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Republic of Azerbaijan: Microfinance Sector Development – Creating an enabling regulatory framework for microinsurance

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CREATING AN ENABLING REGULATORY FRAMEWORK FOR MICROINSURANCE IN AZERBAIJAN

1. Overview

a. The Law of The Republic of Azerbaijan on Insurance Activity (Insurance Law) is the apex legislation governing the business of insurance in the country. In addition, the Civil Code, the Law on Compulsory Insurance and the Law on Deposit Insurance also contain relevant provisions. The Insurance Law is divided into 14 chapters containing substantive as well as procedural provisions on matters relating to licensing of insurers, governance and management, conduct of insurance business, maintenance of solvency, insurance intermediaries, insurance contract, accounts and audit of insurance companies and investment of funds by insurance companies. Various rules, guidelines and normative documents have been framed by the Ministry of Finance under the respective legislation. The scheme of insurance regulation in Azerbaijan in largely compliance-based.

b. The regulations do not contain any direct or indirect reference to microinsurance or insurance for the low income segment. There is thus no special dispensation for microinsurance providers, products or intermediaries. The regulatory provisions deal with the insurance sector as a whole with life insurance and non-life insurance as the only broad categories. There are no specific provisions for special classes of insurance like health and agriculture that carry a clear implication for the low income segment. Similarly, specific categories of intermediaries like banks, MFIs or other mass distribution channels like Mobile Network Operators (MNOs) also do not carry a specific mention in the regulations. At the same time, the regulations also do not discriminate against the categories of products and distribution channels meant for the low income segment. Thus any market participant (insurer or intermediary) intending to work with the low income segment will not face any specific regulatory roadblocks. Therefore it can be said that the insurance regulation in its current form is neutral to microinsurance or inclusive insurance.

2. Regulatory Approaches to Microinsurance[1]

a. Global experience has proved that regulation can play a vital role in market development. Enabling access to insurance for the low income segment augments social protection of the vulnerable masses as well as benefits the insurance industry in terms of higher volumes and better diversification of risk. In nascent markets like Azerbaijan regulation has a bigger developmental role alongside its core supervisory function. Developing insurance for the low income segment needs nurturing from the demand as well as supply sides. Towards this regulators have to go much beyond their conventional roles of supervision of supply and distribution side players.

b. The issue of creating an enabling regulatory environment is quite strategic and goes much beyond drafting of regulations. Regulators around world have adopted various approaches to enable demand creation and promote effective supply of insurance to

[1] Adopted from Regulatory approaches to inclusive market development – Cross country synthesis paper 2', Jeremy Gray, Hennie Bester, Christine Hougard and Mia Thom, Access to Insurance Initiative, 2014.

the low income households. Beyond insurance regulation, other financial service regulators as well as the larger policy making mechanisms of governments also tend to exercise influence on microinsurance development in the country. These approaches are implemented using various legislative, regulatory and policy level tools. A regulatory approach is defined as a specific combination of regulatory and supervisory tools designed to achieve a series policy goals via a specific level of state intervention within a defined product market or across a number of product markets to facilitate access to insurance**.** Implementation of regulatory approaches is done through a mix of fiscal, regulatory, surveillance and enforcement tools.

c. Apart from the larger socio-economic and political philosophy governing the country, selection of a particular regulatory approach or a set of regulatory approaches would depend upon contextual factors like macroeconomic environment and the state of physical infrastructure in the country, latent demand for insurance and other financial services as well as the overall perception of the public on risk management, supply side factors like level of insurance market development and presence or otherwise of informal / semi-formal insurance and other factors like fiscal position and supervisory capacity.
d. A tabular synthesis of various approaches and tools is given Annexure A.

