Draft – Regulatory Framework

People's Republic of Bangladesh:

Pilot Project on Weather Index-Based Crop Insurance

Draft – Regulatory Framework for Weather Index Based Crop Insurance

Prepared for

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Introduction:

Regulatory Framework is very much necessary for enabling and supporting the development of any program / product. As the vulnerable population needs risk mitigation services to cope up with the myriad of risks they will be dealing with. Hence it became obvious to have a proper guidelines and framework to keep in place for development of the sector in delivering the intended products and services to the target markets / clients.

Micro Insurance is one such initiative it has to be supported by the Regulator to develop and nurture to reach an significant level to make its impact and fruitful ness.

It's almost a decade from the first Micro Insurance regulation was introduced. The first Microinsurance regulation was introduced in India in the year 2005.

Over the last decade, at least 18 insurance supervisors have adopted a Micro Insurance specific regulatory framework. At least another 23 countries are in the process of developing some form of microinsurance specific regulations.

The initial impetus for developing microinsurance regulations varies among the countries. When the first micro insurance regulation was introduced in India in 2005, it was to kick-start insurance products, their distribution and uptake for economically vulnerable people at a time where such a market did not exist. Microinsurance regulations were also introduced in some instances as a targeted policy response to immediate challenges, such as regulatory barriers in existing product rules or inadequate transparency rules. In Philippines, a dedicated framework for microinsurance was developed primarily to address the high levels of informal insurance activity. This had led to consumer protection concerns, and therefore the need to regulate these activities by bringing them into the formal financial system. Peru's microinsurance regulations sought to create a wider range of microinsurance distribution channels for insurers to utilize, while also focusing on consumer protection. In all cases, supervisors put in place microinsurance regulations as a catalyst to grow the inclusive insurance market.

When developing the regulation the supervisors/Regulatory authority have sought to strike a balance between establishing an enabling business environment and ensuring vulnerable consumers are protected. On one hand, consumer protection needs to be adequate for a customer base that is new to insurance. This is particularly critical as the inclusive insurance customer's profile is such that they are typically less well educated or financially aware, and at the same time, more financially vulnerable. As such, the need for insurance to provide value for money and engender trust becomes even more paramount. On the other hand, Regulators recognize that insurers need a regulatory environment that provides adequate flexibility and opportunities to operate in a commercially sustainable manner. The target customers in many cases are geographically spread across and more difficult to reach, often too costly for traditional distribution channels to serve them. Many companies have found it difficulty in reaching the economies of scale needed to achieve the business viability.

Being the product of Index or parametric insurance is insurance that does not relate directly to losses, i.e., is not indemnity based, but relates to a parametric index that triggers payouts. Index Insurance works such that when a predetermined level of 'index' is reached, such as a certain level of rainfall or flooding, an insurance payout is triggered. Often the Index Insurance products are been introduced as part of other policy agendas such as climate change adaptation, food security, or agricultural development. While these schemes often benefit low income vulnerable population, Index Insurance has the potential to achieve scale, as there is no need for a costly indemnity based loss assessment. Challenges such as limited availability of reliable and timely data that correlates with the risk, costs of needed infrastructure (like weather stations), lack of financial literacy, basis risk and distribution.

During the present pilot program under the Sadharan Bima Corporation (SBC) which is been allowed by the IDRA (Regulatory Body) to conduct the pilot which is been tested and experienced and found out solutions for some of the identified challenges.

To start with the regulatory framework it is desired come out with the product guidelines, the type of Risk Carriers and the broad guidelines for distribution and the probable commission/incentive mechanism so that the enabling environment and guidelines can be arrived at.

1.0 Objectives of the Policy Framework

Weather Index Insurance as a product needs special attention across its life cycle. Being the product is of innovative nature and involves many stakeholders to design, develop and distribute a proper guideline/framework is necessary to make it more effective and to supervise.

