

INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

AND

MICROINSURANCE NETWORK



**Issues Paper on the Regulation and Supervision of Mutuals,
Cooperatives and other Community-based Organisations in increasing
access to Insurance Markets**

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Introduction

1. The International Association of Insurance Supervisors (IAIS) issues globally accepted principles, standards and guidance papers for insurance regulation and supervision.
2. Since its inception in 1994, the IAIS has developed a number of principles, standards and guidance papers to help promote the development, globally, of well-regulated insurance markets. In June 2007, the IAIS joined with the Consultative Group to Assist the Poor (CGAP) Working Group on Microinsurance, now the Microinsurance Network, in releasing an issues paper dealing with microinsurance generally. The issues paper noted “further work on understanding the role of mutuals and cooperatives in microinsurance is necessary”¹.
3. Further work has been conducted to review various country practices which led to the development of a synthesis of the observations from these cases published in September 2008. This was supplemented by information gathered through an IAIS survey² on the nature and role of mutual and cooperative insurers in their respective jurisdictions. The work done to date has identified Mutuals, Cooperatives and other Community-based Organisations (MCCOs) do play an important role to improve the effective provision of insurance services in some jurisdictions to groups of the population that would otherwise be underserved or not served at all. In 2008, cooperative and mutual insurance accounted for 24% percent of the total formal insurance market globally writing over one trillion USD in premiums, with substantial market shares in many countries³. Although the paper is focused on MCCOs with respect to improving access to insurance for those that are underserved, it is recognized that such insurers can also become large, and can exist in markets providing the full range of both retail and commercial products and services to a broad range of clients.
4. It is recognized that this paper has been developed at a time when the IAIS is considering revisions to the Insurance Core Principles (ICPs). The paper uses, as a basis, the current ICPs and has not considered the outcomes of the review – something to be included in further work. Additionally, the broader legal and policy framework for MCCOs in each country varies reflecting market and other conditions; the content of this paper should be considered against this considerable variation and broader policy context.
5. As a result, this paper has been developed to advance discussion on the appropriate and effective regulation and supervision of MCCOs.

¹ Refer *Issues in Regulation and Supervision of Microinsurance*, June 2007, paragraph 7.

² IAIS/CGAP Joint Working Group on Microinsurance, 2008. Survey on the role of mutuals, cooperatives and community-based organisations in microinsurance.

³ Source ICMIF Mutual Market Share Survey 2008.

Definition of Mutuels, Cooperatives and other Community-based Organisations (MCCOs)

6. This section provides an indication of the types of MCCOs included in this paper. It is important to recognise the paper is not restricted to those MCCOs acting as risk carriers but also includes MCCOs with more limited roles, for example, providing administrative or distribution services only and this is discussed more fully in the following section.

Range of organisational forms included as MCCOs

7. For the purposes of this paper, MCCOs include a very diverse range of types of organisation and may be described differently in different jurisdictions. MCCOs may include organisations and institutions that are:
- not registered under any specific law or regulation;
 - recognised under a specific law even if not distinguished for insurance purposes;
 - recognised under the insurance law itself.

They may be described as:

- Mutuels
 - Mutual Benefit Organisations
 - Cooperatives
 - Friendly Societies
 - Burial Societies
 - Fraternal Societies
 - Community-based organisations
 - Risk pooling organisations
 - Self-insuring schemes⁴.
8. Depending on the organisational form, the characteristics noted in paragraphs 12 and following may differ. The legal obligations on entities regarding these characteristics can vary between organisational forms. The way in which membership rights of an ownership nature are expressed can differ. In some jurisdictions, the oversight and regulation of their structures, democratic processes, and membership groupings may be subject to legislative obligations and, in others, these features may be diverse and expressed only in the governing documents of the organisation or in more general understandings between the membership.

⁴ This paper addresses self insurance schemes where those self insurance schemes insure a group who also effectively sponsors or owns the scheme and that it operates on a not for profit basis.

9. This paper considers the regulation and supervision of all forms of member based organisations particularly with respect to their role in increasing access to insurance products and services in under-served insurance markets.
10. The paper does not address the special case of insurers formed to provide Takaful. The IAIS has issued a paper “Issues in Regulation and Supervision of Takaful (Islamic Insurance)” on August 2006 jointly with the Islamic Financial Services Board (IFSB) and continues to collaborate with the IFSB with respect to standards development.
11. In many jurisdictions, MCCOs may be small compared to other insurers and the issues of proportionate regulation and supervisory burden will be relevant in such cases. But it is equally the case that some MCCOs can be quite large. In fact, MCCOs can and do exist in the fullest range of sizes just as proprietary insurers can be found in all sizes of operation. As a result, the focus of this paper is on the issues that arise as a result of the mutual nature of the organisations and not their size. Examples of challenges that arise with respect to smaller insurers, whether they be MCCOs or not, include:
 - implementing proportionate regulation and supervision;
 - addressing the possibility of a significant burden on supervisory resources presented by a potentially large number of institutions⁵; and
 - where a potentially large number of institutions exist that are not formally covered by insurance regulations, developing and implementing appropriate transitional arrangements from informality to formality...

... all in a manner balancing the need for adequate oversight and the ultimate quality of the promises made whilst avoiding the loss of access to products and services altogether. These matters are expected to be the subject of more elaboration when the Joint Working Group moves forward with their workplan to provide more elaborative standards and guidance with respect to issues of access to insurance products⁶.

Issues relating to the key defining characteristics of MCCOs

12. Key defining characteristics of MCCOs are:

⁵ In some jurisdictions, MCCOs utilise common service providers for technical or administrative services. These “umbrella bodies” can be included in the supervisory process to reduce the burden of supervising a large number of small entities. However, in this paper, the broader issue of supervision of a large number of small insurers is not addressed in detail as it also applies to large numbers of non MCCO entities so is not a specific issue for MCCOs only.

⁶ It is noted that most mutuals can be expected to be small when they start, however the future work of the IAIS and the Joint Working Group calls for elaboration on issues of proportionality and on the treatment of small and, in some cases, informal institutions and on the challenge of formalising informal institutions.

