The role of policy, regulation and supervision in

# Making insurance markets work for the poor

# The case of Uganda • October 2008

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micro insurance network

This document is focus note 7 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 Uganda 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.

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# 1 Uganda economic and financial sector context[1]

***Economic context.*** Uganda is a small, low-income country. Of the total population of 29m (of which 13.1m are adults) 87% still reside in rural areas (which presents a key complication for the distribution of financial services), 96% live on less than $2/day, and 82% live on less than $1/day (World Bank, 2007[2]). As such, Uganda faces many policy challenges, one of which is the development of the financial sector.

***Relatively underdeveloped formal financial sector.*** Only 18% (2.4m) of the Ugandan adult population use any type of formal financial service (tier 1-3 in the table below), while another 3% (0.4m) use semi-formal financial services (tier 4 below). 17% (2.2m) use informal financial services only, while 62% (8.2m) do not use any type of financial service (Finscope Uganda, 2006[3].) These statistics suggest that the population is not actively engaged by the formal financial sector.

***Tiered banking system.*** The banking sector is tiered by regulation into four sub-sectors (see table 1):

***Insurance sector even more underdeveloped, with very young regulatory framework.*** The total insurance market in Uganda is small. The insurance industry's gross premiums totalled only U$52m or 0.6% of GDP in 2005 (Uganda Insurance Commission, 2006[4]). It is also fragmented, with a relatively high number of small players. There is a strong foreign presence, with 12 out of 20 insurers being foreign-owned. The life insurance sector is much smaller than the non-life sector and constitutes only 4% of gross insurance premiums. 41% of all non-life insurance is "miscellaneous accident" insurance, the category under which credit life insurance is traditionally written. Formal insurance sector legislation, regulation and supervision have only been implemented over the last decade. Until recently, the insurance industry operated effectively unregulated, with no compliance culture. The implementation of insurance regulation over the past decade has led to foreign entry, but has also created market uncertainties. As the focus is initially on achieving stability, microinsurance is not yet a high priority.

***Lingering effects of hyperinflation and currency devaluation.*** Uganda was subject to a large currency devaluation following a period of hyperinflation in the 1980s. The currency devaluation implemented by government in 1987 implied

| Tier | Institutions | Number of institutions | Functions allowed |
|---|---|---|---|
| 1 | Banks | 15 (132 branches end-2004) | May mobilise deposits, extend credit and perform foreign exchange transactions |
| 2 | Credit institutions | 2 | Same as Tier 1, but may not perform foreign exchange transactions |
| 3 | Microfinance deposit-taking institutions | 4 | Same as Tier 2, but not allowed to operate cheque accounts |
| 4 | Cooperatives and MFIs | +/- 800 | May mobilise savings only from members, not general public; may extend credit |

**Table 1.** The composition of the banking sector in Uganda.

Source: various, as contained in Genesis Analytics, 2008 (country report)

1 Unless otherwise stated, all information and data quoted in this report stem from: Genesis Analytics, 2008. Unpublished Uganda country study. IAIS/MIN JWGMI study on the role of regulation in the development of microinsurance markets. It reflects the latest available information at the time of writing.
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 DFID Uganda Financial Sector Deepening Unit, 2007. 2006 Finscope Uganda survey.
4 Uganda Insurance Commission, 2006. 2005 Annual Insurance Market Report. December 2006. Uganda Insurance Commission: Kampala

that a life insurance policy with an original value of USh1,000 would subsequently pay out only USh10. The devaluation is often cited as the reason for the low levels of consumer trust in the insurance industry and the low share of life insurance in overall insurance premiums.

## 2 Salient features of the microinsurance market

***Usage.*** The insurance market currently serves no more than 8% (1m) of the adult population. Only 3% (0.4m) of adults use traditional (non-micro) insurance (Finscope Uganda, 2006), while an estimated 0.6m (4.6%) use microinsurance[5]. Uganda is therefore unique amongst the sample countries in that the share of microinsurance exceeds that of the higher income insurance market. The low penetration overall is due primarily to the low and irregular incomes of the Ugandan population that leaves little disposable income to pay insurance premiums. Focus group interviews also show that there is limited understanding of insurance and widespread mistrust of the insurance industry among the population. Interestingly, no informal risk-pooling is picked up in the usage data, though focus groups indicate that some community-based informal risk pooling activity does exist and people also appeal to family networks to mitigate funeral and health risks.