3. Creating an Enabling Regulatory Framework for Microinsurance in Azerbaijan

a. *Defining Microinsurance*: Microinsurance needs to be defined from two standpoints, the first being a conceptual definition of microinsurance that explains how it is different from mainstream insurance. For example the ILO's Impact Insurance Facility defines microinsurance as 'the protection of low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved'[2]. A more functional definition provided by the International Association of Insurance Supervisors (IAIS) describes microinsurance as 'insurance that is accessed by low-income population, provided by a variety of different entities, but run in accordance with generally accepted insurance practises'.[3] While these definitions show sufficient light on the conceptual aspect of microinsurance, a more practical definition may be required for incorporation into regulations under various jurisdictions. Hence, for the sake of regulations a more prescriptive definition is required.
b. In order to define microinsurance more objectively, regulations can define and incorporate concepts of microinsurance product, microinsurance customer or microinsurance intermediary. Defining a microinsurance product would mean prescribing the classes of products that would qualify as microinsurance products and specifying the limits of sum insured or premium for them. Countries like South Africa and India that have successfully created enabling regulatory environment for microinsurance follow this approach.
c. Defining microinsurance market segment is another way of prescribing microinsurance regulation. Under this approach, any insurance product sold to clients belonging to specific market segments like agriculture workers, small farmers, informal workers,

[2] What is Insurance for the Poor?, Craig Chuchill, Protecting the Poor, A microinsurance Compendium, 2006.
[3] Application Paper on Regulation and Supervision Supporting Inclusive Insurance Markets, IAIS 2012

women, population falling below the national poverty line, etc. qualifies as microinsurance. This approach is useful in jurisdictions where particular market segments can be easily identified. Countries having separate identification systems (such as national identity cards) can follow this approach quite conveniently. Peru followed the approach of defining microinsurance products till 2009 but has since then shifted to a more broader definition that includes products 'that provide protection for low income population for economic losses'.

d. Yet another approach of defining microinsurance could be to specify the distribution channel. Hence, for example, any product sold by MFIs or cooperatives or other specified voluntary organizations that generally work with low income population could qualify as microinsurance. Regulations could also provide for licensing of specialized microinsurance agents (individuals as well as legal entities) to distribute insurance / microinsurance products to the low income segment.
e. *Regulatory Initiatives*: Depending upon the regulatory approach adopted and based on the definition of microinsurance incorporated in the regulations, the following regulatory initiatives can be considered.
    i. Mandating insurers to underwrite a specified percentage of their total gross written premium (GWP) from microinsurance products, microinsurance market segment or microinsurance intermediaries, as may be defined in the regulations. The insurers attract penalties if they fail to achieve the mandatory microinsurance targets.
    ii. Encouraging insurers to file microinsurance products (as defined by regulations) that are then exempted from indirect taxes like VAT or even direct taxes like income or profit tax. If the regulatory fees levied on insurers are based on their GWP, the total microinsurance premium underwritten by a particular insurer can be allowed as a deduction from total GWP for the purpose of calculating regulatory gees, as an incentive.
    iii. Liberal requirements for licensing of microinsurance agents. Specialized training, higher caps on commission and authority to collect premium on behalf of the clients are some other regulatory incentives that can be offered to microinsurance intermediaries.
    iv. Exempting microinsurance agents from income or profit tax in order to attract more intermediaries for this market segment.
    v. Creating a separate regulatory framework for licensing of a dedicated tier of insurers for microinsurance, with reduced capital requirements, lenient solvency norms, lesser compliance burden, caps on risk accumulation and prescribed governance criteria like mutual or cooperatives. The mainstream insurers can then act as reinsurers for the second tier insurers.
f. *Non-Regulatory Initiatives*: Many times regulatory initiatives to develop microinsurance tend to be arbitrary and are seen as imposing obligations on the market players. Hence it is always a good strategy to couple regulatory initiatives with some soft non-regulatory initiatives with a view to attain holistic as well as sustainable microinsurance market development. Some of the possible non-regulatory initiatives are listed below.
    i. Public provision of insurance for areas like health, life, agriculture and pensions through social insurance models. Under such models, the government can partly or

fully subsidize premium or claims and can involve commercial insurers in carrying and managing risk. Apart from offering market-based social security solutions, this approach can also induce demand for other insurance products, thereby contributing to the development of insurance market.,

ii. Developing infrastructure for smoothening transactions for all financial services like creating national payment gateways, common repositories for insurance, physical and virtual infrastructure for health systems, etc. Such initiatives reduce transaction costs, improve efficiency in service delivery and enable effective monitoring of impact.