The policy framework outline is for the Weather Index Based Insurance and aims to achieve the following objectives:

1.1 Primary Objective

The primary objective is to assist in establishing a regulatory framework for index-based insurance that will enable the protection of policyholders and the appropriate supervision of industry participants by the Regulatory Authority from time to time. Further to this by having a prudent policy in place it will enable the industry players to share and learn from each other to scale it up in a considerable way

1.2 Specific objectives

i. Reduce the legal and regulatory risk surrounding index based insurance product, by creating a clear distinction between index based insurance and other types of index based risk transfer products, such as derivatives.

ii. Increase the speed and reduce the costs for insurers to develop, get approval and market index-based insurance, by helping set out clear requirements for a product to be approved as an index-based insurance product.

iii. Ensure sufficient and accurate prudential provisioning and reporting of the risks taken on by the insurers, thereby reducing the risk of the insurers not being able to meet their contractual obligations to the policyholders.

iv. Protect the interests of customers by setting principles based rules for index based insurance contracts, covering issues such as the provision of client value, how to reduce basis risk, requiring transparency with respect to the product offering and by requiring insurers and intermediaries to treat their customers fairly.

2.0 Scope of the framework

This policy framework covers the provision of index-based insurance necessary to reduce the risks for the insurers entering the market and for the policyholders who want to purchase the product. The policy framework does not set out any Regulations. However, it does give recommendations on the features of an index-based insurance product that the Insurance Act and Regulations should enable in order to achieve the objectives set out above. It serves as a guiding document for the proposed regulatory mechanism.

3.0 Policy Framework

The following section gives the policy framework that the Authority should use to determine the Regulations for index-based insurance. In addition, the Authority should use the framework when issuing guidance notes and circulars on index-based insurance from time to time.

The regulatory framework recommended in this section should be consistent with the legal framework prescribed by the Insurance Act in force, this was necessary to ensure that the resulting products will be recognized by the law as valid index-based insurance contracts.

Indexes should be permitted to cover any type of risks, not just agricultural risks, as long as the index meets the minimum necessary requirements.

This policy framework consists of various sections, which will cover the following:

Section	Details covered
Section 1	Objectives of the policy framework which outlines the primary and specific objectives of the framework
Section 2	Scope of the framework in which it operates
Section 3	considers some key regulatory considerations and also outlines the product specific guidelines
Section 4	Specifies guidelines that the Authority should develop for approving an index-based insurance product.
Section 5	Outlines the valuation, reporting and sales requirements that should be placed on companies that underwrite these products.
Section 6	discusses requirements that should be put in place to improve consumer protection of the users of index-based insurance.

3. 1 Key regulatory considerations for index-based insurance products

The Authority has been very supportive by allowing the present index based crop insurance by the Sadharan Bima corporation. The Regulatory Authority allowed the pilot project on weather index based crop insurance to be sold without the existence of the necessary regulatory framework for these products by granting them regulatory exemptions. Which has given the opportunity for the pilot to design and develop the index insurance products and distribute the same across the target geographies. And also given the opportunity of refining the products.

Index Based Insurance Definition:

"Index–based insurance contract" means an insurance contract

> ***"under which the liability of the insurer to make a payment to the policyholder is triggered by, and the amount of that payment is determined in accordance with, one or more indexes, rather than on an assessment of the policyholder's actual loss"***

For the purposes of this framework, "insurance contract" means

> ***"a contract under which one party, the insurer, in exchange for a premium, agrees with another party, the policyholder, to make a payment, or provide a benefit, to the policyholder or another person on the occurrence of a specified uncertain event which, if it occurs, will be adverse to the interests of the policyholder"***

If an index-based risk transfer product does not meet these requirements, it cannot be classified as an insurance product. The appropriate classification of non-insurance products is not a matter for the insurance framework but, in order to protect policyholders from being sold inappropriate products, insurers should be prohibited from selling non-insurance index-based risk transfer products, even if it not marketed as insurance.

3.2 Rural and Social Obligation:

To speed up the insurance penetration and to make the insurance available and accessible for the Rural and Social Class, it would be a good idea to introduce certain obligations towards the rural and social sector for every Insurer. (the same has been implemented in India to augment the prospectus for micro insurance). As per the guideline in India, , every insurer who begins to carry on insurance business ensure that he undertakes certain obligations set out by the regulator to comply the rural and social sector obligations. These guidelines will be separate for Life and General Insurers. The rural and social obligation quotas would vary with the age and size of the company. It might be meaningful to put a target in number of policies or percentage of business volume from the rural and social class.

