
Supervisory Dialogue

on

“The impact of informality on insurance markets – what supervisors can do”

Thursday, 17th May 2018, 09:00 – 17:00h

hosted by the

Superintendência de Seguros Privados (SUSEP)

Avenida Presidente Vargas, 730/24th floor, Centro, Rio de Janeiro – RJ - Brazil

Report

This Supervisory Dialogue event provided an overview of how informality is affecting insurance markets, examined the risks and focused on the challenges faced by insurance supervisors as a result.

The event also provided a platform for peer to peer information sharing on the topic. Presentations were made of the approaches taken by supervisors in different regions to encourage formalisation and greater financial inclusion.

The Supervisory Dialogue brought together more than 40 supervisors and regulators from 15 jurisdictions, representing all continents. There were 9 Latin American supervisors from 8 countries: Argentina (SSN), Costa Rica (SUGESE), El Salvador (SSF), Guatemala (SIB), Mexico (CNSF), Paraguay (Banco Central), Peru (SBS) and Brazil (SUSEP and CVM).

General overview of formalisation challenges and trends. The introductory presentation provided participants with an overview of the different forms informality can take and the difficulties encountered in measuring its magnitude. It also examined the repercussions of having informal players in the market from a broad range of different perspectives, including consumers, intermediaries, insurers and supervisors. Among the examples of informal insurance provision were Microfinance Institutions (MFIs) adding credit life that is not underwritten by an insurer, cooperatives that are not supervised under the insurance law but offering insurance, and insurance being distributed through Apps on a mobile phone and technology platforms.

The challenges for Latin American supervisors present more similarities than differences. Supervisors from Argentina, Brazil and Paraguay shared their experiences with the various forms in which informality has taken shape in their markets. The following key challenges for supervisors emerged from the discussion: how best to detect and measure informality, how to identify the different actors and types of providers involved, as well as how to identify the types of coverage most commonly offered.

The main informal schemes in the region were identified to be in auto¹, life, funeral, travel and health coverages. These were felt to arise as a result of: i) insurers' refusal to take

¹ SUSEP reported that 70% of the vehicle fleet in Brazil does not have formal insurance coverage.

certain risks or the lack of formal insurance to cover certain segments; ii) the lower prices charged by unlicensed providers; and iii) the lack of consumer understanding as to what an informal insurance coverage may mean and therefore not being aware that the coverage they have purchased is provided by an informal entity.

With respect to intermediation, challenges of informality were also highlighted as arising from the increased involvement of new types of intermediaries with them getting involved in the distribution of formal insurance, but without proper licensing and training. This was especially felt to be the case for retailers, MNOs and digital platforms offering insurance without appropriate training and/or regulation. Customers did not receive the necessary information for conscious decision-making and insurance is often linked to the purchase of a product or service in a mandatory manner.

Another common challenge faced by supervisors in the region concerned the sale of cross-border insurance by foreign companies without local licensing, in many cases related to digital insurance offers. In this context, supervisors highlighted their concern about the use of technology in the insurance value chain, which ranges from technical service providers and new types of intermediaries to the emergence of digital insurers and peer-to-peer schemes². However, despite the threats, supervisors felt technology brought more benefits than disadvantages, mainly in scaling up insurance, which benefits financial inclusion.

The experiences of South Africa and the Philippines with regard to addressing informality in their markets presented in the second panel, helped identify relevant points that should be considered by jurisdictions when implementing initiatives to encourage formalisation.

In South Africa efforts to promote formalisation have focused mainly on institutions such as cooperatives and funeral parlors. In South Africa the percentage of the population with formal insurance is relatively low³ and a number of consumer abuses by informal funeral parlors were reported so the insurance supervisor decided to embark on a process of formalisation. The [new Insurance Act](#) which will become effective from July 1st 2018 lays the foundations for this.

The Act has a chapter on microinsurance which includes the following, among other provisions: i) a special license for microinsurance, which is limited to simple insurance risk coverages (accumulation products are not allowed); ii) reduced prudential requirements proportionate to the risk profile (lower capital and reporting/corporate government

² In Paraguay, the Central Bank detected insurance schemes through WhatsApp groups among university students.