- **Member ownership:** At least some of the beneficiaries of the services provided by the organisation are, by virtue of their membership, also owners of the organisation or have powers similar to those held by owners in shareholder organisations⁷.
- **Democracy:** By exercising ownership type powers, the members form the general assembly of the organisation and, through this forum, can exercise democratic rights on ultimate decision making such as the election of directors to the governing board.
- **Solidarity:** The extent members are seeking a beneficial outcome where this beneficial outcome is reliant on the membership of the group. This concept is particularly relevant to the issue of capital (refer to the discussion below under “ICP 23: Capital Adequacy and Solvency”).
- **Created to serve a defined group and purpose:** the organisation is established, and members become affiliated with the organisation, through a common goal, purpose, or characteristic.
- **Entitlement to profit:** The profit (or surplus) or loss (deficit) accruing to the members. In the case of losses, there can be a variety of treatments depending on the regulation in each jurisdiction.

Membership:

13. The element of member participation in the nature of ownership of the entity does suggest room for differences in the regulatory arrangements or supervisory focus. In particular, when the policyholders and the owners are, in effect, one and the same, then it can be argued the existence of conflicts of interest and the need to manage them between the rights and interests of policyholders and those of shareholders in a stock company is not as relevant to a mutual insurer⁸.
14. There is, however, a complicating feature. In some cases, either legally or in practice, not all policyholders may have the same rights and the same effective representation on the board of directors. In some institutions there is a feature of partial ownership where some of the policyholders are members and owners and others are not. In such partial member ownership situations there is a potential conflict between the member owners and the other policyholders who do not have ownership rights. In other cases, one or more categories of policyholders may be entitled to different ownership rights than others. It is possible that, although the legal equivalence may exist between groups of members, there may be decisions required in the management of the organisation that have to weigh competing interests between groups of members such as those with one type of insurance and others with a different type or, in entities where insurance is not the core business purpose, between those with insurance and those without insurance. In such

⁷ Member ownership in MCCOs is not identical to shareholder rights and obligations although it may carry many of the same opportunities such as the right to vote at annual meetings or appoint board members. Most critically, member rights in MCCOs are not usually able to be sold / transferred at will as is the case for shareholders.

⁸ Note that, in line with the broader definition used in the Insurance Core Principles, policyholders includes beneficiaries. In particular, third party liability claimants are third parties but the protection of an insurance supervisory framework remains applicable and it is intended that it be read accordingly. With respect to any regulatory and supervisory adjustments for MCCOs, it needs to be recognized that third party beneficiaries are not usually members of a mutual organisation but the protection of the supervisory framework should extend to them.

situations, depending on the orientation of the decision making body, it maybe that some potential conflicts would arise that need to be balanced.

Democracy:

15. MCCOs are usually governed by boards elected or appointed by the membership in some fashion or another. It is often the case that considerable effort is taken to ensure that members have the right to be involved in the selection of the board, to participate in meetings of the general assembly of the membership, and make such decisions as the constitution of the organisation allocates to the general assembly.
16. In smaller MCCOs, achieving the democratic objective is easier than in larger ones. For larger or more geographically dispersed groups, MCCOs sometimes adopt a sub electoral process such as on a regional basis or by groups of policyholders or by type of product or service, or some other means of ensuring that the voice of the members is represented at the general assembly. These processes can reinforce the process of democracy and strengthen the functioning of democracy even in very large organisations. Equally, it is important that such processes do not prevent the voice of ordinary members from being expressed at meetings. The manner that democracy is put into effect can also be determined in association with the history or nature of the membership or the defined group and purpose that forms the organisation.
17. As the effectiveness of democracy of the membership reduces, there is an increasing potential for particular groups to capture the democratic process. The most usual concern is that the management might carry a greater weight than is desirable, thus creating an agency problem⁹. In addition, the same result may occur between various groups of members where the access to democracy can be variable between them. One special case of different groups of members might exist when the state is a member of the organisation – a feature of some historic arrangements that continues in some jurisdictions.
18. Sound democracy also depends on both the access of members to the voting process as well as their being informed and able to make the relevant decisions that come before them. The process of informing members of the content and timing of matters that they are to consider is as important as the process by which they actually can attend and exercise their voice.

Solidarity:

19. MCCOs have, in most cases, a mutual or self-help origination and provide a source of risk pooling for the membership. The consequence of this can be two sided. Although members benefit from the diversification of the risk pool, they may also collectively underwrite the performance of the pool

⁹ “agency” problems refer to situations where particular agents (often senior management) take control with interests that are not fully aligned with those for whom they appear to be acting as agent.

with the implication that members will make additional contributions in the event that the financial performance of the pool requires such contributions. This concept, sometimes officially stated in the articles governing the MCCO and sometimes implied, is referred to as solidarity.

20. Solidarity can differ from the stock company equivalent where shareholders might be prepared to support losses but would not generally be required to do so further than a defined amount and could be considered to do so on commercial terms. For a MCCO, however, the decision to pay further amounts may be made on both commercial and other more social reasons reflecting the sense of solidarity between members of the group. This issue is further discussed in the section “ICP 23: Capital Adequacy and Solvency” below.
21. The strength of solidarity can vary and is closely linked to the other aspects discussed in this section.

Created to serve a defined group and purpose:

22. MCCOs are usually formed by a defined group of people for a defined purpose. Often, legal requirements oblige that they maintain this definition of membership and / or purpose in an ongoing fashion such that new members are also part of the defined group or purpose.
23. The defined group or purpose may be core to the insurance elements of the MCCO. Alternatively, the insurance function may be ancillary and the core purpose may be something else such as, for example, the mutual organisation of sales of agricultural products. The membership may have a common definition that is limited or broad and may be geographically close or dispersed.
24. Depending on the circumstances, the strictness of the definition of the group membership and purpose may be reflected as part of the regulatory or supervisory treatment or may influence how other aspects are considered. The definition may strengthen other aspects of mutuality or, in others, steps may be required to reinforce these aspects and ensure they are functional.