Current situation in Bangladesh:

There are hardly any entry barriers in starting and insurance company and given the low claim payout rates, it is deemed as free investable surplus in Bangladesh. This is evident from the fact that relative to the size of the market, country has extremely high number of insurance companies. Introducing Rural and Social obligation and imposing heavy penalties on insurance companies not fulfilling them would result in growth and development of rural insurance market including Crop and Index Insurance.

The authority has to specify the definition for the rural and social class and it should be strictly monitored for the compliance. This will give enough encouragement to build the market for micro insurance.

The agriculture insurance / Index Insurance can be a part of the product offering to this target segment.

3.3 Product specific Guidelines:

3.3.1 Nature of the product

Index-based insurance is not explicitly dealt with in the Insurance Core Principles. Therefore, in order to be seen as an index-based insurance contract the product must conform to the requirements of generally accepted insurance practices. For making it complacent with the present insurance laws the necessary guidelines are to be issued

3.3.2 Fixed sum/ Agreed Value Policy

- Index based insurance pays out on the occurrence of the insured risk e.g., the risk of low rainfall and not on the occurrence of individual losses by the policyholder. Therefore it cannot be seen as indemnity insurance, and should be considered as a form of “fixed sum” or “agreed value” insurance. This will need to be reflected in the regulatory framework by requiring that insurance benefits are provided on this basis.

- The pay-out can be a proportion of the maximum sum assured, depending on the index measure and the design of the policy. The benefit pay-out can also be staggered to commensurate with the loss as per the observed index.

3.3.3 Cap on the Maximum Sum Insured/total payout:

The maximum sum Insured or total pay-out allowed in the contract should not be specified in the regulations. This is necessary because:

- The damage or losses intended to be covered would be very difficult to assess;

- It allows for the contract to include cover for any mitigation costs and consequential losses from the risk occurring; and

- Maximum sums insured may be an obstacle to Meso and Macro level insurance initiatives.

Therefore, index-based insurance should:

- Not promise to indemnify the policyholder of the losses he/she incurred due to the insured risk occurring within the contract period. This is necessary to help ensure that reasonable policyholder expectations are created around the expected pay-out from the insurance product.
- Have a maximum sum assured that reflects the risks and the needs of the policyholder, taking into account the policyholder’s insurable interest. The risks faced include both the direct losses and indirect consequential losses or for recovering any mitigation costs.
- The maximum size of the total pay-out should be specified in the contract and the insurer must be able to justify why the total cover provided is not excessive given the risks faced by the policyholder

3.3.4 Insurable interest

In order for the contract to be seen as an insurance contract and be enforceable by the policyholder, the policyholder should be able to prove that he or she has an insurable interest in the risk occurring. Insurable interest in the context of index-based insurance should allow for wider economic interests.

Therefore, for the purposes of index-based insurance, a policyholder should only have to demonstrate that the occurrence of the risk would be averse to the policyholder’s interest. A few examples of policyholders with insurable interest include:

- Institutions that provide loans, if the occurrence of the risk reduces their customers’ ability to repay the loan;
- Service or production input providers, if the occurrence of the risk reduces their customers’ demand for their services or inputs;
- Laborers, if the occurrence of the risk reduces their employer’s ability to pay their salary or require their services; and
- Producers, if the occurrence of the risk restricts the availability of their production input, increases the cost of purchasing the input or reduces the price at which they can sell their out.

3.3.5 To include in the Micro Insurance category:

- It would be better to accommodate the Index Based Insurance as microinsurance product, this was on the fact that the product is targeted to the vulnerable population and specifically targeted to the small and medium farmers
- If the index-based insurance qualifies as microinsurance, the Microinsurance Regulations should apply to the index-based microinsurance contract, except to the extent otherwise provided by the Index-based Insurance framework.
- Therefore, the index-based insurance regulations should get preference to the microinsurance regulations in the case of an index- based microinsurance contract.

4.0 Index-based insurance approval guidelines

In setting the product approval guidelines for index-based insurance products, the Authority should take into account the following considerations:

4.1 Product Application Report

- The insurer should only be allowed to sell an index-based insurance contact after submitting a product approval application to and receiving permission from the Authority.

- The application should specify how the proposed product design meets the requirements of the guidelines set out below. If the insurer fails to meet the requirements of these guidelines to a sufficient level to satisfy the Authority, then the Authority should not approve the index-based insurance product for sale.

