A Commentary on Select Recommendations of the Report of the IRDAI Committee on Microinsurance

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The Insurance Regulatory and Development Authority of India (IRDAI) set up a 'Committee on Microinsurance' in April 2019 (henceforth the "Committee"). The Committee was tasked with reviewing the existing regulatory framework[2] on microinsurance in India as well as other jurisdictions and suggesting improvements to the Indian framework. Accordingly, the Committee submitted its report in January 2020[3] and made recommendations along four main themes – products, pricing, process and technology, and distribution. In this report, drawing from the insights gained from an earlier report[4] we had released (henceforth the "NCFI report"), we present our comments on some of the key recommendations[5] put forth by the Committee.

1. Product

1.1. Simple Benefits

The Committee has recommended that the benefits for microinsurance products need to be simple so that they can be easily conveyed by the distributor and understood by the customer. It uses the terms 'Gives' (premiums payable by the customer) and 'Gets' (benefits receivable by the customer) to indicate the disclosures required around these benefits. Additionally, it calls for uniform exclusions across similar products for ease of understanding. While these recommendations can certainly help ease the distribution and comprehension of microinsurance products, they do not adequately address the issues arising from gaps in regulatory disclosure requirements mandated for microinsurance products.

As per IRDAI (Micro Insurance) Regulations, 2015, the microinsurance business is exempted from customised benefit illustration[6] and disclosure norms prescribed in IRDA (Linked and Non-Linked Insurance Products) Regulations. IRDAI's latest circular on this continues to extend this exemption.[7] While the reasoning behind this is not known, a question arises as to why a micro-insurance product should be treated differently from other products, since disclosure requirements are aimed at facilitating an informed decision-making process for the customer.

1.2. Appropriate Cover Levels

The Committee has recommended that the maximum cover that can be offered under microinsurance products be increased to Rs. 5 lakhs across all insurance products citing rising impact from inflation. At present this limit stands at Rs. 2 lakhs for life products, Rs. 1 lakh for general and health insurance (for family/ group health insurance contracts, the maximum cover that can be offered stands at Rs. 2.5 lakhs). While this is a welcome move, we argue in the NCFI report that such prescriptive product-specific regulations restrict the freedom of insurers to innovate in deciding how they want to serve

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[2] At present, microinsurance product space is regulated through IRDAI (Micro Insurance) Regulations, 2015, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo2480&flag=1

[3] Insurance Regulatory and Development Authority of India, *Report of the Committee on Microinsurance*, January 2020, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo4033&flag=1

[4] In our report titled 'A Strategy for Comprehensive Financial Inclusion' published earlier this year, we documented the supply-side challenges to the development and delivery of insurance, investment and retirement products, and provided a set of recommendations under four buckets namely distribution channel design, operations & suitability, business cost reduction, and product design. Report is accessible at: https://www.dvara.com/research/wp-content/uploads/2020/01/A-Strategy-for-Comprehensive-Financial-Inclusion.pdf

[5] This blogpost does not do an exhaustive coverage of all the recommendations made by the Committee

[6] Benefit illustration is a year-by-year summary of costs and benefits associated with an insurance policy

[7] Refer 'Circular on (a) Benefit Illustration; and (b) other market conduct aspects [IRDAI/LIFE/CIR/173/09/2019] issued on 26 September 2019 by Insurance Regulatory and Development Authority of India. Accessible at: https://www.irdai.gov.in/ADMINCMS/cms/whatsNew_Layout.aspx?page=PageNo3909&flag=1

the under-served or low-income customers. A uniform risk cover restriction such as Rs. 5 lakhs in case of life insurance might not be adequate to cover the insurance needs of a low-income individual. The workings/ assumptions based on which the coverage of Rs. 5 lakhs have been prescribed is not known. Additionally, given that microinsurance policies are eligible to be reckoned for rural and social sector obligations placed on insurance companies by IRDAI, this might result in sale of inadequate covers.[8]