iii. Creating support systems for demand creation through well-designed strategies and structures for financial inclusion. Demand creation through sustained consumer education efforts is a long term project but has the potential to develop markets in an organic and sustainable manner. Private sector can also be encouraged to participate in such initiatives.

iv. Offering non-regulatory incentives to market players demonstrating commendable performance on offering microinsurance products. The regulator can declare awards / prizes for insurance companies / intermediaries generating maximum microinsurance business. Such awards can be instituted for categories like maximum microinsurance premium, maximum rural penetration, best claims servicing to microinsurance clients, etc.

v. Another way of promoting microinsurance development could be to 'nudge' the insurance industry to move towards microinsurance without any mandatory compulsion or concession. Insurance industry can be tacitly motivated through policy pronouncements on financial inclusion and emphasizing the need to penetrate down-market through informal interactions as well as on formal platforms. This kind of continuous signaling of public policy goals to the industry can also bring positive results over a period of time.

4. Monitoring Microinsurance Performance of the Industry

a. Developing regulatory mechanisms for monitoring microinsurance performance of the industry is an equally vital aspect of microinsurance development, regardless of the regulatory approach adopted. Measuring performance accurately is a prerequisite to managing it effectively.

b. The regulator needs to capture microinsurance statistics (for premium, policies, number of lives covered and claims) from the insurance companies on a periodic basis. This can be done either by incorporating microinsurance statistics into the primary reporting system for insurers or a separate reporting system can also be devised for the same, again depending upon the regulatory approach adopted. The data so collected from the industry can be analyzed to evaluate current performance and project future trends as well as can also be used as a part of the surveillance tool for issues on consumer protection.

c. Capturing of market data on microinsurance will again convey a policy signal to the insurance industry on the priority accorded to the issue by the regulator.

5. Conclusion

a. The insurance industry in Azerbaijan is technically as well as commercially equipped to enter into microinsurance space. The economic indicators and trends also make this the right time to look at the low income segment from a comprehensive risk protection point of view. As the market based economy moves ahead, the issue of addressing social security needs of the population through social insurance mechanisms also needs to be addressed. Adopting an appropriate regulatory approach towards microinsurance and incorporating suitable elements that reflect the adopted approach in the regulatory framework, could be the first crucial step in this direction.

b. The discussions around microinsurance have already been initiated through a workshop held in Baku in July 2015, as a result of which some market movement might already have started. The momentum needs to be maintained by initiating consultations within the government as well as with the insurance industry on how microinsurance can be incorporated in the policy and regulatory framework.

Annexure A

Regulatory Approaches for Microinsurance Development

Sr. No.	Regulatory Approach	Explanation	Tools	Countries Where Adopted
1.	Public Provision Approach	Provision of basic insurance coverage for specified risks to defined vulnerable populations through premium or claims subsidy. Often made mandatory for target populations. Commercial insurers may be involved as risk carriers.	Social insurance schemes for health, life and agriculture.	China, India, The Philippines, Indonesia.
2.	Directive Approach	Mandating insurers to underwrite a specified portion of their business from prescribed products or market segments. Failure to comply with targets result in penalties being imposed.	Obligations on insurers through regulations.	South Africa, India.
3.	Concessionary Approach	Concessions offered through direct / indirect tax breaks, reduced regulatory fees, relaxed regulatory norms for microinsurance business. Culminates into creating a separate tier of insurers dedicated for the low income segment like mutual, cooperatives and takaful.	The Philippines, South Africa (proposed).	
4.	Nudge Approach	Insurance industry is prompted to take up microinsurance through policy announcements and reaffirmations without any regulatory compulsions or concessions.	Policy announcements, reiterations at informal and formal platforms.	Colombia, Thailand.
5.	Long Term Market Development Approach	Insurance market is allowed to graduate to a level before adopting directive or concessionary approach, Mostly applicable to under-developed insurance markets.	No specific tools.	Zimbabwe.