- The application should include an actuarial report that specifies how the insurer, through product design and the indices used, has aimed to minimize the basis risk expected from the product, given the purpose of the policy and the risks it aims to cover.

- The application should include details on the sales process and the key service providers. Copies of the service level agreements with the key service providers must be provided.

- The application should also include a copy of the marketing material and key features statement that will accompany the insurance product.

- Any significant changes to the product design relating to these criteria should be reported to the Authority. The insurer must receive approval of the changes before they can be implemented in the market. The Authority may update these criteria through the updating of the relevant insurance Regulations and guidance notes.

4.2 Basis of Premium

- Insurers providing index-based insurance products should be able to underwrite policies in the manner they consider most appropriate. There should be no prescribed or minimum premium basis or limits on what is seen as an “acceptable return” on the index-based insurance policy.
- Apart from this it would be glad if a possibility of excluding the Index based products / Micro insurance products from the Value Added Tax(VAT) of the Government which might act as a motivating factor and also facilitate to keep the premiums at an affordable level.

4.3 Changing the premium, cancellation and non-renewal:

Should the insurer no longer find the level of risk acceptable, it may decline to renew the policies or increase the premiums. However, it should be prohibited from cancelling an existing policy or requiring additional premiums to be paid for a policy to stay in force.

Insurers should be required to submit premium rates to the Authority on a file-and-use-basis, with a justification for any significant changes. Subject to this, an insurer should be able to revise the premium rates at any point during the year for new policies sold or for policies being renewed during the year.

The new premium rates should be required to be submitted to the Authority one month prior to the rates taking effect. The company should not have to wait for regulatory approval but should be able to start using the new premium unless the Authority objects.

4.4 Eligibility criteria

The insurer should clearly state the criteria qualifying a person as able to purchase the contract. These criteria should reflect the principles for determining if a person has an insurance interest, as specified in the earlier section under “insurable interest”.

To make the product more attractive, all the possible target institutions and clients are to be notified / brought under the insurable interest clause. So that the product can be made available for all these classes of clientele. The clientele can be individual / Institutional keeping the broad criteria in mind.

4.5 Waiting periods and sales, premium and cover windows

The insurer should not be required to have any waiting periods on the product. The sales, premium payment and cover windows should be clearly specified.

4.6 Exclusions

The insurer should be free to include such exclusions as it considers necessary in the contract. But these should be clearly printed in the literature and the product brochures distributed along with the policy

4.7 Grace period and the right to cancel a policy

The requirement of a grace period may not be applicable to index-based insurance products. Neither the insurer nor the policyholder should have the right to cancel the policy once it is in-force. This is to avoid adverse selection by the policyholder or discrimination by the insurer

4.8 Specify the data source and back-up source

The insurer should clearly specify the source of the data used to determine the index values and if the source of the data is the insurer's own measurements or from an independent source. It should also specify the back-up source of the data, in case the primary data source fails or is found to contain errors. If there is no back-up source available, the insurer should specify the method it will use to approximate the lost or incorrect data.

If the Authority determines that the data or the calculation of the index value is not independent or reliable enough, then it may require the insurer to appoint an independent body or person who will be available to verify the accuracy of data or index. The insurer should then use this verified data to determine the claims due to the policyholders.

The insurer should submit the service level agreement between the insurer and the independent person or body to the Authority for approval before the insurer can start selling the policy.

4.9 Contract requirements

In order to ensure that the contract minimizes the basis risk associated with index-based insurance and ensure that policyholder value is maximized, the indices used to determine the pay-out should have the following attributes:

i. *Easily observable and measurable.*

The insurer should specify how the data used to calculate the index will be observed and how the index values and resulting benefits will be determined.

ii. *Transparent, objective and independently verifiable.*

Any interested third party or the policyholder should be allowed to request the measured data and calculate the index and pay-out level themselves. The method of calculating the index value from the data and the resulting benefit payment should require no subjective interpretation.

iii. *A good predictor of the risk covered.*

Whether the index can be used for a product should not be determined by the level of correlation between the index value and the individual losses, but by whether it is a good predictor of the insured risk. Therefore, the index should not trigger a payment unless the insured risk occurs.