Entitlement to profit:

25. MCCOs, by their nature, accrue surpluses (or perhaps deficits). These surpluses are maintained or distributed for the benefit of the members. It is notable that this surplus accrual and maintenance can be for members collectively rather than individually and separately. Accrued surplus also has a characteristic of being maintained, at least to some extent, across generations of membership. In the long term, there may be some part of retained surplus that arose at a time when none of the current membership held membership. Unlike the normal practice of shareholder based firms, the method of distribution may be more diverse for MCCOs. For example, distribution may be through benefit increases or premium reductions similar to participating products offered by shareholder firms but may also include investments in providing ancillary services or contributing to community projects oriented to improved well-being. Regardless of the method of distribution, issues of equity in the distribution may be critical.

The Role of MCCOs in providing access to insurance services

26. Individuals, households, and commercial enterprises are vulnerable to risks and economic shocks. One way to protect themselves is through the pooling and transfer of risk offered by insurance services. The reduction in risk for individuals through risk pooling also makes dealing with risk more affordable. As a result, access to insurance is a key issue to facilitate economic wellbeing particularly for those with limited resources to protect themselves from adversity. It may be, at the same time that those of limited resources may be more exposed to particular vulnerability. However, in many markets, there can be challenges that limit access to insurance particularly for the most vulnerable including low-income populations, and small enterprises.
27. For effective access to insurance services, customers and insurance providers need to be able to come together to understand risks and insurance needs, provide product information, enroll in insurance programs, make payments of premiums, advise, assess and settle claims, and deal with other administrative processes in a cost effective way, is economically viable, and consistent with market needs. Recognising this range of services implies a definition of insurance services that includes both the provision of insurance coverage and also the distribution and management of insurance contracts.
28. When access to insurance services is incomplete, this may result from various causes. The challenges can be as a result of many issues and include:
- *Geographic challenges:* Where the distance between those providing the services and those wishing to access those services is too great then this presents an obvious barrier;
 - *Cultural challenges:* In many cases, the experience of insurance industry leaders and experts, and their own personal backgrounds can vary greatly from some customer groups making it difficult for them to understand the circumstances, expectations, and attitudes of some parts of the insurance market;
 - *Business model challenges:* To be effective, insurance services are provided through a range of business processes and models. These processes may, however, not be effective or economic when applied to other market segments particularly those segments involving smaller premium amounts per policy. Insurers who attempt to serve the lower premium markets with pre-existing business models often report that this effort is less successful than hoped unless the processes and models undergo material innovation in the approach;
 - *Service and product design challenges:* For the services and benefits of insurance products to be effective for the clients, the approach to delivering these services may need to use quite different approaches, skills and experiences for delivery and how services and product benefits operate;

- *Challenges due to socio-economic circumstances:* In some markets, conventional insurance services are oriented to serve some markets but not well oriented to serve others such as those in the informal workforce, those with highly variable and unreliable incomes, and those with particularly low incomes, or groups of the population who may perceive that conventional insurance is only for wealthy people; and
- *Value challenges:* Some client communities are skeptical and have an uncertain or negative view. These clients might not be agreeable to contribute to profits of commercial insurers; they might thus prefer MCCOs.

29. As noted above, the scope of activities of MCCOs may vary widely. Some MCCOs can be risk carriers acting as insurers and their commitments towards policyholders are substantially identical to those of 'conventional' insurers. Other MCCOs may adopt more specific restricted activities. In some markets, conventional insurers have responded well to the challenges of providing direct access to insurance services. In others, one solution to the challenges has been to recognise the roles MCCOs can play. These roles can form the basis for the regulatory approach recognising the characteristics may exist in varying degrees. There are a number of ways MCCOs can provide insurance services to their members including, for example,

- *As distributors;* MCCOs can act as a channel to clients when they are already acting to bring together client groups and may, in some cases, represent a cost effective and efficient way products can be explained and offered to clients. The key challenge of enrollment of members can be facilitated. In some cases, this distribution is formalised as an agent of an insurer;
- *As collectors of premiums;* Where the infrastructure and normal functioning of the MCCO can be a way to consolidate payment of premiums that can then be aggregated and transferred to the insurer thus providing cost savings¹⁰;
- *As part of the claims assessment process;* Just as microcredit institutions have found it useful to make use of the community organisation as a considerable aid in managing loan payments and reduce the risk of delinquency, insurers can find that moving as much of the claims assessment processes as close as possible to the customer can have advantages in reducing costs and ensuring timely claim payment is able to be delivered;
- *As the policyholders of a group insurance product covering the members of the association;* MCCOs can provide a critical element of the insurance delivery process to reduce cost by providing a natural aggregation of clients into groups. Group based insurances tend to be a lower cost option compared to individually issued insurance delivery. Similar to other group insurance arrangements, the record keeping associated with knowing the list of insured risks etc may be an administrative benefit provided by the MCCO.

¹⁰ The MCCO may enhance its infrastructure in this area through its relationships with other institutions.

- *As part of the process of understanding and relating to the customers;* MCCOs can sometimes have a more intimate relationship with members and amongst members who often come from the same community. Besides managing the risk of fraudulent claims, this provides them with the opportunity to better understand the needs of members. Knowledge of the characteristics of the group also makes pricing easier and removes many of the information asymmetries facing other insurers. MCCOs can act as a voice of their membership when insurers are looking to design effective products and services;
- *As part of the process of educating customers on the operation of the insurance services, And financial literacy generally¹¹;*
- *As providers of ancillary or complementary services;* These could include education on health, provision of other services to compliment the insurance service, or other parts of an overall package for the client. Common examples, but not the only ones, would be the provision of other financial services provided by cooperative microcredit institutions or the provision of health delivery;
- *As a vehicle to reinforce trust in the products;* One of the main reasons for the success of MCCOs in low-income markets is their ability to reinforce trust in the insurance product. This is dependent on the effectiveness of the characteristics noted in paragraph 12. It is sometimes the case that more formal institutions are considered by the informal and lowest income segments as not being “for them”. This is also a reason why member-owned structures often evolve spontaneously in lower-income communities;
- *As a means of reducing costs and making insurance more affordable;* In particular, for those with limited resources and for small premium and claim amounts, every effort made to find cost effective ways to deliver the services will be critical. Even when services are available, they may be too expensive for some segments. An MCCO acting as an aggregator of clients can support the product delivery whether or not the product is formally a group insurance contract or individual contracts leading to cost savings making the products affordable; and
- Although in some business models, the MCCO relies on a conventional insurer to be the risk carrier, in others *the MCCO may carry some or all of the insurance related risk directly* and have demonstrated their ability to do so effectively. There is some evidence that mutuality and surplus retention can help customers with low insurance literacy to accept insurance even when they purchase insurance and no claim arises. In an MCCO structure, the value may be more readily perceived by clients when there is no claim on an insurance product providing risk cover only.

