

ACCESS TO FINANCE

DEVELOPING THE MICROINSURANCE MARKET IN MONGOLIA





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Asian Development Bank

ACCESS TO FINANCE DEVELOPING THE MICROINSURANCE MARKET IN MONGOLIA

Access to Insurance Initiative

Kelly Rendek and Martina Wiedmaier-Pfister

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Note:

In this publication, "\$" refers to US dollars.
MNT = Mongolian togrog

6 ADB Avenue, Mandaluyong City
1550 Metro Manila, Philippines
Tel +63 2 632 4444
Fax +63 2 636 2444
www.adb.org

For orders, please contact:
Public Information Center
Fax +63 2 636 2584
adbpub@adb.org

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Foreword

Mongolia has made significant progress in developing and strengthening its financial services and regulation in the last 2 decades, particularly as it transitioned to a democratic, free market economy and in the aftermath of several banking crises in the 1990s. However, the challenge of providing adequate and equitable financial services to its population of just under 3 million remains, especially those who are most vulnerable to financial risks and economic shocks.

To mitigate these risks, there needs to be a sound portfolio of affordable insurance products and services made easily available to the public. Access to microinsurance can help vulnerable households maintain a sense of financial confidence in the face of illnesses, injuries, or even death of family members, loss of property or natural catastrophes. The effect of these risks on their limited financial resources could prove to be fatal.

Mongolia's microinsurance industry is still in its nascent stage, with pilot projects initiated only in recent years. To assess the opportunities and challenges for microinsurance, Mongolia's Financial Regulatory Commission collaborated with the Asian Development Bank (ADB), the Access to Insurance Initiative of the International Association of Insurance Supervisors, and the German International Cooperation to undertake a diagnostic analysis of the insurance industry in general, and microinsurance, in particular. The aim is to stimulate local stakeholder process to adopt strategies to further develop and expand the microinsurance market in Mongolia. Simply put, the intent is to provide people with better access to insurance products and services, especially those who are poor and underserved.

This study builds on prior initiatives of various donor organizations that contributed research, capacity building, awareness and lessons learned from pilot projects in Mongolia. Key impediments to the development of the microinsurance industry were identified, i.e., from the lack of widespread, cost-effective distribution channels to the inadequate technical capacity of the financial regulator and policy makers of the insurance industry as a whole. This report also presents recommended strategies to address these constraints.

It is ADB's sincere hope that the publication of this report will help regulators, policy makers, and other industry stakeholders better understand and effectively respond to the challenges in the development of microinsurance in Mongolia, and in other developing member countries at a similar development stage. For its part, the ADB stands ready to continue supporting the Government of Mongolia in its efforts to provide an enabling environment for its financial sector to thrive, and to make available various affordable financial products and services to its people.



Ayumi Konishi
Director General
East Asia Department
Asian Development Bank

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About the Access to Insurance Initiative

The Access to Insurance Initiative (www.access-to-insurance.org) is a global partnership of insurance supervisors and development agencies. It is designed to increase voluntary usage of suitable insurance products by contributing to sound policies, regulation, and supervision; through best practice, guidance, and standards. Under the primacy of the International Association of Insurance Supervisors (IAIS), the initiative generates knowledge and contributes to the IAIS standard setting and capacity development measures for supervisors.

The initiative was founded in October 2009 as a partnership among (i) the IAIS, (ii) the German Federal Ministry for Economic Cooperation and Development (BMZ) together with the German Technical Cooperation, (iii) the Consultative Group to Assist the Poor, (iv) the International Labour Organization (ILO), and (v) the South Africa-based FinMark Trust. The United Nations Capital Development Fund and ADB joined as partners in 2010. GIZ is hosting the secretariat on behalf of BMZ.

It conducts diagnostics of the insurance market and related policy, regulatory, and supervisory environment in selected countries to (i) develop country-specific recommendations, (ii) generate cross-country learning on the most suitable approaches that facilitate the growth of microinsurance, and (iii) contribute to the standard-setting process of the IAIS.

The initiative also supports implementation efforts to enhance access to insurance markets on a selective basis. Regular dialogue and dissemination events to develop the capacity of supervisors and other authorities complement the Initiative's activities.

Abbreviations

ADB	Asian Development Bank
A2II	Access to Insurance Initiative
BMZ	Bundesministerium für Wirtschaftliche Zusammenarbeit und Entwicklung (Federal Ministry for Economic Cooperation and Development)
BOM	Bank of Mongolia
CGAP	Consultative Group to Assist the Poor
FRC	Financial Regulatory Commission
GDP	gross domestic product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit (German International Cooperation)
GWP	gross written premium
IAA	International Actuarial Association
IAIS	International Association of Insurance Supervisors
IBLIP	Index-Based Livestock Insurance Program
ICP	insurance core principle
ILO	International Labour Organization
MFI	microfinance institution
MOF	Ministry of Finance
MIA	Mongolian Insurers Association
MNT	Mongolian togrog
NBFI	nonbanking financial institution
NGO	nongovernment organization
NSO	National Statistical Office
SCC	savings and credit cooperative
TA	technical assistance
UNDP	United Nations Development Programme

Executive Summary

Mongolia is the world's 19th largest country, landlocked between the Russian Federation and the People's Republic of China. It has the lowest population density in the world with a population of about 2.9 million. Over 60% of the population lives in urban areas, about 40% of which dwells in the capital city of Ulaanbaatar. The remaining rural population is scattered over wide distances, resulting to challenges in transportation, service delivery, and communication.

Since 1990, Mongolia has gone through a challenging transition from a socialist state to a constitutional democracy and a free market economy. While turbulent at times, the transition has proceeded more smoothly and rapidly than in other former communist countries. The transition, however, placed considerable stress on certain segments of the population, and the cessation of financial support from the former Soviet Union has led to a decline in literacy rates, education, and health care services.

Mongolia's finance industry also experienced difficulties during the last 2 decades, but has emerged strengthened by the process. The banking crises of 1995, 1996, and 1999 led to the enhancement of the banking system's structure and regulation.

The commercial insurance market is still at its infancy since the Government of Mongolia was the sole and direct provider of insurance for many years. The past 2 decades saw the privatization of the government insurance entity and the emergence of new market entrants. Currently, the insurance industry accounts for only 0.9% of the total assets in the finance sector, and gross written premium amounted to only 0.54% of Mongolia's gross domestic production 2013.

The insurance market is concentrated among the top 7 of the 16 nonlife insurers in Mongolia. The largest, and the successor of the former state insurance company, Mongol Insurance, has a market share of about 30%. An analysis of claims and expense ratios denote the relative inefficiency of Mongolia's insurance industry. National Life, the only life insurance company in Mongolia, has yet to turn a profit since it operated in 2008.

Mongolia maintains an extensive government social insurance scheme including pensions, benefits, health, occupational injury and illnesses, and unemployment. The government assumes contributions for certain population segments such as the elderly, the disabled, and the poor. Many, particularly among voluntary participants, remain uninsured. The health care scheme is currently under review to make coverage mandatory for all citizens.