***Players.*** The insurance sector is fragmented, with 20 relatively small players. There is a strong foreign presence and 12 out of the 20 insurers are foreign-owned. In the microinsurance sphere, some of the underwriting is done by commercial insurers, some by MFIs providing credit life insurance themselves. There is little if any cooperative or mutual insurance activity.

***Products.*** The life insurance sector is much smaller than the non-life sector and constitutes only 4% of gross insurance premiums. This small share is often attributed to the currency devaluation of the 1980s that undermined consumers' trust in the life insurance sector. 41% of all non-life insurance is "miscellaneous accident" insurance, the category under which credit life insurance is traditionally written. It is therefore an anomaly that most of credit life insurance is not written under a life license. Microinsurance is virtually exclusively comprised of credit life insurance sold through micro-finance institutions (MFIs).

***Distribution.*** Uganda has limited infrastructure available for the distribution of microinsurance. For example, it does not have a formalised retailer network. The infrastructure that is available, e.g. the bank network and cell phone platforms, is currently not actively utilised to distribute insurance. Bank branch infrastructure is concentrated mainly in urban areas, thereby excluding the majority of the population. The payment system is also weak and cash dominates as a means of transacting.

***Poor value proposition.*** Insurance as currently provided in Uganda offers clients a poor value proposition, with insurers spending a large portion of premium income on administration costs. At 35% of net premiums, the average claims ratio is very low (compared to about 60% in South Africa), indicating that little money is paid back to policyholders as benefits. There are several reasons for this, including a lack of efficiency and competition in parts of the industry, and the high costs associated with relatively weak and expensive communications and payment infrastructure. Insurers are small by international standards, making it difficult for them to spread their fixed costs. A lack of actuarial and other insurance skills also hinders development. The entry of foreign insurers into the Ugandan market is however triggering product innovation and a more competitive marketplace, as seen in a steady reduction in premiums on credit life insurance.

## 3 The insurance policy, regulation and supervision landscape

Before 1996, the insurance industry was effectively unregulated, with nominal supervision by the then Department of Insurance within the Ministry of Finance. Insurance regulation was introduced in 1996 with the promulgation of the Insurance

5 This estimate is based on an AMFIU (Association of Microfinance Institutions of Uganda) estimate that there are between 500,000 and 800,000 micro-credit borrowers with credit insurance countrywide.

Statute, converted to the Insurance Act (Cap 213) in 2000. The Insurance Act governs all insurance business and is supplemented by the Motor Vehicle Insurance (Third Party Risks) Act (Cap 214 Laws of Uganda, 1989) that makes third party insurance compulsory for all vehicle owners. The Cooperative Societies Statute, 1991 and the Companies Act (Cap 110 of 1961) establish the institutional framework for respectively cooperatives and companies. The Insurance Commission was established as supervisor in 1997. The recent nature of the regulation has meant that trust in the industry and a compliance culture is still developing.

***Prudential and institutional regulation.*** The Act does not contain a substantive definition of insurance. It is defined as simply including "assurance and reinsurance", with no further definition of these terms. By convention rather than definition it seems that provision of benefits without any guarantee falls under informal risk pooling rather than insurance. The act restricts the institutions that may provide insurance to companies, insurance corporations, cooperative insurance societies and mutual insurance companies. The latter is restricted to having between 25 and 300 members, which creates a risk pool too small for responsible underwriting. Consequently no mutual insurance companies have been registered.

Capital requirements are currently about $580,000 for either a life or non-life license, double that for a composite license, and $1.4m for a reinsurer. These requirements were instituted in 2002. Previously, local insurers were only required to hold $115,000, while foreign insurers were required to hold the present $580,000. This sharp increase for local insurers has been described as a deliberate attempt by the Commission to reduce the number of insurers in the market (subsequently the insurers reduced from 30 to the current 20). Lower capital requirements apply to mutual insurance companies (but not to cooperatives). They are not required to provide any upfront capital, but must hold a surplus of not less than 15% of assets over liabilities, or such other percentage to be determined by the commission.

***Product regulation.*** The Insurance Act demarcates life and non-life insurance and reinsurance, but does not specify a category of medical insurance or how insurers should treat medical insurance. As a result, the Commission interprets it as residing under "miscellaneous" non-life insurance. Composite insurance products may be provided by composite insurers only. The act provides for a scale of minimum premium rates for non-life product lines to be agreed between the industry association and the regulator. The first finalised set of minimum premiums was agreed upon in 2007 and is now being implemented[6]. Furthermore, all new products must be submitted to the Insurance Commission for approval. Before granting approval, the Commission considers issues like the experience of the insurer in writing the particular type of business, the data and the calculations underlying the pricing. A number of possible microinsurance products have been rejected by the Insurance Commission for failing in these respects.