¹¹ Just as microcredit institutions have taught many individuals with little exposure to financial planning how to make regular payments to cancel a loan, so both MCCO’s and other insurers in the market can educate policyholders how to make regular payments to ensure continued insurance coverage or contribute to a savings fund.

Although far from an exclusive list, the table in the annex provides some actual examples of cases where MCCOs have been playing these roles and, through this, enhancing access to insurance services.

30. The IAIS survey found different variations of MCCOs are a common phenomenon and play a significant role in a number of jurisdictions. Out of the 57 responses received (41 from supervisors and 16 from organisations), 28 respondents confirmed that such entities actively provide insurance cover to the low-income segment in their jurisdictions.
31. Historically, when risks are too large for individuals and households to manage in their own right, they have looked to pool these risks. This pooling may start through relatively intuitive, informal risk pooling and later develops into more formalised products (for example where each member contributes a regular sum each month from which pay-outs are made to those suffering risk events) and, eventually, insurance products provided by formal insurers. Thus informal, community-based risk pooling conceptually provides a trigger for the development of formal insurance. However, the development of insurance markets served by formal insurers has not always removed community-based risk pooling which can still play an important role particularly for parts of the community where access to the conventional insurance market is difficult.
32. When the MCCO is the insurer, this function of risk pooling is readily apparent. When an MCCO is not the risk carrier but acts as a distributor, or as part of the claim management or other process, the pooling aspects are available to insurance cover provided by authorised insurers. But when MCCOs are prohibited from serving in either role, these advantages are not accessible to the market and can result in reduced access to insurance.
33. In the Pittsburgh Communiqué (September 2009) the G20 noted that the leaders committed to “improving access to financial services for the poor” including to “support the safe and sound spread of new modes of financial service delivery capable of reaching the poor”. The experience of a number of countries has been that MCCOs can be one way to achieve these objectives as an active part of the market.

ICP Review - Specific issues that arise on regulation and supervision

34. This paper focuses on the regulation and supervision of MCCOs. To a large extent, it is proposed that the regulatory and supervisory treatment of these organisations should be equivalent to the approach taken to other organisations. However, where there is an adjustment, such adjustments should take account of their particular characteristics of MCCOs. The existence, strength and robustness of the particular qualities noted in paragraph 12 above are important.
35. Types of member ownership roles, democracy, solidarity, definition of common purpose, and profit / surplus retention, may provide an opportunity for regulatory arrangements and supervisory obligations to be revisited. As a result, MCCOs may be able to demonstrate that some of these

processes are sufficient so as to be able to be reflected as a response to some aspects of some regulatory or supervisory obligations. In doing so, however, it may also be the case that some obligations that reinforce or formalise such characteristics might also be included at the same time – that is, a supervisory response may include both a relief from an obligation on other insurers and an imposition to formalise processes from accepted practice to absolute requirements.

36. At the same time, and as noted above, the effectiveness of the mutual processes can reduce as organisations grow in size or have more diverse membership. Many MCCOs go to considerable additional lengths to reinforce the effectiveness of mutual processes. However, it has to be recognised that it becomes increasingly difficult to find material differences once organisations become very large and diverse. As a result, very large MCCOs should often face the same obligations as widely held shareholder companies.
37. When considering the IAIS Insurance Core Principles, this section reviews the ICPs and the issues relevant to their implementation when MCCOs are, or are intended to be, part of the market¹².

ICPs 1 to 5: Supervisory Arrangements

38. ICPs 1 to 5 relate to the supervisor and the supervisor's structures and are not, generally, distinguished by the types of organisation operating in the market. That said, it is relevant to ensure that policies and practices do consider all potential forms of organisation operating in the market. As such, when MCCOs are, or are intended to be, part of the market then these organisations do need to be considered as part of the overall policy, regulatory and supervisory arrangements.
39. In many jurisdictions, the role or potential role of MCCOs may not be recognised in the legal framework or may be specifically excluded. In such cases, the potential role of these organisations may be restricted with negative effects on the access to insurance services as noted above or may be conducted informally. The manner that this issue is reflected in the overall policy framework will be important¹³.
40. In general, providers of insurance services should be included under the supervisory regime rather than excluded. When MCCOs are not recognised and catered for then there is a risk of the presence of underground or informal insurers. In such cases, efforts to reform the regime to include these organisations within the regime would seem to be important so all policyholders should be accorded the benefits of prudential supervision and consumer protection. As noted in paragraph 11, when a significant informal sector has developed, then there are issues about how this sector can be included. Appropriate transitional arrangements will be important to ensure the positive benefits

¹² The IAIS Insurance Core Principles adopted in October 2003 were the basis for this review. The IAIS is currently revisiting the Insurance Core Principles with the expectation that a revised version will be considered. To the extent that this may be able to be incorporated in this section of the paper where there are material issues raised then efforts will be made to do so.

¹³ Refer ICP 1 essential Criteria (a) and (b) in particular and also comments on ICPs on licensing and distribution

are balanced with the prudential advantages as well as the need to ensure the supervisory process can be developed to reflect the impact of numbers of institutions on scarce supervisory resources. Transitional arrangements may also be relevant when regulatory arrangements provide for the possibility institutions are able to form and build capacity over time.