The private insurance business model presents a new paradigm in Mongolia, shifting the government's role from a direct provider to a market facilitator. This limits the mandate of the insurance supervisor to creating an environment that facilitates innovation and fosters competition while protecting consumers.

Established in 2006, the Financial Regulatory Commission (FRC) regulates and supervises nonbanking financial institutions including credit unions and non-deposit-taking lenders, capital markets, and insurance companies. The FRC issues insurance regulations and issues licenses for insurers, agents, brokers, loss adjusters, and actuaries. Despite its relatively recent formation, it has made significant strides in issuing regulations for insurance operations, supervising performance, and promoting professionalism in the insurance industry.

While Mongolia has no specific regulation on microinsurance, the FRC internally considers policies with under MNT10,000 (\$8) annual premiums as microinsurance policies. However, there are no separate categories for reporting or regulating microinsurance. The insurance regulatory environment does not specifically consider microinsurance clients, providers, or intermediaries as entities specializing in microinsurance.

Expanding access to financial services in the underserved population is part of the mandate of the Financial Stability Committee of the government. But, given the Mongolian banking crisis in the recent past, the committee's priority has been ensuring banks' stability to prevent a collapse of the economy. The development of the nonbanking sector, in general, has therefore received limited priority from a policy standpoint.

The microinsurance market in Mongolia is in its early stages, and microinsurance pilots have only been initiated in the last few years. Existing products include health insurance offered through the microinsurance project of the United Nations Development Programme, health and accident coverage under Tenger's microinsurance product, and index-based livestock insurance offered through the Index-Based Livestock Insurance Program. So far, none of these programs have demonstrated sufficient success for long-term sustainability.

Analysis of these pilot projects reveal a number of emerging lessons that can be leveraged for future microinsurance development:

- (i) Private health microinsurance products in Mongolia need to be integrated with the benefits and structure of the existing public health system. Reimbursement procedures for insured medical expenses need to be carefully designed so that incentives for policyholders, insurers, and health care providers are appropriately aligned.
- (ii) Cost-effective distribution is a key challenge given the large distances, low population density, and manual premium collection processes.
- (iii) The willingness of insurance providers to proactively drive and participate in the microinsurance market is a crucial element. Commercial insurers have shown interest in developing microinsurance programs primarily due to the significant amount of available donor funding.

New focus group research and prior microinsurance market research reveal a sizable unmet need for insurance products in Mongolia. Health risks are identified as the primary risk faced by this market, followed by disability and business risks. Some community risk management efforts exist, but are not widespread. This suggests that with the right products and distribution approach, there is room for development in the microinsurance market.

However, the potential market is likely to be small given even optimistic assumptions. If the poorest 25% of the population, who are unlikely able to afford even low premiums, and the wealthiest 15%, who are able to purchase higher end products, are excluded from the potential microinsurance market, the maximum size of the market is only about 430,000 households. Even with this number, lack of financial education and understanding of insurance serve as a significant barrier to developing this potential market. Cultural aspects and experiences with social insurance also create a negative predisposition toward private insurance.

Perhaps the biggest challenge is the lack of widespread, cost-effective distribution channels. This is crucial to keeping microinsurance premiums affordable. Nontraditional distribution channels are often needed to reach clients in remote locations. Leveraging the existing networks of banks, microfinance institutions (MFIs) and other nonbanking financial institutions (NBFIs) would help establish microinsurance in Mongolia. Technology developments for mobile banking and payment systems may facilitate premium collection and claims payment, and demonstrate potential for new microinsurance distribution models.

Inadequate technical capacity is another constraint in developing Mongolia's insurance market. Innovation in the microinsurance sector is not likely to succeed or be sustained without improving the current capacity of the broader insurance sector; including the industry, the financial regulator, and policy makers. Investment in capacity building will develop the entire insurance industry and support the growth of microinsurance.

Donor involvement is a key driver of microinsurance in Mongolia. Support from donors spurred important pilot projects and enabled research, capacity building, and awareness on microinsurance. Consequently, donor funding generates interest in microinsurance from industry participants. However, donor involvement can also be a limiting factor to effective market development, skewing the rational allocation of scarce national resources toward the development of the insurance market.

Strategies and Recommendations

Many of the recommendations focus on the need to expand regulatory options for innovative and cost-effective distribution mechanisms. This is a key priority that will result in the immediate opening of the insurance and microinsurance market. Particularly, allowing all currently regulated financial institutions such as banks, MFIs, and NBFIs to act as both insurance agents and brokers will have an immediate impact.

Focusing initial microinsurance efforts to the urban population makes sense given the challenges in reaching the rural population. Existing community groups such as cooperatives, associations, teachers, or borrowers would seem to be the easiest market to reach. As insurers and the FRC are still learning from existing microinsurance projects, pilots in areas with higher population concentrations and more developed distribution channels will allow faster learning. These lessons can then be extrapolated to expand projects into more challenging segments.

A potential direction for the FRC to consider in expanding the microinsurance market would be a simple definition of microinsurance products allowable under both the existing "Ordinary" and "Long-Term" insurance classifications. It would permit both life and nonlife insurers to offer composite microinsurance products that qualify under the benefit definition and limits. As Mongolia currently has only one life insurance company, it will expand the microinsurance market in a controlled manner while allowing the nascent

life insurance industry to develop. The initiative would be innovative within the worldwide microinsurance community, and provide leadership for other countries.

In summary, the development of microinsurance in Mongolia needs to be considered within the context of overall insurance market and regulatory environment development. It is difficult to develop the microinsurance market without a viable life insurance segment or a strong nonlife retail insurance focus. While certain regulatory achievements have already been made, there is an urgent need to improve the overall regulation and technical capacity of the insurance industry before the microinsurance segment can be sustainably developed.

Introduction

This study was commissioned by the Financial Regulatory Commission (FRC) of Mongolia, under a regional technical assistance project with the Asian Development Bank (ADB), and in collaboration with the Access to Insurance Initiative. It builds on a number of microinsurance development projects in Mongolia, as well as previous analyses of the insurance regulatory system.

The project's objective is to study the potential opportunities and challenges for microinsurance in Mongolia, using the methodologies of the Access to Insurance Initiative. The scope includes a review of the country-specific context, supply-side and demand-side issues, as well as an analysis of the current policy and regulatory framework. This review and consultation is intended to spur a local stakeholder process that could adopt and oversee strategies to support microinsurance development in Mongolia.

Definition of Microinsurance

Microinsurance, as defined by the International Association of Insurance Supervisors (IAIS) and endorsed by the Access to Insurance Initiative, is the insurance accessed by low-income people, provided by a variety of institutions, run in accordance with generally accepted insurance principles, and funded by premiums.

This definition conveys a number of important principles. First, microinsurance is not a stand-alone concept or financial product, but is integrated into and influenced by the overall insurance environment and general financial services sector. Products under microinsurance schemes can therefore include insurance for any risk or contingency covered by traditional insurance products.