1.3. Return of Premium

The Committee has recommended that return of premium paid by the customer should be extended as a product feature to general and health insurance products as well. The justification provided for the same is that products having this feature hold greater value for low-income households as compared to pure risk insurance products. While the return of premium products offer capital protection (premiums returned on survival are not adjusted for inflation), there is a need to address certain inherent drawbacks that are associated with them. These products have been found to be more expensive[9] compared to pure risk products offering the same level of risk cover or in other words, offer lower risk cover for the same level of premium. However, one benefit that could be made available under the return of premium plans is that if the premium has been paid for a certain specified period, non-payment of subsequent premiums will not result in lapsation of the policy but will be considered as resulting in a paid-up policy with reduced benefits and sum assured.[10]

1.4. Symbiotic Structure with Cooperatives/ Self-help Groups and Outsourcing of Support Activities

The Committee proposes a tiered approach to providing insurance by making cooperatives/ self-help groups as partners on a risk sharing basis. Pre-defined claim levels will determine who will bear a particular claim, i.e., the insurance company or the partner. However, the Committee does not go into the specifics of regulation and financial management of such a structure. Cooperatives/ self-help groups, being at a local level, have been found to have cost and informational advantages which can help in improving insurance penetration levels and provide useful insights for designing relevant products. However, an arrangement such as this would need to take into consideration the risk absorbing and risk management capacity of such community level organisations. Being exposed to covariate risks, there are greater chances of them failing and customers losing their money.[11] Hence, identifying the type of intermediary who can be a partner in such a format and the appropriate risk management mechanisms would become important.

The Committee also proposes to use this relationship to outsource onboarding/ claims related activities from the insurer to the partners. While proximity and ease of access to customer base might help ease these processes and make them more efficient, these advantages might not be sufficient to ensure the delivery of such product life-cycle services. The incentive structure for distribution of microinsurance products, presently uniform year on year, could be redesigned in a manner that incentivises microinsurance agents and other intermediaries, proportionate to the cost and effort required, to provide support at important junctures of the product life cycle to help facilitate a smooth

[8] See 'A Strategy for Comprehensive Financial Inclusion' by *Dvara Research* published in January 2020. Report is accessible at: https://www.dvara.com/research/wp-content/uploads/2020/01/A-Strategy-for-Comprehensive-Financial-Inclusion.pdf

[9] On comparison of a term return of premium product and a regular term product offering the same level of life cover, it was found that return of premium products are twice or thrice more expensive

[10] Bajaj Allianz Life Insurance Co. Ltd., *Bajaj Allianz Life Bima Dhan Suraksha Yojana: A Micro Term Plan with Return of Premium*, accessible at: https://www.bajajallianzlife.com/content/dam/balic/pdf/micro-insurance/BDSY-brochure.pdf

[11] 'Issues in Regulation and Supervision of Microinsurance', June 2007, International Association of Insurance Supervisors and CGAP Working Group on Microinsurance, accessible at: https://www.iaisweb.org/file/34275/issues-paper-in-regulation-and-supervsion-of-microinsurance-june-2007

experience for customers.[12] This includes periodic follow up with customers to ensure that their policies are active and providing support for smooth claims processing.

2. Pricing

2.1. Expense of Management

The Committee has recommended relaxing the limits on expense of management on microinsurance products, specifically for general and health insurance. At present, in the case of life insurance companies, expense caps are described according to product categories and the number of years a company has been in operation. Additionally, in case of regular premium policies, caps are prescribed differently for the first year and subsequent renewal years.[13] In the case of general insurance, caps vary depending on the type of general insurance and the value of gross premiums written by the insurance company in India.[14] Given that expenses incurred (including commissions and administrative expenses) as a percentage of premium are usually higher in case of microinsurance, this is a welcome move.

2.2. Premium Frequency in Instalment

The Committee has recommended allowing customers the option to pay premiums in daily/ fortnightly/ monthly/ quarterly instalments. Alternatively, it recommends payment of mortality premium in a lump sum and the remaining in instalments. While this is an important feature that will facilitate accumulation of the full premium amount required for the customer segment it is targeted at[15], it is unclear if the risk cover would come into immediate effect upon payment of the first instalment/ mortality premium in a lump sum. Additionally, more clarity is required as to how this provision would operate when a claim is rejected after paying the first instalment/ mortality premium in case of a general insurance product. For instance, in the case of cattle insurance, would the policyholder remain liable to pay the remaining instalments in a premium with respect to such rejected claims?

