Microinsurance: Some Opportunities and Challenges for Actuaries

Craig Thorburn
cthorburn@worldbank.org
+1 202 473 4932
Skype: craig_thorburn
Overview

• Not a product, a paradigm
• Regulation: Proportionality in practice
• Price as a barrier, value as a goal
NOT A PRODUCT, A PARADIGM
Financial Inclusion

- “a state in which all working age adults have **effective access** to credit, savings, payments, and **insurance** from **formal** providers. “Effective access” involves **convenient** and **responsible** service delivery, at a **cost affordable to the customer** and **sustainable for the provider**, with the result that financially excluded **customers** use **formal financial services** rather than existing **informal options**”.
  - (Source: Global Partnership for Financial Inclusion (2011) *Global Standard-Setting Bodies and Financial Inclusion for the Poor: Toward Proportionate Standards and Guidance*)

- **Financial inclusion contributes to financial stability.**
- The Principles for Innovative Financial Inclusion (Principles), endorsed by the **G20** leaders in 2010, help create an enabling policy and regulatory environment.
Barriers and Innovations

• **Less than full inclusion** means there is some **barrier** leading to some people being **underserved**.
  – Many forms and types;
  – From both sides;
  – Not just cost – so issues are not just about “little” versions of policies.

• **Innovations** are needed to overcome, remove, or work around “barriers”.
# Examples of Innovations

<table>
<thead>
<tr>
<th>Innovations</th>
<th>Examples</th>
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<tbody>
<tr>
<td><strong>Products</strong></td>
<td>Shorter policy terms, Few if any exclusions, Bundling of products</td>
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<td><strong>Services</strong></td>
<td>Use of games to explain product options and decide on customer needs</td>
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<td>Simple and rapid claim payment</td>
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<td>Use of technology for enrolment, phone stored value premium or claim payment, RFI chips, Satellite imagery.</td>
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<td><strong>Delivery channels</strong></td>
<td>Banks, Microfinanciers, Bank correspondents, utilities, agricultural and other cooperatives, health service providers, community groups, religious groups</td>
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<td><strong>Insurers</strong></td>
<td>Large and small, dedicated to microinsurance or not, dedicated to insurance or not, dedicated to finance or not, NGOs, MFIs, Registered Pilots.</td>
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Challenge for actuaries

- Only limited innovation in actuarial service delivery so far
- Limited numbers of actuaries are engaged in the issue and few spend much time in countries with a high activity, but this is growing.
REGULATION: PROPORTIONALITY IN PRACTICE
IAIS Background

- Joint Working Group (JWG) between IAIS and MicroInsurance Network established in 2005;
- Issues Paper on Microinsurance in 2007
  - Key conclusion “ICPs and Standards are sufficiently broad but can be implemented in a manner that achieves observance but potentially conducive for or even quite prohibitive of access to insurance”.
- Issues Paper on Mutuals, Cooperatives and Other Community Based Organisations (MCCOs) issued in 2010
  - Setting out issues, structure for addressing them, and providing indication of the direction for JWG guidance.
- Application Paper finalization in October 2012
1. Insurance should be **formal**
2. **Innovations** have to be facilitated
3. **Proportionality** in practice
4. **Roles** and responsibilities need to be allocated and defined
5. **Definitions** need care
1. Insurance should be formal

- Informal: Either exempt, so not defined as “insurance” in the law, or illegal.
- Barriers sometimes mean existing formal insurers move away from the client group making them “underserved”.
  - Their needs remain, but without formal cover;
  - They find solutions in informal mechanisms and informal schemes.
Consider Standard 1.3.