41. The roles of policymaking, regulation and supervision of MCCOs are often shared between a range of government ministries and agencies. As MCCOs can be part of a range of social and economic policy areas including financial services, agriculture, social welfare, health and community relations, the likely range of interested agencies can be greater than would be the case with, for example, other forms of insurers. These other agencies may not all be as fully conversant with issues with respect to providing financial products and services, particularly insurance. It is also likely that arrangements for effective, complete, and coordinated oversight will be more challenging and will have to consider a wider range of potentially competing objectives that will require special attention¹⁴.
42. In such a situation, it is also possible that oversight of the supervisory elements included in the ICPs may be allocated to one or more agencies for MCCOs and to another for other insurers. Alternatively, the responsibility for most or all of the elements may rest with the one agency or be shared between agencies. As ICP 3 notes, the clear and transparent allocation of responsibilities is important. It is also important that, when shared, structures for each supervisory authority are in place to ensure the requirements of ICP 3, 4 and 5 are supported in each authority where supervisory functions are carried out to the extent relevant to their allocated responsibility. The expectations for cooperation and information sharing set out in ICP 5 will be critical.

ICP 6: Licensing

43. ICP 6 deals with the licensing of insurers and states “an insurer must be licensed before it can operate within a jurisdiction”. Insurance legislation, observing ICP 6 essential criteria (a), would require insurers to be defined, including in their legal form, licensed, and the sole providers of insurance activities. It is, however, possible to observe the criteria with a range of alternatives and some may be more or less conducive to the development of access to insurance. In this context, some jurisdictions include MCCOs in the permissible legal forms and others do not. Similarly, some jurisdictions have defined legal forms for those carrying out a distribution function (refer also ICP 24: Intermediaries below). Studies have shown MCCOs can play an important role in the markets to enhance the acceptance of and access to insurance services. As such, depending on the nature of the challenges to access to insurance services in a jurisdiction, a barrier to MCCOs providing insurance services directly or as an insurance distributor may represent a barrier to the provision of such services to particular groups of the population.

¹⁴ Refer ICP 2 explanatory note 2.3, and essential criteria particularly as relates to competing or conflicting objectives and the need to resolve, explain and provide markets with transparency as to how objectives are implemented, and ICP 3 explanatory note 3.4 and essential criteria.

44. Where MCCOs are not currently permitted to act as insurers or as distributors of insurance then this may, in some cases, represent a material barrier to the provision of insurance services to particular groups of the population. In such cases, jurisdictions may wish to assess the effect of the prohibition and may consider amending their requirements to legally include these organisations in the insurance markets. When amending the requirements in such a way, it would seem not all MCCOs that are more generally registered or licensed should be automatically licensed specifically with respect to insurance. A separate licensing process to provide insurance services would offer a flexible route and cater clearly to those organisations not providing as well as those providing insurance services. The model often applying to other forms of entities could also apply to MCCOs¹⁵; that is, a general registration authority may exist but, for those wishing to provide insurance services would be subject to a specific insurance license. In such cases, it would seem to be most practical for an insurance supervisor to be the licensing authority for insurance purposes and to follow the insurance core principles to avoid inconsistencies or differential practices.
45. To include MCCOs in the insurance market as insurers, it will be important to consider the other issues discussed in this paper as they will be relevant to establishing an appropriate prudent regulatory and supervisory regime. These issues are also relevant to the licensing criteria noted in ICP 6, essential criteria (b):

- **The requirements on boards, given they are often selected through a broad democratic process;**

The suitability of owners can be different in the context of MCCOs. Although it is not to be expected there will be a dominant owner when the structure automatically implies a widely diverse and democratic structure, one element of a suitable significant owner (their capacity to contribute capital) will also need to be considered differently (see ICP 23: Capital Adequacy and Solvency).

A diverse ownership base can also present some unique risks. In some instances, it is possible that senior management may have a greater effective control over the entity due to the absence of a strong shareholder to provide a counter balance. Also, although the potential for conflicts of interest between those of shareholders and policyholders do not exist when policyholders and shareholders are the same, there can still be conflicts between the interests of management and staff and the interests or policyholders owners or between groups of policyholders. With respect to such conflicts, the effectiveness of the democratic processes in a mutual organisation will be important mitigants. Many mutual organisations go to considerable lengths to ensure policyholder democracy is effective and not undermined (refer also ICP 9: Corporate Governance). As noted in paragraph 17, it is also possible that the democratic process may be less than fully effective and this would have implications for this issue also.

- **The assessment of ownership structures, given the mutual nature of the organisation;**

¹⁵ For example, shareholder corporations may be licensed generally under the corporations law but still require a specific insurance license if they are to be insurers.

Mutual organisations have a defined ownership structure and this is usually detailed in the defining documents of the organisation’s constitution or the provisions of the applicable legislation. Although this structure means there may appear to be fewer permutations of ownership at the highest level, the detail of the organisational governance will be important to be considered as part of the need to be assured that the effective reliance on the democratic principles, to the extent there is such reliance, is supported within the defining documents of the organisation or within the provisions of applicable legislation; and

- **Capital.** (refer to discussion on ICP 23: Capital Adequacy and Solvency below).
46. ICP 6 also addresses specific issues relating to licensing insurers established in another jurisdiction. It is feasible that a MCCO may seek a license in more than one jurisdiction. In these cases, the same issues of cross border cooperation would apply but the additional consideration of the effective operation of the policyholder democratic processes is also relevant. MCCO insurers, in such cases, should ensure the voice of the policyholders in multiple jurisdictions is able to be expressed effectively.
 47. A further issue with respect to licensing relates to whether or not a limited license with defined conditions or limitations may be appropriate. Again, this may be an issue independent of the institutional form. It may be a useful way to address the challenges presented by a market that has developed in an informal fashion recognising that it is desirable for providers be included in the formal structure and it may be that MCCOs might be the principal form of organisation to be addressed, but it is not specifically mutual structures or the legal form that might give rise to this issue.
 48. ICP 6 essential criteria (h) suggests the power to place conditions or additional requirements on licenses when appropriate is a useful part of the supervisory and regulatory process. This option may provide a flexible way for particular issues in licensing MCCOs to be implemented when the option is available rather than waiting for extensive modification to the primary law. In such cases, it is useful if the usual conditions are developed in a consultative manner consistently with essential criterion (k) of ICP 3 and are applied uniformly in a transparent way so as to ensure all current and potential market participants are aware of and familiar with the rules.
 49. Essential criterion (i) of ICP 6 indicates “the supervisory authority assesses the application and makes a decision within a reasonable time. No licence is issued without its approval”. For this to occur where there is more than one supervisory agency it will be important coordination is effective and efficient as part of the licensing process and the roles and responsibilities of the relevant authorities are clearly defined.
 50. Some licensing regimes do recognise there are cases where a number of entities are considered to be conducting insurance business are not formally licensed. However, it is desirable that a process that moves toward formalisation should be in place.