The definition of microinsurance explicitly indicates that such insurance should be funded by premiums and run in accordance with accepted insurance principles, which provide that premiums should be proportionate to the risk. Social welfare programs and emergency assistance by governments are therefore excluded. Microinsurance can include, however, insurance providers other than insurance companies or microfinance organizations, such as government, other commercial entities, and nonprofit organizations. It is also not limited to insurance for individuals, but can include insurance products developed for small businesses or other groups.

Microinsurance focuses on providing access to insurance products and services to populations that are traditionally underserved. Its definition specifically refers to low-income people, who may have less access to traditional insurance products for several reasons: unaffordable premiums, inappropriate product designs, or providers focused on serving the more traditional and profitable middle to high income market. Other definitions of microinsurance either focus more on product characteristics, or on a quantitative description such as level of benefit or premium.

Notably, majority of Mongolia's population could be considered poor or vulnerable, and the reach of traditional insurance is very minimal; microinsurance for Mongolia's population can be considered almost mainstream. The issues are therefore less about the income level of the microinsurance market, as they are about (i) appropriate product design;(ii) affordable premiums; and (iii) delivery mechanisms designed to meet a small, geographically dispersed, and economically vulnerable population.

An important issue in Mongolia is the negative connotation associated with labeling people as "poor" or "low income." Due to a strong legacy from the previous communist government, there is a cultural preference to treat everyone equally. Along this line, Mongolian participants in the diagnostic process preferred defining microinsurance not as insurance for "poor" or "low-income" people, but rather as insurance that is available to all, irrespective of wealth, including those who have no access to traditional insurance products. Microinsurance in this context possibly means making insurance available and accessible to anyone who wants or needs it. This is a broader concept of microinsurance than that often used, but is still consistent with the objectives of the Access to Insurance Initiative to promote policies of financial inclusion and access to insurance for underserved populations.

Therefore, while the authors provide an analysis of income segments and poverty, they work with a broad definition of microinsurance for this review that includes, as its foundation, the premise of providing full access to appropriate and affordable insurance services to those who currently do not have such access. This broad definition hopefully fosters market development and an appropriate regulatory environment.

Methodology

This review used materials from a wide variety of sources, including previously published material, industry data from the FRC, and interviews and workshops conducted in Mongolia.

The primary in-country visit was conducted over 3 weeks in March and April 2011, which included a half-day workshop with key stakeholders and individual meetings with industry participants. The activity included interviews with the FRC's director of insurance, FRC insurance department staff, the Ministry of Finance, the Ministry of Social Welfare, several insurance companies, current microinsurance providers and/or programs, insurance industry associations, insurance brokers, banks, nongovernment organizations (NGOs), cooperatives, mobile banking projects, as well as current and potential microinsurance clients.

Following an initial analysis, the diagnostic team returned to Mongolia in early July 2011 to present preliminary findings and suggestions. This involved a half-day dialogue workshop with many of the same key stakeholders, as well as separate meetings with the FRC insurance director and the newly appointed deputy chair of the FRC. Inputs from the interim review have been incorporated into this paper's conclusions and recommendations.

The final report will be presented and discussed in a full stakeholder workshop with the goal of designing appropriate implementation strategies based on the findings and recommendations.

Structure of Analysis

This report is structured following the diagnostic methodology: Section 4 presents the wider context of Mongolia, socioeconomic factors, and a summary on the financial services industry. Section 5 presents a detailed analysis of the overall insurance market, followed by a separate discussion of the existing microinsurance landscape in Section 6.

Section 7 looks at the demand for microinsurance in Mongolia. As microinsurance is quite new, there is little evidence of demand, so this section focuses more on developing the profile of potential microinsurance clients as found during the focus group research and other market studies.

Section 8 discusses the issues of insurance policy, regulation and supervision, mainly to identify gaps or barriers that might impact the development of microinsurance.

Section 9 outlines the key drivers for developing microinsurance in Mongolia, and Section 10 provides a set of recommendations for developing strategies to move forward. The review concludes in Section 11 with initial implementation priorities.

Context

Since 1990, Mongolia has gone through a challenging transition from a socialist state to a constitutional democracy and a free market economy. While turbulent at times, the transition has proceeded more smoothly and rapidly than in other former communist countries. The transition, however, put pressure on certain population segments, and the cessation of financial support from the former Soviet Union has led to a decline in literacy rates, education, and health care services.

The country had experienced periods of deep recession and economic growth, the most recent cycle occurring from 2008 until the present. Income disparity among various groups continues to rise, and an average of 39% of the population lives below poverty level. Over 40% of the population lives in the capital city of Ulaanbaatar, while the rest is widely dispersed over a vast, difficult terrain.

Mongolia is divided into 21 administrative units known as *aimags* (provinces), which are further subdivided into *soums* (districts). Ulaanbaatar is administered as a separate region, divided into 9 districts known as *khoroos*.

Macroeconomic Trends

Agriculture and mining activities constitute most of Mongolia's economy, making it vulnerable to severe weather conditions and copper and gold prices.

