision to the low-income market, as does the service tax.

Rural and social sector quotas force move down-market, but do not necessarily improve the livelihoods of the poor. The impact of the quotas has been ambivalent. While it has prompted some insurers to experiment with new distribution channels through NGOs, MFIs and the rural banking network, many insurers still do not regard this as a profitable market opportunity beyond the quotas. The quotas furthermore do not specify that policyholders need to be poor and it is reported that many insurers meet the quotas by focusing on higher-income individuals within the rural and social sectors.

Microinsurance regulations open space for microinsurance distribution, but impact undermined by restrictions. The concessions granted to microinsurance agents bring down intermediation costs and allow enhanced functions such as the routing of premiums. This is however undermined by the fact that these concessions are only available to a limited category of agents. The implication of the exclusion of for-profit entities from the microinsurance agent definition is best illustrated in the case of non-bank finance companies (NBFCs) that are for-profit companies, often MFIs, registered by the Reserve Bank of India. NBFCs account for more than 80% of the clients served by microfinance and are therefore a ready base for micro-insurance distribution. Their exclusion from the microinsurance agent definition implies that insurers have to forgo this cheaper distribution opportunity. It is estimated that, largely as a result of this restriction, only 20% of microinsurance products are currently distributed through microinsurance agents.

Demarcation relaxed for microinsurance, but no composite products yet. Despite the relaxation in the demarcation requirement for microinsurance, and despite the high potential demand indicated by the focus groups[14], no composite microinsurance products have yet been registered. It is argued that this is due to reluctance on agents' part to bind themselves to any one other insurer. Furthermore, the fact that the microinsurance regulations restrict microinsurance agents to partner with one life and one non-life insurer exclusively makes it impossible to combine the best products from different companies into a bouquet that will suit the needs of particular types of clients within the microinsurance space.

5 Key insights and lessons from India

Large microinsurance potential, but limited uptake to date. The sheer scale of the Indian market represents large potential for microinsurance still to be unlocked. Health insurance is in particular demand. A number of factors have however thus far inhibited the growth of the microinsurance industry, among them a lack of awareness among the public of the value to be offered by insurance. Informal risk-pooling mechanisms have not penetrated the market in any significant way.

14 Focus group participants indicated a high preference for composite products, particularly if there was a health component attached to it.

History of government involvement. The private insurance market and the regulatory authority are very new, with a history of state-owned insurance monopolies. Government remains involved in the insurance sector and often subsidises schemes, thereby using the insurance market as a type of social insurance mechanism.

Regulatory push for market expansion. The regulatory authority has a development mandate and has implemented a number of measures to expand the reach of the insurance market. The approach followed is to use quotas to compel insurers to reach down-market into the so-called rural and social sectors. This has triggered some interest in the low-income market, but not beyond that required by the quotas.

Microinsurance space within regulation, but restrictions undermine effect. Instead of creating a dedicated microinsurance tier which spans the full regulatory spectrum, the chosen route has been to limit application to the intermediation side, through the creation of a specific category of microinsurance agents that can partner with insurers for the distribution of microinsurance products, and for which demarcation and certain intermediation requirements are relaxed. The space is therefore relatively limited and does not allow for a separate prudential tier, implying that minimum capital requirements remain a significant barrier to entry. On the market conduct side, the microinsurance category has not yet had much success: currently only 20% of microinsurance is estimated to be distributed via microinsurance agents. Therefore, even though the microinsurance regulations have served (together with the quotas) to draw the attention of the market to microinsurance, it has by and large not yet been able to become a vehicle for accelerated outreach to low-income clients.

Assessment: lessons from the Indian experience. Only about 2% of the low-income market is estimated to be reached by microinsurance[15], despite rural and social sector obligations on insurers and the creation of microinsurance agents within regulation. The uptake of microinsurance has seen some increase but is mainly linked to the growth of the microfinance sector rather than microinsurance per se. Uptake of non-credit linked insurance is still very limited. This begs the question: is the Indian experience or a proactive/direct regulatory mandate for low-income portfolio expansion a good example for others to follow? Regulatory reform is still at a nascent stage and time will tell its true impact. The research has flagged various challenges as listed above. The regulations have however to some extent created supply side interest. Combining this with efforts to create demand-side interest in micro-insurance would go a long way in furthering the interests of economic inclusion and reducing vulnerability amongst large segments of the low income population. ■

15 Excluding the very poor who are served through government-subsidised schemes.

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 fourth 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