

# PROMOTING INNOVATION IN AN INDEX BASED INSURANCE WORLD

An introduction to the IAIS (draft) Issues Paper on Index Based Insurances



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## OVERVIEW

1. Project Background, Scope and Structure
2. Key features of the paper
  1. Pilots and proportionality
  2. Micro, Meso and Macro schemes
  3. Legal certainty
  4. Measuring and communicating basis risk
  5. Security and Reinsurance
  6. Project Sponsors
3. Next steps

## Project Background, Scope and Structure



### BACKGROUND TO THE PAPER

- Several approaches to act over years were not taken up in the work plan
  - Focused on Accounting treatment concerns, insurance definition concerns
  - Case became stronger as market has continued to develop, and
  - Motivation for insurance supervisors is **consumer protection**.

## THE SCOPE / TARGET OF THE PAPER

- **Focus on areas that aim to improve the situation for low income people.** IAIS has been working on a range of “inclusive insurance” issues since 2006. The longest of any of the Standard Setting Bodies.
- **A more inclusive insurance market.** Discusses micro, meso and macro schemes so aims at an insurance market that better serves the underserved (directly or indirectly)
- It is **usually weather or other catastrophe risks related to agriculture or to natural catastrophe resilience. It can be other indexes.** BUT excluding mortality and investment index products (largely for convenience).
  - Some comments suggested focusing on one or other particular type of index (for example, index based crop insurance) but this was not considered to be necessary.
- **Project Sponsors** are a defined group in the paper – people who are part of the team bringing the project to fruition including insurers but also other parties involved.

## OUTLINE

- Introduction
- Background
  - Some definitions, and some guidance on stakeholders
- Supervision and Regulation
  - Formality
  - Insurable interest
- Consumer protection
  - Including products, basis risk, ex-gratia payments, subsidies, competition, and security of promises
- Pilots and proportionality
  - The ultimate goal defined
  - Proportionality for those not yet at the ultimate goal

## Key Features

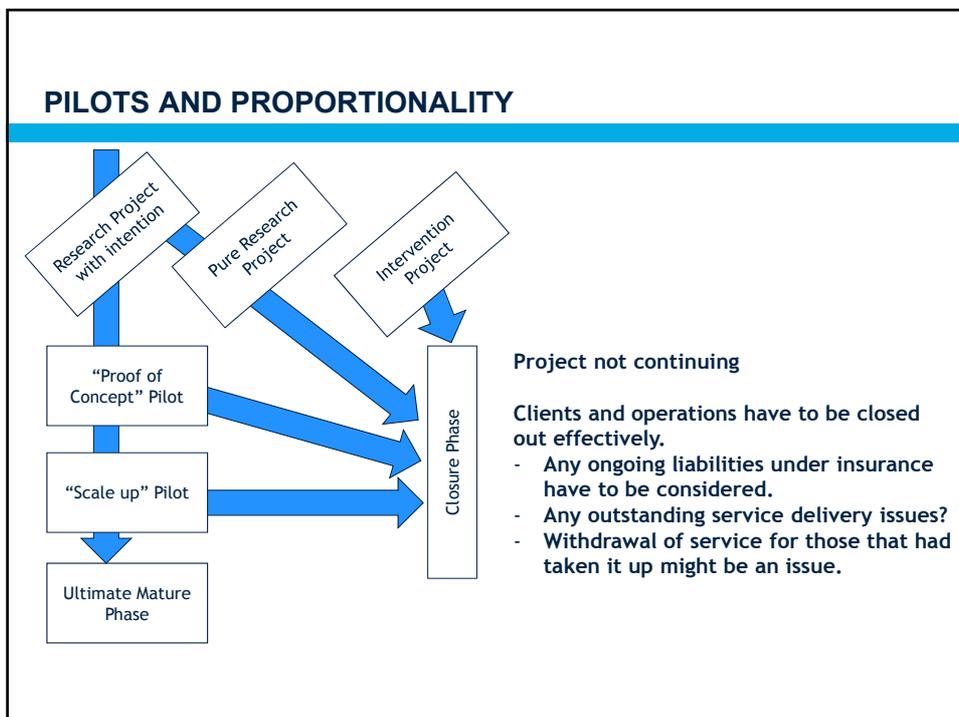
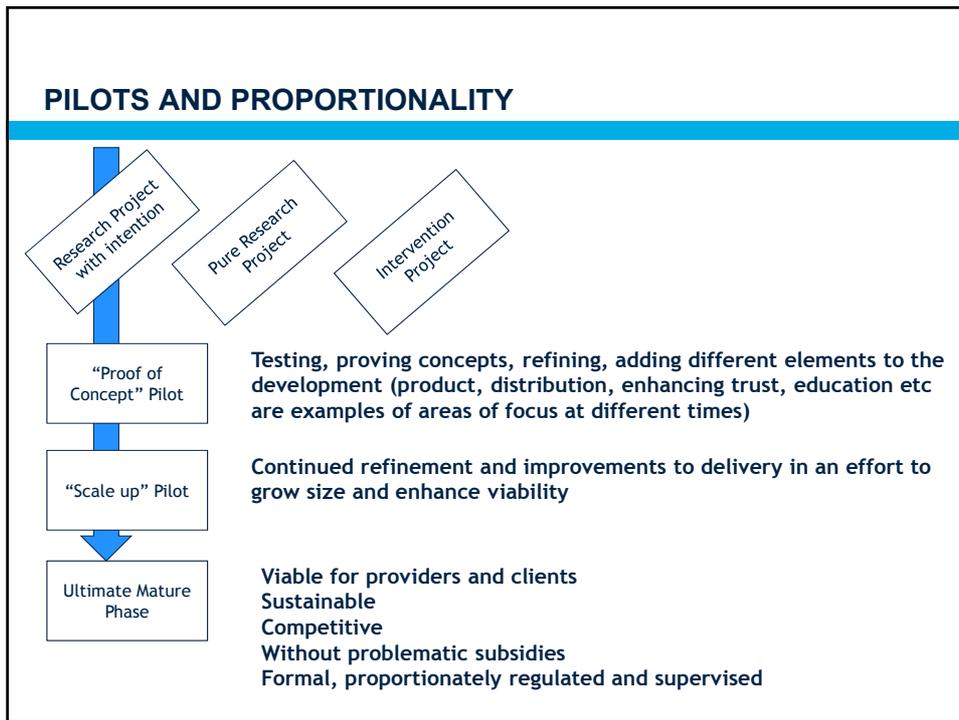
*Pilots and Proportionality*