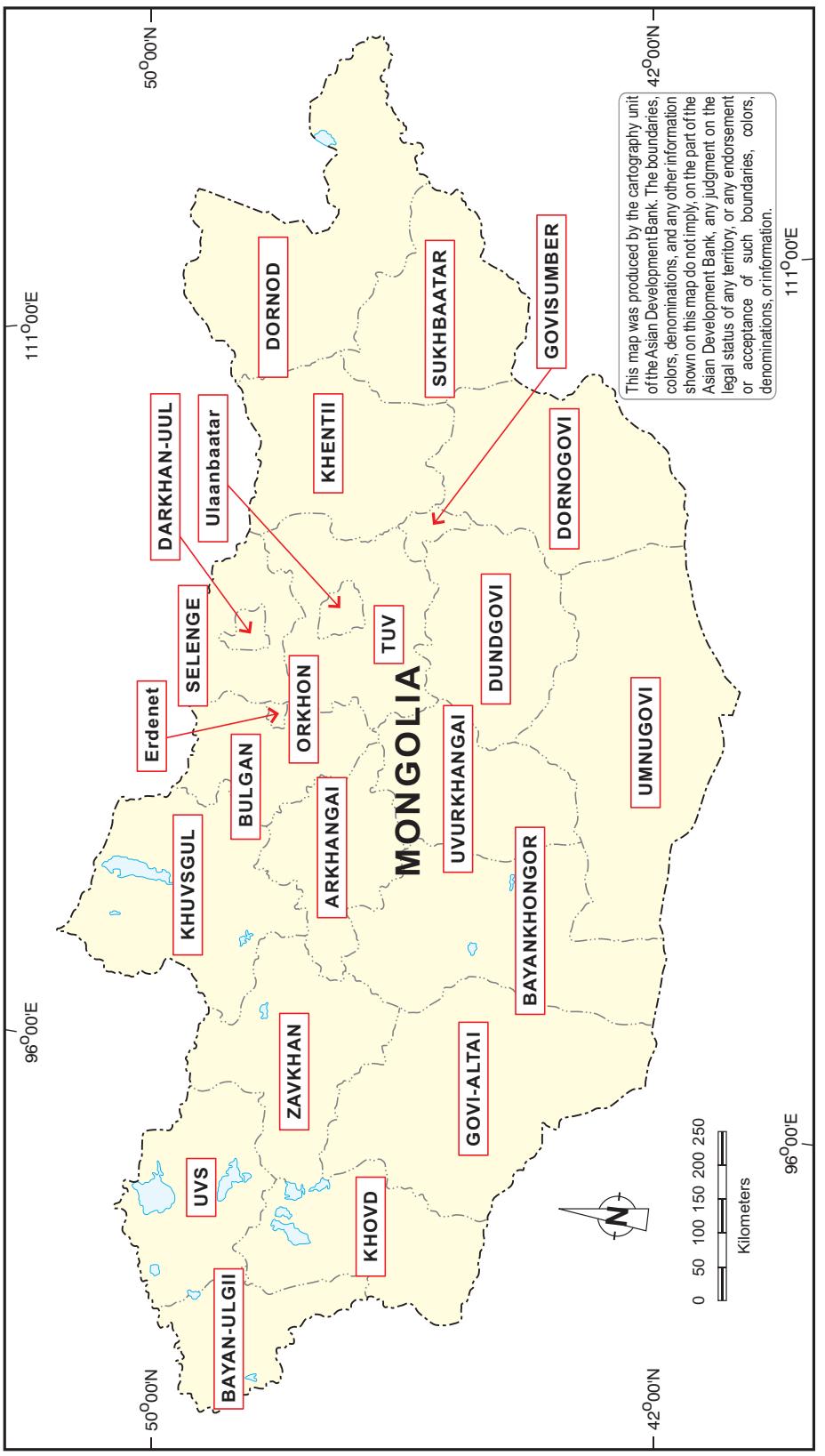
Harsh winters in 2000 and 2001 took a heavy toll on livestock. Compounded by falling export prices, they resulted to zero or negative growth in gross domestic product (GDP). From 2004 to 2008, Mongolia experienced average annual growth of close to 9%, largely as a result of high copper prices and new gold production. Inflation rate soared in 2008, only to drop again with falling commodity prices and the fallout from the global financial crisis.¹

The price of copper dropped 70% by the end of 2008, triggering a financial crisis. In 2009, the International Monetary Fund extended an 18-month Stand-By Arrangement with Mongolia to restore economic stability.² As economic activity stabilized and copper price rebounded in 2009, Mongolia returned to economic growth. The end of 2010 saw further growth, primarily due to the booming mining sector. However, inflation rose again, and Mongolia's economy continued to be vulnerable to both internal and external influences.

¹ CIA. 2011. *The World Factbook*. <https://www.cia.gov/library/publications/the-world-factbook/geos/mg.html> (accessed 26 August 2011).

² International Monetary Fund (IMF). 2011a. Ex Post Evaluation of Exceptional Access Under the 2009 Stand-By Arrangement. Washington, DC: IMF

Figure 1: Map of Mongolia at Aimag Level



Socioeconomic Trends

Mongolia is the world's 19th largest country, landlocked between the Russian Federation and the People's Republic of China. With a population of only over 2.9 million,³ it has the lowest population density in the world. Over 60% of the population lives in urban areas, approximately 40% of which dwells in the capital city of Ulaanbaatar. Darkhan-Uul, Erdenet (Orkhon *aimag*) and Choibalsan (Dornod *aimag*) are the primary urban centers outside the capital. The remaining rural population is scattered over wide distances, resulting in significant challenges in transportation, service delivery, and communication. More than half of Mongolia's population now lives in or near urban centers.

Mongolia is considered a young country, with over 58% of its population under age 30. This trend is likely to continue as fertility rate has been increasing over the last several years. Females outnumber males at all age groups over 20 years, and represent over 51% of the total population.

Employment and labor force

Employment patterns have changed dramatically over the last 20 years as Mongolia shifted from a socialist to a free market economy. During the 1990s, most businesses and collective livestock herds were privatized, bringing wealth to some while leaving others vulnerable to harsh winters and uncertain income. The privatization of state-owned enterprises pushed many out of the formal workforce, and led to the development of a larger informal economy. In contrast, Mongolia's mining sector rapidly developed in recent years.

Agricultural workers declined over the years, as harsh winters in 2000 and 2001 caused many herders to abandon the countryside and move to urban centers. Employment in agriculture relative to total employment was close to 50% from 1998–2001,⁴ but has dropped steadily to current 35%. Another harsh winter in 2010 killed roughly 22% of Mongolia's livestock, causing a new wave of migration to the cities.

Total unemployment rate for 2009 stood at 11.6%, significantly higher compared to 2007–2008 period where the estimated unemployment rate was at 9.2%.

It is difficult to estimate the scale of the informal economy from the official statistics. A January 2011 World Bank report indicates that total workers and real wages in informal markets increased in September 2009 to September 2010, but dropped significantly in the following period.⁵

The size of the informal labor market could be deduced from the number of people paying social insurance premiums: these are compulsory for those formally employed and voluntary for those who are self-employed, herders, or unemployed. Many in the informal economy choose not to pay these premiums, and only 55% of the employed population was paying compulsory social insurance premiums based on Mongolia's 2009 figures.⁶ Considering the number of those officially unemployed who may also participate in the

³ National Statistical Office of Mongolia. <http://www.nso.mn/v3/index2.php>

⁴ World Bank. 2011. *The World Bank: Data by country - Mongolia*. Washington, DC: World Bank. <http://data.worldbank.org/country/mongolia> (accessed 27 August 2011).

⁵ World Bank. 2011. *Mongolia Quarterly Economic Update (January 2011)*. Washington, DC: World Bank.

⁶ Government of Mongolia, National Statistical Office of Mongolia. 2009. *Mongolian Statistical Yearbook*. Ulaanbaatar: Government of Mongolia.

informal sector and adjusting for employment in agriculture, approximately 10%–20% of the economically active population is involved in the informal economy.

Education

In contrast to other developing countries, Mongolia enjoys a strong emphasis on education for all and a high level of literacy among its population. By 1989, adult literacy levels were as high as 97%, although the transition to democracy led to a subsequent decline in overall literacy rates. Literacy remains high in most areas of the country nonetheless, except among smaller ethnic groups such as the Kazakh minority in the western *aimag* of Bayan-Ulgii and the Tsaatan in northern Khovskol.⁷

School enrollment also suffered an immediate decline in the early years of democracy, though the downward trend is slowly being reversed. Gross enrollment ratios are high across all of Mongolia's regions, posting a national average of 99.2% for primary and 93.2% for secondary education in 2009. Dropout rates are also low, but slightly higher for males than female. Females have higher school enrollment, higher graduation rates, and higher literacy rates; and about two-thirds of the university graduates in 2009 were female. One explanation is that boys are more frequently withdrawn from school to help earn income.