***Market conduct regulation.*** The distribution of insurance is limited to registered brokers and agents. A broker is an independent contractor working for commission, while an agent is appointed by an insurer to solicit applications for insurance in exchange for commission. Brokers are required to be bodies corporate or companies incorporated under the Companies Act. Legally, companies may be agents but in practice most agents are licensed in their capacity as individuals. The Act expressly prohibits employees of insurance companies from being insurance agents. Two limited exceptions apply: (i) bancassurance is allowed for banks and micro deposit-taking institutions, but they are only allowed to distribute products covering their own credit exposure; (ii) compulsory third party vehicle insurance, as a commoditised product, may be bought directly at petrol stations. Although direct sale of products by an insurer to the public is not prohibited by legislation, this distribution channel is used on a very limited basis. As there are currently no call centre distribution channels, clients have to approach an insurance company and ask to purchase a product directly.

The Act does not contain any prescriptions on how the sales process should be conducted and whether the client is entitled to advice or product disclosure and what this should entail. It however establishes an obligation for the Insurance Commission to provide a bureau where members of

6 Determined according to different products and expressed as a rate per 1000 Ugandan Shillings sum assured.

the public can submit complaints related to insurance. It also explicitly prohibits misleading advertising.

Only registered brokers (not agents) may collect premiums on a credit basis. This implies that if an insurance policy is sold by an agent or directly, and the policy is written for a period longer than a month, clients will not be allowed to pay premiums on a monthly basis. The Act furthermore stipulates that a scale of maximum commission rates is to be agreed between the intermediary and insurer associations and the supervisor. Different maximum commission levels are determined for different classes of insurance and these levels vary between 25% for consequential loss and 5% for motor third party insurance. Overall, commissions account for about 24% of net premiums received by insurers in the Ugandan non-life market. Maximum commissions are not set for life insurance.

***Financial inclusion policy.*** Financial policymakers have paid some attention to promoting access to credit or microfinance. The Poverty Eradication Action Plan (PEAP) of 2004 identifies rural financial services (defined as credit or microfinance) as a focus area for the elimination of poverty, though no specific regulations have been issued in this regard. Microinsurance is not included in the scope of the PEAP, but the fact that virtually all microinsurance is credit life means that the development of the rural financial services industry could lead to microinsurance expansion.

## 4 Impact of policy, regulation and supervision on the market

***Despite introduction of regulatory framework, some regulatory uncertainty continues to plague the market.*** Regulatory certainty was greatly improved by the establishment of the Uganda Insurance Commission and the introduction of the insurance regulatory framework. Only once such certainty was achieved did foreign insurers start to enter the market. Therefore the introduction of a regulatory regime was fundamental to the development of the Ugandan insurance market. Unclear regulation and ad hoc enforcement have however meant that some uncertainty has persisted in the low-income market. For example, though insurance is demarcated into life and non-life, some grey areas remain, with common practice being to write credit life insurance under a non-life license. This creates difficulties for those insurers not willing to interpret the law in this way. The absence of explicit health insurance regulation has furthermore created uncertainty for players in this space or interested in entering the market[7]. At the same time it has however also opened a space for market development, with new entrants and product innovation occurring around the regulatory gap.

***Market conduct regulation inhibits market development.*** Uganda is judged to have high intermediation costs relative to the other countries included in this study. This can partly be ascribed to the fact that such a large proportion of the population live in hard-to-reach rural areas with poor bank and payment infrastructure that makes premium collection expensive. There is however also a strong regulatory driver behind this phenomenon. Despite limitations, the strongest distribution network remains that of the banking sector. By not allowing bancassurance apart from credit life insurance on the bank's own loans, regulation effectively neutralises the single most important alternative distribution footprint available in a poorly served nation. Furthermore, the fact that minimum premium rates are set stifles competition in the market and the commission caps can make it uneconomical to distribute insurance to lower income consumers. Lastly, the fact that the provision of credit on premium payments is restricted to brokers makes direct distribution unattractive, thereby further limiting potential distribution channels.