ICP 7: Suitability of Persons

51. ICP 7 deals with suitability of persons and includes the range of persons that are of most interest being “significant owners, board members, senior management, auditors and actuaries” and the requirement for these persons to be appropriate with respect to their “integrity, competency, experience and qualifications”.
52. Fitness and propriety of boards of directors, both individually and collectively, is referred to in this paper in the section on “ICP 6: Licensing” and also relevant in the context of this ICP. For MCCOs, the democratic principles imply the members of the board are selected, and representative of, the policyholder / member body. As a result, members of the board will usually have a stronger link and obligation to policyholders and be less subject to types of conflicts of interest between those of shareholders and policyholders. To this extent, these issues could be less of a supervisory concern provided the democratic process works effectively. As noted above, this democratic process can be more or less effective and, by the very nature of the process, will become less distinguishing as organisations become very large and will require constant scrutiny from the supervisor.
53. When a board is constituted largely of elected representatives there is the risk the board does not encompass the same diversity of experience that a more ‘selected’ board may arrange. When the democratic process is a key support of governance there may be a need to ensure appropriate expertise and diversity of commercial or insurance experience is also available, otherwise the board may not be collectively fit and proper in terms of the competencies required. For example, an MCCO based on membership of a particular profession or industry may not automatically draw a board with experience in commercial and insurance related matters. Surveys indicate many MCCOs are very conscious of this issue and provide regular training for new directors and on an ongoing basis although it may not always be easy to access such training without significant effort. Some MCCOs also indicated their boards are only constituted by members elected and not by any members who also hold management responsibilities and as such are “wholly independent”. In addition, the access of the board to independent expert at the board’s own initiative; the ability of individual directors to initiate investigations or to secure advice; or very robust processes whereby directors can obtain access to management to inquire and understand issues, can enhance their oversight role and help these directors to carry out the responsibilities expected of them¹⁶. In some markets, MCCOs are obliged to or spontaneously adopt the practice of having some appointed independent directors who bring particular expertise to the board. In others, MCCOs may have access to technical service providers as a cost effective way to build and maintain expertise. Importantly for supervisors, however, even if all these steps are taken it still should be recognised the selection of governing bodies can present issues in some cases.

¹⁶ Refer IAIS Corporate Governance Survey Report.

54. Additionally, due to the democratic processes, there may be cases where continuity of directors and officers may not be the same for MCCOs as for other legal forms. To preserve the value of this process, it may be the case where organisations (and regulatory and supervisory arrangements) need to consider alternative approaches to ensure risks are balanced with benefits including not having coincident terms for all board members.
55. Finally, the issue of the suitability of owners as subscribers of capital is different for MCCOs. This issue is raised in several of the ICPs and is addressed in this paper under the section on “ICP 23: Capital Adequacy and Solvency”.

ICP 8: Changes in Control and Portfolio Transfers

56. When MCCOs are part of an insurance market, it should be specifically ensured that the path to change of control through demutualisation is set out. This addition is not otherwise required and should be in place regardless of whether demutualisation is intended to be used in the foreseeable future. It is desirable for the route toward demutualization to be made available and properly defined as an option in the event demutualization is needed. Under ICP 8, demutualization should be subject to the specific approval of the supervisor. In such cases, especially as they may be rare, the supervisor will probably need to be able to request special expert reports regarding the treatment of policyholder interests.
57. It should be noted the ICP does not restrict supervisory scrutiny to direct ownership rights but also to the operation of effective control. These issues would also arise for MCCOs because it is possible to have indirect control over a MCCO and, accordingly, it is possible to change control through changes in indirect controllers.
58. Other issues relating to transfer of portfolios would normally be identical or largely similar to those issues that arise with respect to the transfer of participating or non-participating policyholder portfolios between shareholder companies.
59. ICP 8 also makes reference to the adequacy of owners as contributors of capital but this issue is addressed in the section on “ICP 23: Capital Adequacy and Solvency”.

ICP 9: Corporate Governance

60. The approach to corporate governance requirements can take into account the nature of MCCOs including the democratic processes where these are robust. As a result, this particular aspect of insurance regulation can offer both opportunities and carefully considered balance of obligations on MCCOs. As is envisaged in the ICPs, it may be useful to consider separately defined rules for corporate governance for MCCOs that are both facilitative of access and reflect the nature of the mutuality. In some jurisdictions, the manner the governance issue is addressed is to subject the

democratic processes to review rather than orient the particular requirements to an assumption that such processes do or do not exist. That is, the democratic processes can be given credit under the regime but should be subject to review and assessment.

61. At the same time, the effective functioning of the board remains a key objective of supervisory oversight and should be subject to the same overall review by supervisors. The manner that supervisors and MCCOs achieve this objective may, however, take account of the structure of the MCCOs.
62. One issue relating to effective governance, and also related to changes of control, is the risk of control of a mutual entity being secured by an aggressive outsider when the democratic processes are less strong. MCCO structures may be more vulnerable to such interventions as the cost of taking control can be lower than would be the case when a direct purchase of equity is required. This can provide an attractive target for asset stripping activities or other frauds. As a result, care is needed to ensure such actions can be subject to effective supervisory oversight and, if necessary, intervention.

ICP 10: Internal control

63. The obligations on insurers, whatever their structure, regarding internal controls as elaborated in the ICP 10 would appear to be universally applicable as the ICP recognises the relevance of the nature and scale of the business.

