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Regulating microinsurance in Sri Lanka: Striking a balance

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By Manavee Abeyawickrama

The introduction of the Microfinance Act in 2016 has caused many to believe that the concurrent regulation for the microinsurance sector is a natural consequence. In fact, the Insurance Board of Sri Lanka (IBSL) has intimated that the introduction of new regulations is to encourage the growth of the 'pro-poor' insurance market.

Since its introduction as a subsidiary service for microfinance activities, microinsurance has focused on loan protection and insurance for life savings and soon evolved into policies that provide welfare benefits specifically targeting the needs of the low-income population.

Despite the steady progress of the formal insurance sector with a 16 percent growth in gross written premium (GWP) and a 15 percent rise in insurance density (per capita premium) in 2015, insurance penetration (premium as a percentage of gross domestic product (GDP)) seems to have stagnated at around one percent, indicating a large untapped potential in the market. Low penetration levels have been attributed to a number of factors including the low levels of disposable income, a lack of awareness of the benefits of insurance and a sense of lost confidence in the industry.

Alternatively, the stakeholders argue that low recorded penetration is a result of widespread social welfare schemes offered by the government and the largely undetected informal sector whose efforts are not reflected in the official statistics.

Microinsurance has been identified as a potential tool for minimizing gaps in insurance penetration and a means of improving social safety nets in the country. However, the absence of a clear focus on microinsurance within insurance legislation continues to be an impediment. It is against this backdrop that this article aims to bring cognizance to the implications of such regulation on the existing microinsurance sector.

Necessity for regulation

Currently, the insurance industry in Sri Lanka is regulated by the Regulation of Insurance Industry Act No. 43 of 2000. Though microinsurance is arguably subsumed by the definition of insurance provided for in the act, it fails to provide an explicit classification. As a result, microinsurance has assumed a secondary role to regular insurance – often carried out as a corporate social responsibility (CSR) activity.

Despite numerous promotional efforts by the Insurance Association of Sri Lanka and IBSL, the industry remained cautious against actively engaging in microinsurance. This reluctance is a result of the stringent regulatory conditions that came into effect towards the latter half of 2015 – particularly the introduction of a rigid risk-based capital framework, mandatory segregation and listing requirements.

As formal providers struggled to overcome regulatory bottlenecks, Sri Lanka saw the emergence of a parallel sector of microinsurance providers comprising of village-level co-ops and community based organisations (CBOs). Though many of them are monitored by government agencies such as the Cooperative Development Department and NGO Secretariat, their insurance services are carried out unregulated and their reach and strength is unknown.

Despite their success in catering to the needs of the poor, their capacity to take on high-risk remains uncertain. As the risk exposures undertaken by these organizations are non-transparent, even a potential systemic risk to the industry could go undetected. Thus, regulatory interventions are imperative to ensure the sustainability of the industry, particularly, to safeguard against the threat to already vulnerable segments of society.

Avoiding over-regulation

Regulation could promote or impede the development of any industry. A microinsurer would typically depend on volumes and accessibility over high returns. Thus, it is fair to assume they would not have the infrastructure to meet stringent regulatory requirements, especially since costs of compliance cannot be transferred to low-income policyholders.

Countries have employed various tactics to create an enabling environment for microinsurance. For example, in India, all insurers are expected to sell a percentage of their products to select rural sectors. Whilst the policy was instrumental in improving insurance penetration levels, critics argue that it was too restrictive, reducing the flexibility of a demand-driven market. Contrastingly, countries like Belize have looked at formalizing small-scale CBOs with the intention of encouraging participation in insurance.

In Sri Lanka, the informal sector holds an incomparable reach in the grassroots as CBOs leverage their extensive networks to cater to poorer communities. Therefore, regularization should be done with careful consideration – without disrupting the existing financial eco-system on which rural communities depend.

Way forward

Legislation should create a level playing field in the industry by encouraging participation from the formal and informal spheres. It should promote a supply of diverse insurance products that would complement and not duplicate the existing social protection mechanisms in Sri Lanka. In this regard, a possible solution would be to adopt a reporting or disclosure mechanism that would allow the IBSL to monitor the activities of informal providers. In doing so, insurers will be expected to maintain separate portfolios for microinsurance so progress could be regularly evaluated.

As a supervisor, the IBSL will be able to screen microinsurance activities without hindering their everyday operations. Facilitating such supervision would, however, demand improved regulatory networks – possibly the establishment of supervisory units across the island.

Alternatively, the IBSL could adopt a 'light-touch' regulatory approach to microinsurance. This would call for the relaxation of strict capital requirements, restrictions on owners and employees and rigid operational procedures warranted by current regulations.

The regulatory emphasis should be on bringing professionalism to the microinsurance industry without overextension that might kill a thriving, living system that works well for the marginalized.

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