An additional recommendation made by the Committee is the possibility of allowing the premium to be defined as a percentage of the daily wage with savings benefit varying depending on the amount of contribution. In such a scenario, appropriate disclosures indicating the allocation of premium money between insurance cover and savings benefit would be essential. This would help the customer in making an informed decision about their ability to meet the financial obligations they are taking on and the minimum amount required to ensure continuous risk cover. However, unless addressed specifically in the form of benefit disclosure with these specific details, this could be a potential area of concern which can lead to lapsation of policies.

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[12] See 'Possible Solutions for Distribution Channel and Incentive Design Issues' in 'A Strategy for Comprehensive Financial Inclusion' by *Dvara Research* published in January 2020. Report is accessible at: https://www.dvara.com/research/wp-content/uploads/2020/01/A-Strategy-for-Comprehensive-Financial-Inclusion.pdf

[13] Refer IRDAI (Expenses of Management of Insurers transacting life insurance business) Regulations, 2016, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo2864&flag=1

[14] Refer IRDAI (Expenses of Management of Insurers transacting General or Health Insurance business) Regulations, 2016, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo2850&flag=1

[15] Rajeev Ahuja and Basudeb Guha-Khasnobis, 'Micro-Insurance in India: Trends and Strategies for Further Extension', June 2005, Working Paper No. 162, *Indian Council for Research on International Economic Relations*

3. Distribution

3.1. Business Model for Microinsurance Distribution and Including More Entities Under the Definition of Microinsurance Agents

It is well-documented that microinsurance is a low-price, high-volume business, with sustainability dependent on keeping the transaction costs low. This has led to insurers partnering with institutions with established customer base and transaction channels that can deliver microinsurance products.[16] In this context, the Committee's recommendation for insurers to come up with customised products and processes which can be integrated into the core activities of intermediaries without significant additional cost has the potential to make the delivery of microinsurance products efficient and commercially viable. The Committee has also recommended including more entities such as Mobile Network Operators, Utility Companies, and Retail Chains under the definition of microinsurance agents. While this can help improve the reach of microinsurance products given such entities' expansive networks and established trust[17], it raises concerns around monitoring adherence to institutional conduct obligations which are essential to ensure that the customer interests are at the centre of sale processes. As we have argued in our earlier work, any financial service provider serving retail customers should be knowledgeable about the product being sold, act with professional diligence and disclose all relevant information in a meaningful manner, among other conduct obligations.[18] The conduct of such a wide network of microinsurance agents might prove difficult to monitor for insurers and supervisors for wrongful acts leading to mis-sale or harmful advice. Hence, new mechanisms will be required to ensure that customer outcome are not neglected with the expansion of delivery networks.

3.2. Remuneration (Commission) Based on Product Category

While the maximum commission payable for sale of microinsurance products for pure microinsurance agents is governed by IRDAI's microinsurance regulations, that of insurance agents and other intermediaries such as brokers and corporate agents is governed by IRDAI (Payment of commission or remuneration or reward to insurance agents and insurance intermediaries) Regulations, 2016.[19] Hence, the incentive structure is based on intermediary category rather than product category. To address this issue, the Committee makes a case for harmonising this difference and making product category as the basis for commissions for sale of microinsurance products.

While the above recommendation creates a level playing field between intermediaries within microinsurance business, a trade-off still exists for intermediaries (other than pure microinsurance agents) between microinsurance and regular products. For the latter set of products, the present incentive structure allows for a high upfront commission in the first year.[20] This, along with small ticket sizes in microinsurance, does not create sufficient incentives for these intermediaries to sell microinsurance products. An insurance intermediary (other than pure microinsurance agents) would

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[16] 'Microinsurance Demand and Market Prospects: India', August 2006, Allianz AG, GTZ, and UNDP