***Institutional limitations on the market.*** Whilst the inclusion of a mutual insurance company institutional category in the Insurance Act with lower capital requirements indicates a willingness on the part of the authorities to facilitate insurance provision by smaller mutual entities, the limit placed on

7 Note that, while health microinsurance is not explicitly part of the scope of the study, this was a particular gap in the insurance regulatory framework that emerged in Uganda. Health insurance was also shown by focus groups to potentially be the product with the highest likelihood of spontaneous demand among the low-income population. This is due to a distrust in the life insurance industry (due to past hyperinflation experiences) on the one hand, and indicative of a poor public health system on the other hand.

maximum membership (300 members) is not high enough to facilitate the creation of a large enough risk pool to write insurance. The mutual option that could encourage community-based insurers to emerge, is therefore an option in name only.

## 5 Key insights and lessons from Uganda

***Salient market features and challenges to market expansion.*** Uganda has a small, relatively young insurance market with a high foreign presence. It is distinguished from the other sample countries in that it has very low levels of informal market activity[8]. The microinsurance market is estimated to virtually exclusively comprise credit life insurance. The development of microinsurance has therefore been on the back of microfinance. Many challenges are faced in expanding the insurance market:

- The extremely low and irregular average household incomes in Uganda mean less disposable income to pay for insurance.
- There is limited understanding of insurance and widespread mistrust of the insurance industry among the population.
- Insurance as currently provided in Uganda offers clients a poor value proposition.
- There is furthermore a limited footprint of formal sector activity, such as banks and national retailers which could be used as channels to distribute insurance.

At the same time, the generally low income levels imply that any expansion of the reach of the insurance sector is likely to entail "microinsurance". Focus groups have indicated a strong need for the mitigation of especially health risks. Entry of foreign insurers into the Uganda market over the last ten years is also starting to lead to product innovation and a more competitive marketplace, as seen in the steady reduction in premiums on credit life insurance.

8 The anomaly of a very small informal sector is difficult to explain, as in many other countries the poor tend to pool risk informally in the absence of formal market options. Though the research did indicate some evidence of informal savings clubs and social support structure, little informal risk pooling mechanisms (outside of the family circle) was found.

***Market implications of relatively young regulatory framework.*** The establishment over the past ten years of a regulatory framework has led to greater certainty, thereby encouraging entry of foreign insurers. At the same time, some gaps remain:

Specific and inhibitive restrictions apply to market conduct: limited distribution of insurance by banks and MDIs; minimum premium rates; commission capping; and the restriction of the provision of credit on premium payments to brokers (which makes direct distribution unattractive).

The recent nature of regulation implies that trust in the industry and a compliance culture is still developing.

Absence of explicit health insurance regulation has created uncertainty for players in the space or potentially entering it, but has also created a gap for market development, with new entrants and product innovation occurring.

***Size*** and other compliance restrictions on mutual insurers have contributed to discouraging the emergence of these providers, despite regulation making some concessions for them.

Thus far, the supervisor has had to focus on cultivating a compliance culture, affording little attention to microinsurance. The regulatory attitude has however been open to the benefits which foreign entry to the market can bring.

***The challenges of expanding access to microinsurance in a very poor country.*** The Ugandan experience reveals the challenges of expanding microinsurance in the context of a poor developing economy with an underdeveloped financial sector. This is amplified by a lack of well developed informal risk pooling mechanisms – implying that the overwhelming majority of the population is vulnerable to financial shocks, without any risk mitigation apart from family support. Insofar as it has achieved some take-up, microinsurance has been limited to credit life insurance. As the market develops, it is therefore important for non-credit life insurance to be established in the low-income market. To achieve this, low-income individuals need to be "won over" through positive experiences in credit life insurance and insurance in general to break the prevailing mistrust in insurance.

***Regulatory lessons from the Ugandan experience.*** The introduction of a new regulatory regime offers the architects thereof a unique opportunity to pre-empt potential pitfalls and ensure a framework that will facilitate financial inclusion – an objective especially important in a country with such high poverty levels as Uganda. While the Ugandan case has shown the impact that the introduction of greater certainty can have, it also illustrates the potential pitfalls to be avoided – namely the creation of an overly restrictive regime designed without explicit regard for financial inclusion, and that does not clear up all uncertainties in the market.

## The focus note series

**Focus note 1:** What is microinsurance and why does it matter? The rationale 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.

**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 seventh 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 Wirtschaftliche 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.
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