ICP 11 to 17: On-going supervision

64. ICPs 11 to 17 relate to ongoing supervision. They include the functions of market analysis, reporting to supervisors and off-site monitoring, on-site inspections, preventative and corrective measures, enforcement or sanctions, winding up and exit from the market, and group-wide supervision. Market analysis performed by supervisors should include MCCO activities. Another distinctive MCCO issue relates to the provision of the avenue of exit through demutualisation and this is noted above in the section relating to “ICP 8: Changes in Control and Portfolio Transfers”. Other matters raised in these ICPs are independent of the nature of the structure of the entity and should be equally applicable.
65. The ICPs recognise the importance of providing effective paths for wind up and exit. The issue of demutualisation as a path is noted in the above commentary on “ICP 8: Changes in Control and Portfolio Transfers”. The balance of the issues raised in ICP 16 would appear to be generically applicable to both MCCOs and other insurers.

66. ICP 17 also recognises group supervision matters. Although ICP 17 may not be generally applicable to MCCOs, there is a view that the role of apex organisations can give rise to some group related issues and ICP 17 could be considered as part of the treatment of such arrangements¹⁷.

ICPs 18 to 23: Prudential requirements

67. ICPs 18 to 23 relate to various prudential requirements. Their common goal is to ensure that insurers have the ability under all reasonably foreseeable circumstances to fulfill their obligations as they fall due. The requirements relate to risk-assessment and management, insurance activity, liabilities, investments, derivatives and similar commitments, and capital adequacy and solvency. All requirements apply uniformly regardless of the form of insurer except that special considerations may apply with respect to capital and solvency.

ICP 23: Capital Adequacy and Solvency

68. Capital, for a MCCO, may require specific consideration. The issues noted here arise from the nature of the organisational structure and not the type of insurance business conducted so are only part of an overall design of a capital and solvency regime in a market with both MCCO and other insurers.

69. On the one hand, the structure of the organisation may imply that the organisation's main source of capital is through retained profits or surplus¹⁸. As such, unlike shareholder companies, these entities cannot adjust and raise capital as needed so they may need to align their capital needs with available resources more carefully. At the same time, the balance between retaining capital to support business growth and distributing profits to members is particularly important and demands consideration of fairness and equity between generations of policyholder members. Long standing MCCOs can build up an "estate" of capital generated from those who are no longer members and the management of this estate becomes increasingly important as the MCCO increases in size. Supervisors will have an interest in both capital adequacy and fairness and equity associated with these issues. Also, when making changes to the capital requirements, arrangements for transition would need to consider the ability of insurers to generate capital making this a special consideration when MCCOs are affected by any revisions.

70. Some regulatory and supervisory systems also recognise guarantees from third parties. In fact, this has been the way many mutuals started originally. However, the reliance on such guarantees tends to have a very limited duration during the start up period and is usually quickly replaced with

¹⁷ Apex organisations are entities that are formed to provide services to groups of mutual organisations or to facilitate groupings of such organisations or both. They can be owned or operated by the group of organisations that they provide services to or be more independent in legal terms.

¹⁸ Another way that some MCCOs address these issues includes collecting an "entrance fee" that directly increments their own funds when new members join the organisation.

retained surpluses. In some recent instances, development agencies and non-governmental organisations have acted as a source of seed capital or initial guarantees.

71. Some MCCOs may have access to capital through calls on members. This may be viewed as being akin to uncalled capital from shareholders except some recognition may be made of the elements of “membership”, “solidarity” and the fact the membership is drawn together through a “defined group and purpose”. As a result, such calls might be expected to respond differently to those purely sent to owner investors. At the same time, assessing the strength of a potential call is complex: for example, such solidarity can break down or dissipate as the membership grows larger and more diverse and has less strong “solidarity” even though the threat of loss of access to insurance would provide an incentive for members to respond positively¹⁹. Additionally, in times of considerable adversity, and if there is some alternative available, members may select against the insurer and abandon the solidarity altogether²⁰.
72. Also, particularly with respect to microinsurance clients, their capacity to make a material call is less likely to be available with the same level of certainty as is the case with an identical solidarity based group of wealthier members.
73. As a result, it would be most unusual for insurance regulation and supervision to give considerable reliance to callable but unpaid capital or reserve items when considering the financial security of the institution unless there was a strong demonstration that such calls had been met in practice and reflected very strong solidarity, strength of member belonging, etc.

ICPs 24 to 28: Markets and consumers

74. ICPs 24 to 28 relate to issues for the protection of policyholders in markets and to the role of intermediaries, consumer protection, fraud and issues of money laundering and terrorist financing. These are essential areas of insurance supervision, and may have a reputational or prudential impact on insurers if not well managed.
75. Those ICPs relating to fraud and to anti-money laundering and countering the financing of terrorism (AML/CFT) are not unique to any organisational type so do not require detailed discussion, however, there are aspects of the member relationship relevant to how implementation of the ICPs with respect to intermediaries, consumer protection and disclosure are considered.

¹⁹ In France, after huge tempests in December 1999, one important mutual called supplementary contributions from its members. Policyholders were geographically widespread over France so ‘solidarity’ was probably weak. However, nearly 99% honoured the call. It is likely that the threat of losing insurance cover (the mutual would have terminated the contract of those who didn’t pay) played a part.

²⁰ In Australia, several professional organisations provided professional liability cover for their members based on this principle. It worked well in normal environments for a long period but, when the collapse of a major insurance provider and reinsurer to the schemes led to very material calls on members and an alternative provider was available who did not have to charge for both the current and retrospective risks, members abandoned the scheme.