Where there is uncertainty, it may be advisable to include a separate trigger for the insured event, leaving the role of the primary index to determine the size of the payment due under the contract. However, this should not be a regulatory requirement

iv. *Predictive variable.*

The regulations should also allow the index to be based on a predictive variable. This will allow for the benefit to be paid out prior to the risk occurring, allowing the policyholder to use the benefit payment to finance the mitigation costs incurred for the risk.

4.10 Claims notification and payment process

As the index will be more accessible to the insurer than the policyholder, payment should be made without the necessity for a policyholder to lodge a claim.

Once the data necessary to calculate the index and benefits due is available, the insurer should provide the policyholder with a formal notice of whether or not the policyholder is entitled to a payment and, if so, the details of the payment to be made.

Insurers should be required to put in place a process by which they will automatically pay the benefit from a valid claim. Therefore, as part of the application process the method and place of paying the policyholder should be captured.

The product application report must specify the claim processing and payment speeds (turnaround times for the settlements) the product will aim to meet and justify the reason for this.

4.11 Dispute / Grievance resolution mechanism

The insurer should specify the appropriate dispute resolution mechanism that it will follow in the case of any disputes between parties involved in the provision of data, calculation of the index or payment of claims. This should also cover how complaints by policyholders will be resolved.

The regulator has to set out an escalation mechanism for the dispute/grievance resolution mechanism. At first the customer has to be directed to the Insurer to seek for clarification, in case of non-satisfaction the further recourse for escalation has to be made available.

While doing the framework the regulator has to specify the time limits in which the complaint has to be attended and resolved. In case of any noncompliance with the complaint resolution it should be brought to the notice of the regulator and appropriate action should be taken.

This mechanism must be approved by the Authority prior to the launch of the product.

5.0 Valuation, reporting and sales requirements

5.1 Product category and commission caps

Due to the unique nature of the index insurance products, the Insurance Regulations should specify “index-based insurance” as a separate class of insurance business

Insurers should first apply for permission and receive approval from the Authority to sell index-based insurance before being allowed to do so.

Where index-based insurance is also microinsurance, insurers should be required to report their index-based microinsurance business separately.

In addition, the commission level cap that applies to index-based insurance should be set to reflect a realistic estimate of the costs involved in the distribution of index-based insurance.

5.2 Bundling of products

Because of the nature of the product, and because an indemnity is not provided, insurers should be allowed to bundle index- based insurance products with other insurance and non-insurance products. However, the sales requirements that apply to the stand-alone index-based products should still apply when the product is bundled with other insurance/non insurance products.

Proper guidelines for product bundling should be put in place. While doing so it should be clearly outlined on which type of bundling is allowed and up to what extent.

5.3 Distribution Channels

The Regulator should specify the possible distribution channels for the index insurance product. Keeping the product complexity and the insurable interest of the parties, the channel should be allowed. While doing this the appropriate channels used across the various countries are to be explored. The channels like the Banks/ MFI/Cooperative/NGO and Agri Input companies will be best suitable for product distribution.

Apart from this, it should be explored to allow the mobile network operators and aggregators to allow as a distribution channels which can enhance the outreach to a mass scale by using the technology based solutions.

5.3 Sales process

The insurer should be required to take care to prevent the policy being sold to a person who does not meet the eligibility criteria for the product. The product is targeted to reach the farmers, but always it might not be sold directly to the farmer. When it was sold through an aggregator or channel partner the necessary precautions has to be taken to safeguard the moral hazard and other issues involved in the sale process. When using the aggregators, group polices or portfolio cover, the insurer should consider the following in to consideration:

5.3.1 Aggregator

Insurers should be able to make use of aggregators to distribute the insurance to individual policyholders, if the law permits. Aggregators should be able to assist in the collection of the premium and the pay-out of the claims. However, as the contract is ultimately made between the insurer and the individual policyholder, the premiums to be collected from and claims to be paid to the policyholder must be as specified in the insurance contract.

In order to act as an aggregator, an organization does not need to have an intermediary license. However, the insurer should first submit the service level agreement between the aggregator and the insurer to the Authority before the insurer can start selling the policy through the aggregator.