[17] Craig Churchill, 'Protecting the poor: A microinsurance compendium', International Labour Office, Geneva, accessible at: https://www.ipcc.ch/apps/njlite/srex/njlite_download.php?id=7394

[18] See 'Universal Conduct Obligations for Financial Service Providers Serving Retail Customers' by Deepti George, *Dvara Research* published in May 2019. Paper is accessible at https://www.dvara.com/research/wp-content/uploads/2019/05/Universal-Conduct-Obligations-for-Financial-Services-Providers-Serving-Retail-Customers.pdf

[19] Insurance Regulatory and Development Authority of India, IRDAI (Payment of commission or remuneration or reward to insurance agents and insurance intermediaries) Regulations, 2016, accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3032&flag=1

[20] As per IRDAI (Payment of commission or remuneration or reward to insurance agents and insurance intermediaries) Regulations, 2016, the commission can be as high as 40% in the first year for pure risk regular premium products and can range anywhere between 15% to 35% for non-pure risk products

be able to earn a certain desired level of commission income from the sale of fewer non-microinsurance products.[21]

3.3. Introducing the Concept of Master Agent

The Committee has recommended introducing a two-tier distribution structure with a Master Agent who has a well demonstrated financial and operational standing and microinsurance agents such as cooperative societies or self-help groups who would be the grassroots level consolidator. Each of them, including the insurer, would have a clear demarcation of their roles and responsibilities. This arrangement is intended at generating huge volumes to make distribution of microinsurance products a viable business. Such a cooperative architecture has been found to combine the advantages of economies of scale realisable through larger organisations, with lower transaction cost for distributing microinsurance products achievable through local institutions and ground level agents.[22] However, it is unclear as to what type of registration/ licensing the Master Agent in such a structure is required to hold, i.e., a microinsurance agent registration or any other registration/ license. This would, in turn, determine who would bear the cost of training the agents (the current microinsurance regulations require insurers to train all microinsurance agents and their specified persons[23] at their expense). Additionally, care should be taken to ensure that in prescribing commissions for both the Master Agent and the microinsurance agent within the present ceiling, the remuneration of ground level microinsurance agents is maintained at a level which can enable them to sell microinsurance in a viable manner. Hence, unless this model is able to generate high volumes, this can prove to be expensive for the insurer and for the agents once they have to start reaching out to people outside their natural networks.[24] It would, therefore, be important to take these factors into consideration before operationalising this recommendation.

3.4. Flexibility for Distribution

Under the present regulations, microinsurance agents can sell microinsurance products of up to a maximum of one insurer in each product category – life insurance, general insurance, agriculture insurance, and health insurance. Given that these are restrictive and in order to enable microinsurance agents to develop a holistic portfolio of products, the Committee has recommended increasing this limit to three in each category, as applicable to corporate agents at present.[25] The Committee further argues that this recommendation would sync well with its recommendation of introducing the concept of Master Agent. While this is agreeable, placing any level of restriction might act as a hindrance to microinsurance agents in developing a holistic portfolio as envisaged by the Committee and in ensuring that a customer has a range of products to choose from suited to his/ her requirement.

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[21] See 'A Strategy for Comprehensive Financial Inclusion' by *Dvara Research* published in March 2020. Report is accessible at: https://www.dvara.com/research/wp-content/uploads/2020/01/A-Strategy-for-Comprehensive-Financial-Inclusion.pdf

[22] Christian Biener & Martin Eling, 'Insurability in Microinsurance Markets: An Analysis of Problems and Potential Solutions', January 2012, *The Geneva Papers on Risk and Insurance - Issues and Practice*

[23] A microinsurance agent, being an institution and not an individual, may employ specified persons with the prior approval of the insurer for carrying out their functions

[24] Craig Churchill, 'Protecting the poor: A microinsurance compendium', International Labour Office, Geneva, accessible at: https://www.ipcc.ch/apps/njlite/srex/njlite_download.php?id=7394

[25] Agriculture is not included as a separate category of insurance for corporate agents. Refer IRDAI (Registration of Corporate Agents) Regulations, 2015 by Insurance Regulatory and Development Authority of India, Accessible at: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo2611&flag=1