³ 58% of the population have some form of insurance (formal and informal); over 90% of those insured have funeral insurance; and 30% have insurance from informal providers.

requirements); iii) uncapped commissions paid to intermediaries; iv) limitation of benefit values; and v) 12 months limited term contracts with automatic renewal allowed.

Among the lessons learned, the Financial Services Board (FSB) highlighted the need: i) to know the market well and how it works; ii) to engage stakeholders to support the regulatory framework; and iii) to ensure capacity building of the supervisor.

In the Philippines, the supervisor studied the informal providers and formalised the existing businesses starting in 2006. Major informal schemes were linked to MFIs and cooperatives. Hence, the supervisor created a new form of insurance provider under the [mutual regulatory framework](#) – the microinsurance mutual benefit associations. This fell under the implementation of the national strategy aimed at providing insurance through more adequate and safer mechanisms. As a result, formal microinsurance coverage is currently provided to about 30% of the country's population.

In 2010 another step was taken to encourage formal insurance provision through cooperation between financial sector authorities with the objective of enabling insurance to be distributed through the Rural Banks. This initiative established simplified requirements for microinsurance agents, to allow the Rural Banks to get a lighter intermediary license.

The Comisión Nacional de Seguros y Fianzas (CNSF) from Mexico presented their work on "regulatory sandboxes, to provide an example of one way supervisors can potentially deal with bringing unlicensed entities under their supervision. A sandbox is a regulated test environment to facilitate innovative insurance solutions, most of them related to the provision of insurance with the use of new technologies. The implementation of a sandbox must take into account four elements: i) to whom it is directed; (ii) the eligibility criteria for participation; iii) the parameters that will need to be complied with; and (iv) the information requirements. The sandbox approach provides new opportunities for insurers and their distribution partners, enabling them to test – under supervisory monitoring, new technologies and models that can bring a series of improvements to the sector, such as: efficiency in claims payment procedures, lower transaction costs and reduction of underwriting risks.

However, at the same time it is important that supervisors consider and establish safeguards against potential risks arising from innovations, some of which are inherent in the use of new technologies. These risks could include: a vulnerability to cyber-attacks, concentration risk, discriminatory practices and decreased consumer confidence due to failures of new players. Supervisors need to strike the right balance between the benefits of innovation and the protection of consumers' rights.

Supervisors agreed that a sandbox approach could also be useful for supervisors when trying to combat the challenge of formalization for innovative models aiming to support greater financial inclusion.

In a last interactive session, all supervisors at the event were encouraged to share their experiences with formalisation. The main challenges that came to the forefront included: how to detect informality, how to assess the risks involved, how to best to mitigate the risks and how to determining the right supervisory measures to be taken to deal with informality once identified. Observing closely and regulating the use of technology, mystery shopping or developing a specific tailored licensing regime based on the principle of proportionality were provided as examples of approaches supervisors are considering or have taken to detect and try to reduce informality in their jurisdictions.

Key Takeaways:

Rather than recommending concrete actions, attention was drawn to some positions and/or measures that **should be avoided** by supervisors in dealing with informal schemes, such as:

- i) ignoring high levels of informality in their jurisdictions;
- ii) ignoring insurance programs outside their perimeter of action, even if the law so provides;
- iii) establishing procedures that will not be enforced in practice; and
- iv) the use of disproportionate measures that hinder access to risk transfer tools and discourage entities from obtaining a license.

Supervisors should also engage to find solutions to some of the common challenges facing informal markets, such as:

- (i) the lack of data to measure the real magnitude of informality;
- (ii) the lack of interest of the formal industry in providing coverage to certain segments; and
- (iii) the threats that the use of technology brings to the insurance sector to leverage its benefits in an environment of consumer protection.

In developing adequate formalisation strategies, supervisors should consider the following:

- Take time to understand the market, its different components and how it works;
- Define the steps to formalisation in a clear and transparent way;

- Support multi-sectoral information sharing and cooperation and where necessary establish strategic alliances with other authorities to achieve supervisory objectives;
- Stay focused on consumer protection issues, seeking to work in partnership with consumer protection agencies; and
- Engage in national strategies to foster financial education.