### FROM THE IDEAL WORLD TO THE REAL WORLD

**In the index based insurance area, there is a far greater preponderance of pilot projects.**





## SHIP BUILDING



## Key Features

*Micro, Meso and Macro Level Schemes*

## DEFINING MICRO, MESO AND MACRO ALLOWS DIFFERENT APPROACHES



Our definitions might not be your definitions:

Micro involves small policies for individuals or group schemes where individuals get coverage.

Meso insures the meso entity and they communicate to members about their insurance of the meso entity but not insurance for individuals directly. No guarantee that things flow to one or other member of the meso organization.

Macro is sovereign covers, and no communication of individual policy linkage from government to public.

## KEY ITEMS IDENTIFIED IN THE PAPER

Making it clear that macro and meso are not micro

Meso – relief in disclosure and consumer education by ensuring micro level clients are not considered to be insurance clients

Macro – relief from most requirements is usual but some reporting is encouraged

## Key Features

*Legal certainty*



### CHALLENGES TO LEGAL CERTAINTY

Is it insurance or a derivative?

Outcome: Product is included in the insurance supervisory framework

Regardless of whether or not it is insurance for taxation or accounting purposes in the jurisdiction.

If it looks like a duck it probably is a duck – what do people reasonably think it is? Particularly relevant for micro clients if they think they have insurance. How do the TCF and such approaches apply? It is not acceptable not to have consumer protection and complaint handling and fairly treated customers. Why duplicate it? For supervisors this is not only about the index based product but also for the implications for the insurance market as a whole. Product sponsors should not (some do by their actions) advocate that their product should be carved out and that the rest of the insurance market is not their concern. (Remember the Philippines case of education funding insurance)

## PAPER ADVOCATES THAT

Index based insurances should be included under the scope of insurance supervision.

Regardless of the treatment for other purposes.

Insurable interest should not be a cause of this issue. The paper advocates a solution.

Issuance by an insurer is important but can be varied under proportionality for macro schemes

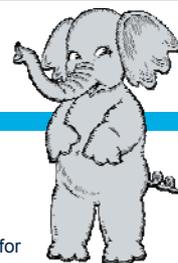
During pilots, licensing and formality can have proportionate solutions.



## Key Features

*Measuring and Communicating Basis Risk*

## MEASURING AND COMMUNICATING BASIS RISK



Whilst basis risk is an issue with index-based insurance the paper makes the following observations:

1. Not all problems that happen are basis risk problems even though it can be blamed for it.
  1. In fact, many of the reasons projects fail are nothing to do with basis risk.
  2. Attributing failure incorrectly to basis risk is a problem to be avoided.
2. Not all basis risk events are the same – adverse basis risk is worse for policyholders than perverse basis risk
3. Not all clients are the same – micro clients are less able to withstand an adverse basis risk event than others
4. Communication is important by product sponsors
  1. Be open with clients that basis risk is a possibility
  2. Use back testing results to illustrate products
  3. Stochastic modelling might be useful for more sophisticated clients
  4. Share information with the insurance supervisor

## Key Features

*Security and Reinsurance*

## DURING PILOT STAGES

Need to have the risk taking capacity. Can be through

- Capital
- Reinsurance
- Full asset support from a reliable source

## Key Features

*Project sponsors and supervisors*

## FOR PROJECT SPONSORS

Some guidance for Project Sponsors and Supervisors to help encourage communication at an early stage

Annex provides concrete summary for project sponsors of some particular considerations

**Next steps**

## NEXT STEPS

1. December 2017 and January 2018: Public Consultation at twice standard length of time
  1. Consultation comments should be submitted through IAIS on-line system.
  2. Closing date is not flexible for this final consultation round.
2. February 2018: Review and update paper
3. March 2018: Paper progresses through various committees to be adopted

Thank you!