Household Income and Measures of Poverty

Sources and overall levels of household income vary significantly between urban and rural areas. Those in rural areas have a higher proportion of income from agriculture and herding operations, and depend more on government transfers including pensions, social welfare payments, and other allowances.

In 2011, the government introduced new monthly payments to each Mongolian citizen,⁸ which increased the average household income by up to 30% since 2009. However, as the cost of goods and services, especially food items, has also increased significantly during this period, the net disposable income of each household may have worsened.

The Government of Mongolia defines a region-specific poverty line by calculating the minimum subsistence level in each region as detailed in Article 3 of the *Law on Defining Minimum Subsistence Level of Population* (1998).

Linking this information together, in 2009, with an average monthly household income of just over MNT455,000 for families in Ulaanbaatar, and an average household size of 4.1, the average per capita income of MNT110,976 (\$89) is just barely over the minimum subsistence level. Since the percentage of the population under this poverty line is only at 26.7% (Table 1), this indicates a wide disparity in incomes both above and below the average. Additional statistics from the National Statistical Office (2009) indicate that the consumption levels of the nonpoor are 2.6 times greater than those of the poor. An analysis of income and expenditures by quintile shows a large and increasing gap between the rich and the poor in Mongolia.

⁷ B. Yembuu and K. Munkh-Eredene. Paper commissioned for the EFA Global Monitoring Report 2006. Ulaanbaatar: EFA.

⁸ In 2009, the Government of Mongolia created the Human Development Fund, an investment fund to collect and manage mining revenues and taxes. In January 2011, the government began paying, through direct bank deposits, each Mongolian citizen MNT21,000 (\$17) per month, referred to as the "motherland payments."

**Table 1: Minimum Monthly Subsistence Level
(per capita, in MNT)**

Region	2006	2007	Feb 2008	Oct 2008	2009	2010	2011
West	37,000	54,700	70,700	94,300	96,100	97,000	104,300
East	34,800	51,800	65,600	85,100	86,300	90,900	105,100
Central	39,000	56,700	73,100	90,800	91,200	91,700	106,600
Khangai	38,300	54,600	70,600	89,000	90,600	91,500	105,100
Ulaanbaatar	42,800	60,100	73,300	94,800	101,100	101,600	118,100

Source: National Statistics Office of Mongolia.

According to the World Bank's 2005 online dataset, 49.1% of Mongolia's population lives on less than \$2 a day; and about 22% of the population lives on less than \$1.25 a day.

Mongolia also ranked low: 110 out of 187 nations, in UNDP's 2011 Human Development Index, a composite index including elements of life expectancy, education, and income. In 2010, Mongolia ranked further down compared to its 102 rank.

Financial Services

Mongolia's financial services mostly comprises commercial banks: as of June 2010, approximately 95.6% of the industry's total assets is held by banks,⁹ with the remaining 4.4% divided among nonbanking financial institutions (NBFIs) such as insurance companies, microlending institutions, and savings and credit cooperatives (SCCs). The sector currently consists of 14 commercial banks, 16 insurance companies, 143 SCCs (as of Q32013), and 188 other NBFIs.¹⁰ The Bank of Mongolia (BOM) regulates and supervises the commercial banks, while the Financial Regulatory Commission (FRC), established in 2006, oversees all nonbanking financial institutions.

The industry has been through hard times during the last 2 decades, but has emerged strengthened by the process. The banking crises of 1995, 1996, and 1999 led to the strengthening of the banking system's structure and regulation; fueling the industry's growth up to 2008. The significant drop in the price of copper caused another crisis by end of 2008, which resulted in two of the commercial banks being placed under receivership.

Following the 2008 crisis, the Government of Mongolia made a blanket guarantee on all commercial bank deposits, which has since been tightened and will eventually be phased out in favor of a limited deposit insurance scheme. The parliament approved a revised banking law in 2010, but implementation challenges remain. While the overall regulatory structure for commercial banks has been strengthened, significant weaknesses in execution and supervision exist. The industry is exposed to a number of risks, and reforming the industry remains a priority for the government.

Banks and Microfinance

Banking is highly concentrated to three dominant commercial banks: Khan Bank, Trade and Development Bank, and Golomt Bank. Mongolia enjoys a huge network of

⁹ World Bank. 2011. *Mongolia Quarterly Economic Update*. Washington, DC: World Bank.

¹⁰ Bank of Mongolia. <http://www.mongolbank.mn> (accessed 27 August 2011)

bank branches throughout the country according to World Bank statistics (footnote 4). However, the numbers do not provide details with respect to the geographical dispersion of bank branches. It could well be the case that there are more bank branches than necessary in urban locations, and few in rural areas.

Khan Bank and Xac Bank are the leading providers of microfinance services, along with other institutions including Credit Mongol, Vision Fund, Mongol Post Bank, and TransCapital Financial Services. Almost all financial institutions provide some services to the lower income segment, but only Xac Bank, Credit Mongol, Vision Fund, and TransCapital Financial Services market themselves specifically as microfinance institutions.

As Mongolia's largest bank, Khan Bank has the widest distribution of rural branches and the greatest outreach. Microfinance funding partners and network members include Kiva, Mercy Corps, the Mongolian Microfinance Association, Vision Fund International, International Finance Corporation, Women's World Banking, and Oikocredit, among others. Statistics from 2009 indicate the size of the microfinance sector in Mongolia.¹¹

Table 2: Microfinance Usage in Mongolia, 2009

Microfinance Institution	Number of Deposit Accounts	Deposits (MNT)	Number of Active Borrowers	Loan portfolio, Gross (MNT)	Percentage of Women Borrowers (%)
Khan Bank	2,446,687	1,064,781,030	309,866	641,888,803	44.9
Xac Bank	194,286	166,857,857	75,736	263,594,653	55.0
Credit Mongol	2,203	6,935,024	49.2
TFS	1	2,235,249	1.1

... = data not available, TFS = Transcapital Financial Services.

Source: Microfinance Information Exchange, Mongolia.

A 2009 industry report by the Microfinance Initiative for Asia¹² listed the following priorities for development of the sector, which include indirect opportunities for the development of microinsurance: (i) development of mechanisms to improve outreach in rural areas through information technology improvements (e.g., mobile phone banking, points of sale, Internet banking); (ii) improvement of the product mix to increase customer outreach through agency arrangements (e.g., for insurance), non-collateralized loan products, and savings mobilization; (iii) improved risk management systems to monitor and/or hedge foreign currency borrowing; and (iv) funding diversification through savings mobilization.

Savings and Credit Cooperatives

The original Law on Cooperatives was adopted in 1998 and did not distinguish between the financial intermediation activities of savings and credit cooperatives and cooperatives created to provide nonfinancial services to their members. A 2002 revision of the law specifically acknowledged SCCs, but regulation was not under any government agency until the FRC was formed in 2006. In the meantime, new legislation was drafted in 2006,

¹¹ Microfinance Information Exchange. *Mix Market*. <http://www.mixmarket.org/mfi/country/Mongolia> (accessed 27 August 2011)

¹² Microfinance Initiative for Asia. 2009. *Mongolia: Microfinance and Financial Sector Diagnostic Study*. Washington, DC: International Finance Corporation.

subsequently revised in 2010, and approved into law by the parliament in December 2011.¹³ The newly enacted law on Savings and Cooperatives stipulates the legal and regulatory framework that governs SCCs and its operations in Mongolia.