- Revisit exemptions and exclusions in the context of the objectives of insurance supervision
  - the protection of policyholders and the development of safe, fair, stable insurance markets (Standard 1.3);
  - Normally these customers would not justify exclusion;
- By extending formal services to this client group, let it not be second grade services.
3. Proportionality in practice

• ICPs already invoke proportionality in certain cases.
• Very important in terms of (i) Rules, (ii) Supervisory processes, (iii) Supervisory practices
• Consider ‘risks’ in terms of ‘nature, scale and complexity’.
  – Easy to think of technical insurance risk, but also applies to other risks and perspectives, eg the supervisory perspective to AML or fraud or consumer protection.
  – Not every risk is defined by the product.
• Consider ‘risks’ to ‘supervisory objectives’.
ICPs tend to consider
- “A” = the intensity of supervisory (and regulatory) activity
- “B” = the nature, scale and complexity (considered together) of ....

Usually “of” risk, the entity, but sometimes something else.

Application paper advocates consideration of supervisory objectives (Standard 1.3).
Apply proportionality but ...

• There is a limit to how far you can go.

• There is **a minimum size** below which it is “inappropriate for an entity to retain insurance risk for *technical* and *business* reasons”.
  
  – Levels should be set on the basis of size, nature and complexity of the risk – not just size of the entity.

• Below this level, insurance risk should not be retained.
Zone of no retention

- Technical Barrier:
  - Despite being small and simple, if an insurance portfolio is too small it does not provide any material pooling benefit sufficient to justify the effort.

- Business Barrier (reflected in regulation):
  - Minimum requirements for business processes to retain and manage a business risk.
So what are the “Absolute Minimum Requirements”?

- Consider the entities and risks to supervisory objectives of the minimum “nature, scale and complexity”.

Supervisory Intensity

Nature, Scale and Complexity

Zone of no retention

Proportionate Requirements
Options – the full service insurance license

- Entities are permitted to offer any product they like and invest freely.
- Subject to normal prudential and consumer protection restrictions:
  - risk management systems, pricing, reinsurance, investment policies, actuarial controls, corporate governance, internal controls, distribution responsibilities etc.
Implication

- Microinsurer focussed entities may have a less complex risk profile and be smaller.
- Normal prudential and consumer protection restrictions are disproportionate and a barrier.
Consider...

- Dedicated Microinsurer License at point ‘B’
- Conditions for ‘B’:
  - You can only do microinsurance / you cannot do exotic insurance
  - You can only invest in more restricted options
  - You have to have risk management etc in line with these restrictions
- Insurer ‘A’ can offer microinsurance but without other restrictions so is not subject to conditions.
Consider...

• More restricted Dedicated Microinsurer License at point ‘C’
• Conditions for ‘C’:
  – You can only do a defined product / no variations
  – You can only invest in very restricted options
  – You have to have very defined risk management in line with these restrictions
• Insurer ‘B’ can offer product innovations but needs to have a product development and risk assessment capacity.
Challenge for actuaries

• Applying an ERM approach to supervisory risk
  – Assessing the technical minimum
  – Balancing supervisory intensity to risk
• Defining products and processes for minimum risk entry point cases
PRICE AS A BARRIER, VALUE AS A GOAL
Price as a barrier

• Although there may be other barriers, price constraints are a reality that needs to be addressed at all levels...
  – Premium taxes
  – Operational innovations
  – Partnerships and leverage
Part of the problem?

• Actuaries criticised for heavy contingency margins in the face of limited data for pricing.
  – How can margins be reduced despite data limitations?
  – How can more transparency be brought to where margins actually are?
  – Can other funding options for uncertainty be found?
The Value Question

- Microfinance has been through significant value debates
  - Including local political intervention
- Debate on limited value in insurance space focusses on
  - low claims ratios in credit life products
  - designed for the lender and not the client
- Can the value be defended and explained?
Product design scandals

• Pilots that do not work
  – Who is responsible for outcomes?
  – Has a donor dependency been created?

• Index based products that have unacceptable basis risk
  – What is needed to get it right?
  – Going beyond the attraction of the mathematics to find the reality.
Challenge for actuaries

• Are we bringing enough innovation to pricing approaches, or are we part of the problem?
• How should the value issue be measured and, if necessary, addressed?
END