Permission to continue using the third party service provider or aggregator will depend whether the requirements of the agreement has been met to a satisfactory standard.

5.3.2 Group Cover and Master policyholder

Insurers providing index-based insurance products should be able to underwrite policies on an individual or group basis.

The individuals within the group, or the group itself, should not be given the option to cancel their cover at any time during the policy period.

In the case where the master policyholder in a group cover has the right to determine the pay-out made to the individual policyholders, the method or formula used by the master policyholder to calculate the pay-outs must be agreed on between the insurer and the master policyholder and clearly documented by the insurer to avoid any confusion / dispute.

5.3.3 Portfolio cover

Insurers should be allowed to sell index-based insurance to organizations that use the policy to protect themselves against losses from the risk event, as measured by the index, adversely impacting their clients or their business interests.

Therefore, even though their clients are not the policyholders and only indirectly benefit from any pay-outs, these organizations should be allowed to purchase the product.

5.4 Ongoing product monitoring

Due to the indirect nature of the pay-out from index-based insurance, the underwriter of these products must provide the Authority with more detailed on-going product information. This is necessary in order to allow the Authority to verify whether the product provides sufficient value for money to the policyholder and that the claims are paid in line with the results of the index measurements.

Therefore, it is recommended that the following information be provided to the Authority on a periodical basis as prescribed by the regulator:

- ***Key performance indicators***

Insurers should separately collect and store the information on their index-based products. The Authority will issue guidelines on what key performance indicators the insurers should report on a periodic basis.

- ***Index and claims data***

The insurer should report the value of their index and their pay-out on each of their products, to verify that the actual payments match their contractual requirements.

The Authority may also direct the insurer to report the assessed actual losses incurred by the policyholders, in order to determine whether the design and index are sufficiently addressing the basis risk of the product.

5.5 Valuation methods

The normal rules for calculating technical liabilities, as they relate to general insurers, will almost certainly not be wholly appropriate for index- based insurance products. Therefore, the Authority should impose special conditions on insurers to ensure that policyholders are adequately protected and that there is no contagion between index-based insurance and other lines written by the insurer.

The four areas where the specific conditions should apply are:

5.5.1 Un- *E*arned Premium reserves:

In the case of traditional insurance products, premium is released from unearned premium to earned premium in tranches over the duration of the policy as the risk expires. With index-based insurance policies, the risk does not expire on a proportionate basis over the duration of the policy. Therefore, the prescribed method of calculating the unearned premium reserves for index-based insurance should reflect one of two possible methods.

The method can assume that the risk from the policy remains until the end of the insured period (when the index value is measured and the claim determined). Therefore, all premiums received should be regarded as unearned until it is known whether payment is due under any policies. Alternatively, the method can assume that the risk from the policy expires proportionally over the cover window of the policy. Therefore, the proportion of the premiums received regarded as unearned should be the proportion of the cover window that is still outstanding. This method is especially appropriate if the index can trigger multiple pay-outs over the cover period depending on its measured values.

If payments are due, the appropriate amount of premium should be treated as a known claims provision, pending payment.

5.5.2 Outstanding claim incurred reserves

For similar reasons for adjusting to the method of calculating the unearned premium reserves, the method of calculating outstanding claims incurred reserves should also adjusted for index-based insurance.

In this case, the same methods prescribed by the Authority can be used as for general insurers. However, the appointed actuary in charge of calculating the reserves should adjust the application of these methods to reflect the unique nature of index-based insurance and comment on how the reserve was calculated in valuation report.

5.5.3 Capital requirements

Due to the **covariate** nature of the index-based insurance risk, the insurer is likely to experience a number of good years and less frequent bad years. If the underwriting gains in the good years are treated as profit, there is a possibility that if the claims are sufficiently large, they will have an adverse effect on the insurer's solvency.

In order to protect the insurer against these covariate risks, sufficient capital should be held by insurers who sell index-based insurance. The Authority should therefore require specific capital requirements for insurers who sell this class of business.

5.4 Reinsurance requirements

Index-based insurance products expose insurers to catastrophic risk. Therefore, in addition to the provisioning and capital requirements, adequate reinsurance coverage should be obtained (where the premium income is sufficient to justify it).