Currently, 143 SCCs operate, and are licensed by the FRC. The FRC's ability to directly supervise all of the licensed SCCs is constrained by training and resources, and it is considering a tiered supervision structure similar to that in other countries.

SCCs concentrate on savings and lending, and do not provide insurance.

Capital Markets

The Mongolian Stock Exchange was established in 1991, primarily to assist the government in privatizing 474 state-owned enterprises. Secondary market trading began in 1995, and many of the newly privatized companies reorganized as limited liability companies (LLC) were delisted. The Mongolian Stock Exchange currently lists 336 companies, with a market capitalization of MNT1,373.9 billion (\$1.1 billion).¹⁴

As the capital market is still new in Mongolia, it is relatively small compared to other markets in the region, and lacks liquidity and depth. Participation by institutional investors such as insurers could improve the depth and quality of the market; however, the development of a capital market hinges on effective implementation of sound international practices in accounting, auditing, and corporate governance. Favorable macroeconomic conditions can also greatly help in creating a conducive environment for capital markets to develop and flourish, in addition to ensuring that the appropriate financial infrastructure is in place and the availability of sufficiently trained human resources. The Mongolian Stock Exchange actively engages international consultants, and in December 2010, signed a cooperation agreement with the London Stock Exchange Group to develop the market and improve operations.

The absence of a well-developed capital market currently limits the investment opportunities and asset-liability management capacity of insurers. Insurance regulation also restrains the allowable asset classes for insurers. Consequently, life insurance products such as endowments and whole life are not competitive against bank deposits. This impedes the development of both traditional life insurance products as well as appropriate, relevant microinsurance products in Mongolia.

Technology

Mongolia considers itself an “early adopter” of information technology, and significant investment is under way to improve the existing technology in the communication and financial sectors.¹⁵ Mobile phone penetration is very high—four mobile phone operators cater to over 2.2 million people, with registered subscribers at over 84% of the total population by end of 2009 (footnote 4). Internet services are increasing, with over 56 internet service providers reaching over 106,000 subscribers, as of 2009. Mobile phone

¹³ International Monetary Fund. 2008. Mongolia: Financial System Stability Assessment. Washington, DC; FRC, Department of Cooperatives. 2010. *Draft Law on Savings and Credit Cooperatives - Introduction (English)*. Ulaanbaatar: FRC.

¹⁴ Mongolian Stock Exchange. 2010. *Annual Report*. Ulaanbaatar: Mongolia Stock Exchange.

¹⁵ ICTPA of Mongolia. 2010. *White Paper on ICT Development in Mongolia - 2010*. Ulaanbaatar: ICTPA.

and internet service levels have improved and prices declined over the last few years, improving cost and accessibility.

Financial services exploit these developments through mobile banking and e-payment systems, such as the initiatives by MobiFinance (a related subsidiary to one of the main mobile phone providers, Mobicom); and Xac Bank, one of the main microfinance players. MobiFinance uses a mobile payment service within the Mobicom cellphone network known as “Most Money,” which can facilitate transactions within their network and with registered commercial banks. The technology features an “e-wallet” or “stored value account” approach where fund transfers can be made directly or through agents to another Most Money subscriber. MobiFinance is expanding the network of agents and is working on interbank transfers.¹⁶

Xac Bank launched its AMAR (mobile banking) project in 2009 to provide banking services to the currently unbanked, and lower the cost of banking services. As of September 2010, AMAR had over 46,000 registered clients, with about 33% in rural areas. In addition to noncash banking transactions, cash transactions can be made through any of its 2,900 agents throughout the country. AMAR services are available through any mobile phone network, but only to Xac Bank clients.¹⁷

Despite these advances, regulation of mobile banking services is currently inadequate, although there is a working group developing new legislation. One deterrent to expansion is that under current regulations, account registration must be done in person.

Social Welfare

Mongolia’s social insurance scheme includes five types of social insurance: (i) pensions, (ii) benefits, (iii) health, (iv) worker’s compensation (occupational injury and illnesses), and (v) unemployment. Retirement, disability, and survivor pension payments fall under pensions; while benefits include maternity benefits, funeral benefits, and illness (short-term disability). Participation is mandatory for permanent employees, and voluntary for the self-employed. The government assumes contributions for those deemed as “vulnerable,” including the elderly, disabled, and poor. Currently, many among voluntary participants are not enrolled. The government is currently reviewing the health care scheme to make coverage mandatory for all citizens.

Social Health Insurance

For many years, the government was the direct provider of health care services and health insurance. With the transition to democracy in the 1990s, new systems and services were put in place, including the creation of a Health Insurance Fund. Not surprisingly, however, health care services have deteriorated over the last 2 decades, with the poor and rural residents suffering the most. While Mongolia spends more on its health care than most countries in transition, there are still crucial challenges to meet. The main barrier to accessing health care services for Mongolians are out-of-pocket costs, including user fees, or costs of receiving treatment outside of

¹⁶ Interview with J. Saruultuyam and P. Tseyen-Oidov of Mobi-Finance, Ulaanbaatar, Mongolia (31 March 2011).

¹⁷ Xac Bank. 2010. M-Banking: AMAR Service (powerpoint presentation). Ulaanbaatar, Mongolia.

their primary residential area.¹⁸ Specialized treatments are often not covered by the government scheme.

Health care coverage is estimated at 77% of the population for 2009, from previous 90% coverage at the time the Health Insurance Fund was implemented. Civil service and formal sectors are fully covered. Vulnerable populations make up 60% of those insured, with premium contributions either subsidized or fully covered by the government.¹⁹

The Health Insurance Fund is funded through premium contributions, state subsidy, and interest earned. Premium contributions for employed persons are 4% of monthly salary, equally shared by the employer and employee. Contributions for self-employed voluntary members are 1% of monthly salary, and the premium contribution for unemployed or otherwise voluntary members is MNT500 per month (\$0.40). The flat rate contribution for voluntary members has not kept up with inflation and is more like a nominal user fee than a premium contribution. At this rate, people are less aware of the true cost of medical care services.

Administration of the state health care system is somewhat complicated. The Ministry of Health provides services and runs hospitals, while the Department of Social Welfare collects contributions and administers payments. The Health Insurance Fund is managed separately. The government intends to streamline the system and improve health care services.

Pensions

The government pension scheme under the social welfare department provides pension benefits, survivor benefits, and disability benefits to retirees according to their contributions. Pensions are available to eligible males and females over 60 and 55 years, respectively.