ICP 24: Intermediaries

76. The effective delivery of insurance services to underserved markets is particularly dependent distribution being cost effective and able to be leveraged as a connection between the insurer and the customers. As in conventional insurance, the role of “distributors” may extend beyond agency or sales arrangements to include policyholder registration, some elements of ongoing administration, and, in some cases, elements of claims assessment or processing. Extended roles for distributors can be beneficial to the financial effectiveness of the insurance provision. Extended roles can also draw on the elements of solidarity to reinforce effective claims assessment, for example, instead of relying on the alternative of intensive assessment of documentation where such an assessment may not be practical or effective for remote or small market participants. MCCOs are, in some situations and for some clients, an appropriate part of the distribution and ongoing administrative process.
77. ICP 26 essential criterion (a) indicates all intermediaries should be licensed or registered. The same should apply to MCCOs acting as intermediaries. Where legislative requirements imply intermediaries are natural persons then this can restrict the role of MCCOs and the provision of insurance services in some jurisdictions where an MCCO is not considered to be a natural person in legal terms. As a result, providing a route for MCCOs to be intermediaries supports the provision of insurance services to underserved markets.
78. To that end, there is the potential that the normal field of activity of intermediaries can be expanded in some cases and focused in other respects to reduce the regulatory burden and to encourage insurance service provision. Some jurisdictions have created a special class of intermediary to provide focused and defined services. When a special class is introduced, there is a benefit that the requirements of the ICPs that insurance intermediaries should be competent for their role can be targeted. ICP 26 essential criteria (b) notes “intermediaries to have adequate general, commercial and professional knowledge and ability as well as having a good reputation”. As is the case for conventional insurance, it would be appropriate to consider MCCOs may be functioning in a limited and defined role and their obligations should be proportionate to that limited and defined role.
79. Where the distributor / agent is an MCCO, there may be other opportunities to recognise and take advantage of the structure for effective oversight. For example, some MCCOs use apex organisations or join collectively in other ways to develop business systems or share processes. The existence and use of apex organisations can also provide an opportunity for supervisors to reduce the time and cost of supervision²¹.

²¹ For example, where a number of MCCOs make use of administrative platforms provided by an apex organisation then the review of this arrangement might be done without having to repeat it separately for each MCCO. Such arrangements for supervisory review or other supervisory functions usually can be done reflecting how the apex organisation is included in the regulatory perimeter.

ICP 25: Consumer Protection

80. There are also some elements of ICP 25 on Consumer Protection where MCCOs would present an opportunity for an alternative approach, if desired, taking into account the nature of their organisation where the MCCO is either an insurer or an intermediary. Given members have both a policyholder and an ownership right in MCCOs then their position, and the awareness of the obligations of the MCCO to the member may be stronger in some cases depending on how well the aspects of mutuality mentioned in this issues paper actually function in practice.
81. Additionally and as already underlined, the potential for conflict between the interests of owners and policyholders might be mitigated somewhat by the fact both are the same in a mutual organisation. This, however, does not address the situation where the policyholder and the ultimate beneficiary may be unrelated persons, in particularly the case of third party liability insurances.
82. As a reflection of this aspect of mutuality, some but not all MCCOs are able to demonstrate a high level of consumer and client awareness and focus on addressing client concerns, the need for client understanding, and complaint resolution particularly diligently. In some markets where consumer protection mechanisms may be less well developed or specifically for microinsurance clients who may find access to more conventional mechanisms less effective for them, effective resolution of concerns through internal mechanisms is important and, in dealing with this issue, the effectiveness of internal processes and customer orientation might be considered.

ICP 26: Information, Disclosure and Transparency towards the Market

83. The role of members as owners and as voters can be supported or made less effective depending on the information disclosed to them. The effectiveness of communication to owners and ensuring they can exercise their responsibilities as owners are thus important in mutual structures. As a result, many MCCOs can place particular importance on the disclosure and transparency of information and the availability of boards and management to answer questions and address concerns through democratic assemblies and annual meetings. From a supervisor's perspective, the effectiveness of disclosure underpins the effectiveness of the democratic element of MCCOs and, to the extent the regulatory and supervisory arrangements can recognise such arrangements then the effective operation of disclosure and democracy is critical to any approach to regulation and supervision and should be subject to supervisory assessment.
84. Subject to reflections of size etc, and consistent with essential criterion (a) of ICP 26, information disclosure obligations can be problematic for all market participants if reporting of information is materially different in scope. For example, market participants should be able to benchmark their performance against the market as a whole and not only a subset of the market.

Annex: Examples of the Role of MCCOs

Function	Country	Description
As distributors	India	The Microinsurance agent regulations brought out by the Insurance Regulatory And Development Authority (India) have recognised self help groups to tie-up with insurer not only for collection of proposal forms but also for collection and remittance of premium and policy administration service. Local handling of marketing and sales lowers transaction costs.
Supporting premium collection	Philippines India	Remittances of funds from Filipino workers overseas have been an important source of support to local families and the wider economy. Church groups providing support to communities of foreign workers have worked with insurers in the Philippines to collect premiums on insurance products during their regular community meetings and remitting them collectively to insurers, reducing cost and improving the efficiency of these contributions.
As part of the claims assessment process	India	The Microinsurance agent regulations brought out by the Insurance Regulatory And Development Authority (India) have allowed self help groups to assist in the claims settlement process.
As the policyholder of a group insurance product	Sri Lanka Philippines Guinea	Savings and credit cooperatives (SACCOs) are able to reduce transaction costs and offer group insurance coverage tailored to the needs of their members by negotiating lower premium rates than what would otherwise be offered by insurers. This fact is also an example of motivating collective risk reduction through individual action and has implications for influencing the quality and cost of services provided to low-income segments.
As part of the process of understanding customers	India Nepal South Africa	Mutual societies are active in information dissemination of formal social protection and poverty alleviation programs. They also ensure registration of all eligible citizens and monitoring by civil society.
As part of the process of educating customers	Ethiopia Zambia Brazil India	Community groups along with MFIs, perform needs analyses and awareness campaigns in a variety of ways, including focus group meetings, street plays, and inviting microinsurance claims recipients to tell others about the benefits of insurance. This enhances awareness of insurance and encourages collective action and risk reduction activities by all group members.
As providers of complimentary services	Brazil India Philippines	Many credit cooperatives complement their financial services offering, namely savings and loans, by cross selling life and non life insurance. Sometimes this may involve non –financial products too.
As carriers of insurance risk	West Africa	The UEMOA legislation, brought out Economic Community of West African States (ECOWAS) , has developed a multinational framework which allows mutual social health organisation to underwrite health insurance and simplified accounting requirements have been prescribed for such providers.