6.0 Consumer protection

To safe guard the interest of the policy holders in various stages of the insurance distribution, the following rights should be focused while designing the consumer protection guidelines

- Right to professional diligence
- Right to Protection against unfair terms of contract
- Right to Protection against unfair market conduct
- Right to requirement of fair disclosure
- Protection from conflict of interest of advices

6.1 Market conduct

The insurer should conduct their business in such a way as to not unfairly advantage themselves at the expense of the policyholder. Therefore:

i. The sales, premium collection and cover windows for the product should be specified in the policy documentation and the insurer should not be allowed to shorten or lengthen it, either directly or via removal of sales support to its agents.

ii. Policyholder should not face unreasonable barriers at the expiry of the policy to change product, switch provider, submit a claim or make a complaint.

6.2 Key features statement and marketing material

In order to ensure that consumers understand the product and the risks they are covered for, the insurer should provide its policyholders with a key features statement/brochure that will explain the following features of the index-based insurance policy sold to them:

i. State the risks against which the insurance is being provided.

ii. Explain to the policyholder what basis risk is, what the possible sources of basis risk are for the particular product, given the product design and the location of and risks faced by the policyholder.

iii. Inform the policyholder of the limited role of index-based insurance in protecting against the risk faced (the basis risk) and that the impact of other risks not covered by the index are not covered by the product.

iv. Explain that the policy covers the policyholder for an amount that depends on the measurement of the index. The material may not promise in any way to indemnify the policyholder of the losses he/she incurred due to the insured risk occurring.

v. Specify which index that will be used to determine the pay-out to the policyholder. The policy should also indicate the likely frequency at which the index would trigger a pay-out and highlight the catastrophic or else working cover nature of the product.

vi. Specify the eligibility criteria of the policy, including what criteria will be used to determine whether the policyholder has an insurable interest at the time the contract is entered into, and the possible consequences if the policyholder does not meet the eligibility criteria.

The marketing material provided to potential policyholders should provide clear information and keep the policyholder appropriately informed before, during and after the point of sale.

6.3 Claim processing and payment speed

In order to improve the trust and effectiveness of index-based insurance, all payments for index-based insurance policies must be verified, communicated to the policyholder and paid within specified days(to be specified) days after the claim date implied by the index and contract, or the end of the contract period, whichever is earlier.

However, for some product designs, the claim processing and payment speeds will have to be shorter. This is especially the case for index-based insurance products that covers mitigation costs and/or uses an index based on a predictive variable. It is also the case of index-based microinsurance business.

In these cases, the insurer should specify a faster claim processing and payment speed when designing the product. The Authority should take the purpose of the product into account when reviewing the specified speed as part of the product application. It should also monitor the actual processing and payment speeds against this faster requirement.

6.4 Independent data validation

If the insurer has to appoint an independent body or person to verify the data used for calculating the index value, the insurer should have a service level agreement with this independent body. The service level agreement should specify:

a) The responsibilities of the independent body;

b) How conflicts over the verified data, calculated index values and the benefits to be paid will be resolved;

c) The requirement of the independent body to report to the Authority if it suspects that the insurer has not correctly notified and paid the policyholders where a benefit is due;
d) What penalties the independent body will be liable for if they calculate the data and index value incorrectly or if they fail to perform their responsibilities as required by the service level agreement.

The final responsibility for the accuracy of the data and claims should remain with the insurer.

6.5 Market conduct supervision and complaint resolution

In order to ensure that the insurer has calculated the index value correctly and made all the contractual payments, the Authority should implement specific market conduct supervision requirements for index-based insurance products. The Authority should also issue guidelines on how the insurers should structure the dispute resolution mechanisms.

The Regulations should require specific penalties for insurers who breach the requirement to initiate and make the necessary claim payments.

The Authority should have the power to appoint an independent expert to review any complaints lodged by policyholders on their index-based insurance policies. The independent expert should be given full access to the index data and the method of calculating the index value.

6.6 Capacity building and consumer education

There is currently a lack of capacity in the insurance industry to design, underwrite and correctly sell index-based insurance. Therefore, the Authority should develop this capacity by supporting the training of experts in the field.

There is also a lack us knowledge, understanding and trust in the product by the community members/ target clientele. Therefore, the Authority should support the development of consumer education material and assist in educating the public on how the product works and when it should be used.

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