The government is reviewing the pension system to develop a three-tiered system in Mongolia: (i) a base pension amount available to everyone, based on current income and funded by tax revenues; (ii) a secondary tier funded by employee and employer contributions, including possibly voluntary contributions from self-employed or herders; and (iii) a third tier from the private sector. There is currently no legislation on private pensions, making its operations unregulated.

The pension benefits scheme is funded on a “pay-as-you-go” basis from employer and employee salary-based contributions, as well as voluntary contributions from self-employed persons paid at the local social insurance office. Disability benefits due to non-occupational disabilities are also paid from the Pension Fund for eligible members.

Minimal survivor benefits for children and disabled family members, as well as funeral benefits in the amount of MNT300,000 (\$240), are payable under the pension scheme for employees who have made contributions for at least 36 months, or in the case of death due to occupational causes.

¹⁸ ADB. 2010. *Protecting the Health Status of the Poor During the Financial Crisis in Mongolia*. Manila.

¹⁹ ADB. 2010. *Review of the Mongolian Health Insurance System*. Ulaanbaatar: ADB; Mongolia Department of Health. 2009. *Health Indicators 2009*. Ulaanbaatar: Mongolia Department of Health.; O. Bathuyag. 2010. Mongolian Social Insurance Summary (PowerPoint presentation) Ulaanbaatar.

Social Welfare Benefits

Pension benefits for those extremely poor and outside the coverage of the Pension Fund are available from the Social Welfare Fund. The benefits are not universal and are conditional on eligibility approved by the local Livelihood Support Council.²⁰

Unemployment insurance benefits are available to employees who have made contributions for at least 9 months during the previous 24 months; benefits payable are between 45%–75% of the salary, for up to 76 days. Payment of benefits is provisional on the cause of unemployment—for example, dismissal with cause does not entitle one to state unemployment benefits.

Workers' compensation benefits are available for occupational injuries and illnesses through a separate social insurance fund, with a certain amount of benefits from employers. Disability benefits not covered through the Pension Fund or Workers Compensation Fund are paid from the Social Welfare Fund.

Social welfare benefits also include maternity leave benefits and funeral grants. Vulnerable persons receive funeral grants from the Social Welfare Fund if they are ineligible from the Pension Fund; equivalent to 75% of the benefit payable to pensioners or MNT225,000.

Article 18 of Mongolia's labor law requires employers in the formal employment segment to have a social welfare policy for occupational injuries and illness, maternity leave, funeral grants, and other benefits. A usual practice is that family, friends, and colleagues contribute donations in case of a death to cover funeral costs.

²⁰ UNFPA Mongolia Country Office. 2010. *Assuring Income Security in Old Age: Views of the Mongolian Elderly*. Ulaanbaatar: UNFPA.

Insurance

Mongolia's insurance industry accounts for only 0.9% of the financial services' total assets, and these are primarily nonlife insurance. Commercial private insurance is still very new in Mongolia since before the 1990s, insurance was provided by the state through a national government insurance organization starting in 1934.

The state insurance company was privatized in 1997 and became the Mongol Insurance Company, which remains to be Mongolia's largest insurance company. New insurers emerged in subsequent years, especially with the passing of a new insurance law in 2004. There were 17 licensed nonlife insurers by the end of 2013, while the country's only life insurance company, National Life, began operations in 2008. These insurance companies are regulated by the Financial Regulatory Commission (FRC), which was established in 2006.

Insurance penetration and density are still undeveloped compared to other countries. Mongolia's total insurance premium in 2013 was only 0.54% of its GDP, well below the average of 2.98% for emerging markets and the world average of 6.9%. Premiums in life insurance are far greater in developed countries while the opposite is usually the case in many emerging markets, including Mongolia. This may be partly due to lack of sufficient depth in capital markets, a prerequisite for the development of long-term insurance products.

Insurance Providers

Mongolia's insurance industry has been growing significantly over the last 5 years, as indicated by the increasing premiums and current assets. Mongol Insurance, the biggest insurer, has a market share of about 30% based on gross written premium. Nearly 88% of premiums are written by only seven insurers, indicating a fairly concentrated market. Aggregate net income after tax has grown from a slightly negative position in 2006 to MNT4.6 billion (\$3.69 million) by end of 2010.

National Life, the only life insurance company in Mongolia, started operations in 2008, and has yet to turn a profit.

Most of the insurance companies are privately owned. Foreign ownership is permitted so long as the insurance business is located and managed in Mongolia. Mongol Insurance and Ard Insurance are examples of local insurance companies with significant foreign ownership. Meanwhile, the state has ownership stakes in at least two of the smaller insurance companies.

The FRC approves appointments to governing positions in insurance companies. It has also issued a corporate governance code, but has yet to establish regulatory requirements for risk management and internal controls.

There are some insurance companies licensed to provide reinsurance services. Currently, there are 13 domestic reinsurance companies in Mongolia. Much of the domestic insurance business is reinsured globally; insurers do not need regulatory approval for external reinsurance but merely provide the regulator with details of their reinsurance arrangements.

Businesses in Mongolia are required, as provided in Article 17 of the Law on Insurance, to purchase their insurance through an insurer licensed in Mongolia; either from a domestic insurer or a Mongolian-licensed branch of a foreign insurer. This leads to widespread fronting arrangements, particularly with foreign mining companies, where domestic insurance policies are backed with global reinsurance and structured through Mongolian brokers who have been contracted by international brokerage operations. Although there are indications that the FRC would prefer to curtail this type of practice to protect the domestic insurance industry.

Current assets of insurance companies are invested primarily in cash and short-term instruments, due to restrictions on allowable investments²¹ and lack of depth in Mongolia's capital markets.

Informal Market

While there appears to be no significant informal insurance market in Mongolia, there are some community-based groups that provide certain types of assistance to their members—small organizations with limited reach and without any central organizational structure.

Examples of such organizations were given by participants from the focus group research, and are described in Appendix 5.

Insurance Products

The insurance products available are almost entirely short-term nonlife products, mostly sold to corporate clients. However, the retail market for life and nonlife is starting to develop, although still primarily directed at the high-income segment.

Microinsurance is a new concept, with three specific pilot projects under way, although there are several “microinsurance-like” products that could be adapted to fit the microinsurance market. This section provides an overview of insurance products in Mongolia, while Section 5 discusses microinsurance in detail.

Nonlife, Short-Term Products

Mongolia's insurance market is concentrated largely on corporations, particularly property and liability insurance for mining operations and other big industries. The retail segment is relatively undeveloped, and is focused primarily on auto insurance and personal accident policies.

²¹ FRC Resolution No. 170 (June 2010). Investments in equities are not allowed, and there are restrictions on the allowable allocation percentages for certain asset classes.

There is no mandatory insurance coverage in Mongolia although a legislation for mandatory driver's liability insurance was finalized and passed in 2011.

Long-Term Insurance, Including Life Insurance

National Life developed its products and insurance procedures with the assistance of international consultants, as well as their reinsurer, Munich Re. They are currently licensed to offer term life insurance, health insurance, endowment insurance, and pension insurance. Term life (67% of gross written premium [GWP]) and health (32% of GWP) are the primary products sold. National Life's health insurance is a high-end product that includes worldwide coverage and emergency medical assistance. The term life product is sold predominantly on a group insurance basis through employers, and by end of 2010, policies had been issued to over 2,500 persons. Disability coverage is available as a rider on the term life product and has been included with almost all policies issued to date.

National Life intends to expand its offerings but is being hampered by the lack of education and knowledge about life insurance among Mongolians. Given a cultural bias against discussing death, they are positioning their products to include more savings and investment options.

Client Value

The analysis of incurred claims and expense ratios indicates that existing insurance products in Mongolia offer limited value to clients. An incurred claims ratio shows the amount of gross premium that is being "returned" to the insured client in the form of benefits. A claims ratio of less than 50% normally indicates poor insurance value for clients: more than half of the premium is being used to pay for expenses or is contributing to profit rather than being paid as claims. Low claims ratios may indicate that premiums are too high, but may also point to overly difficult claims procedures or a high level of claim rejections. In developed countries, the usual earned loss ratio for property and casualty products is within 60%–95%, depending on the product and distribution channel. For example, in 2010, the Canadian general insurance industry reported an average earned loss ratio of 70%.

In our interviews, insurers believed claim ratios of 25%–30% were appropriate, which is inconsistent with providing adequate value to clients. A number of sources commented that insurance companies lack credibility with clients due to a history of nonpayment of claims, which affects their perception of client value and take-up of individual retail products in the market.

Nonetheless, claims ratios need to be low enough to ensure that the insurance operation is able to sustainably cover its expenses. For nonlife business, the typical "combined ratio" (incurred claims plus expenses) should be less than 100%, with the excess premium as well as investment income contributing to profit and surplus. Start-up operations, particularly microinsurance, may take several years to develop a sufficient client base to adequately cover expenses and claims.

FRC data for premiums, paid claims, and technical provisions ("reserves") were used to estimate the incurred claims ratios by company and product line for 2010. Since there are errors and inconsistencies in the data, these can only be considered estimates, but are useful guidelines nonetheless. Analysis was done on a net basis, i.e., reinsurance premiums and recoveries are excluded.

Incurred claims ratios by company range from 15%–89%, with an industry average of 38%. Incurred claims ratios by nonlife product category range from 12% for cargo insurance to 75% for financial insurance. Car insurance incurred claims ratio of 59% and driver's liability insurance incurred 48%. However, personal accident and health insurance has an incurred claims ratio of only 22% for 2010, indicating low value for these clients.

Expense ratios (the total of operating and management expenses expressed as a percentage of net earned premium) range from 17% to 222%, with an industry average of 58%. Combined ratios (expenses plus incurred claims) range 36%–257%, with an industry average of 96%.

In general, these statistics indicate that current insurance products do not provide sufficient value to clients, and insurance companies spend more on operating expenses than on actual benefits. Several companies with combined ratios greater than 100% are either operating at a loss or relying on investment income.

Distribution and Premium Collection

Insurance companies sell policies through their branch offices, tied agents, or through brokers. Currently, only licensed agents and brokers are permitted to sell insurance products in Mongolia. Table 3 illustrates the number of licensed participants in the insurance market over the last 4 years, indicating growth in terms of potential outreach.

Table 3: Licensed Insurance Industry Participants

Industry Participants	2007	2008	2009	2010
Insurance Companies	15	16	18	17
Branch Offices	91	120	129	138
Insurance Agents	690	1,167	1,676	2,061
Brokers	2	4	5	9
Loss Adjusters	0	0	2	6

Source: Financial Regulatory Commission of Mongolia.

Branch offices are typically located in *aimag* or *soum* centers, while agents are also found in more rural areas. The broker companies are all located in Ulaanbaatar. Broker companies tend to operate at the high income and/or corporate end of the market and insurers tend to see them as competitors than partners. Only seven of the nine licensed brokers were active in the market in 2010.

Given the easy access to banking and other financial services in Mongolia, significant potential exists for commercial banks, microfinance banks, savings and credit cooperatives, and other microfinance institutions (MFIs) to act as insurance intermediaries. Banks have a higher presence than insurance companies in rural areas; forging distribution partnerships would be a promising approach for developing Mongolia's microinsurance market.

While savings and credit cooperatives and other NBFIs are not currently allowed to act as insurance intermediaries, they target the same underserved financial market and would also act as natural aggregators of potential clients. Since employees of these organizations are eligible for licensing as insurance agents, this is a potential strategy for developing

the microinsurance market especially in rural areas. Similar opportunities might exist for nonfinancial cooperatives, such as agriculture or retail cooperatives.

Employers or associations may act as “aggregators” in the market in that they provide a pool of members or employees for group insurance policies, although licensed agents or brokers are still required to complete the insurance sales process. An example would be the apartment insurance by Ard Insurance through the apartment associations, where the associations need to be formally licensed as agents.

Insurance intermediaries are generally not involved in claims administration or settlement, although this may be a matter of practice rather than regulation. This could be explored since microinsurance distribution and administration requires a different structure to reach sufficient members of the target population. Third party organizations could potentially act as “full-service” microinsurance intermediaries by not only selling insurance to appropriate risk groups, but providing policy administration and claims settlement functions as well. Such organizations do not exist in Mongolia outside of the insurance companies and branches themselves.

Premiums are typically paid up front on an annual basis, both in the corporate and retail markets. Even for insurance offered through banks such as credit insurance on loans or property insurance on mortgages, the annual premiums are usually deducted from the loan proceeds. Policyholder administration systems are inadequate, linkages to automatic payment systems are not yet in place, and renewals are not automated. In addition to technology issues, it is difficult to regularly contact clients: they may not use banking or other financial services regularly, and there is no residential postal service in Mongolia. Many potential clients will not have regular periodic income, and may prefer annual premium payment when funds are available to them.

Most insurers mentioned expanding their services through mobile banking and mobile payment systems. While two mobile payment systems are currently being developed in Mongolia, it is not yet clear how effective this would be. Electronic payment systems may be more significant in the development of microinsurance in Mongolia. The high penetration rate of mobile phones presents an opportunity for reduced distribution costs. However, consumer protection implications need to be appropriately addressed.

Other potential avenues for cost-effective distribution could also be explored. While no system of residential mail delivery exists in Mongolia, a wide network of postal branches nationwide offer various payment systems. This could be leveraged to enable premium collection and claims payments processes, particularly in rural areas.

Professional Technical Capacity and Training

Lack of knowledge and technical capacity at the insurer level was identified as a barrier in developing sustainable and affordable microinsurance products. The industry lacks staff resources adequately trained in product development and pricing techniques. There is no formal market research process for product development in insurance companies, and products offered are very similar. Premiums are set relative to competing products, without adequate actuarial involvement.

There is no formal training or professional institutes for the insurance profession in Mongolia, although the National University offers insurance-related courses. Underwriters,

and insurance professionals other than actuaries or intermediaries, are not subject to any training or licensing requirements.

Formed in 2008, the Mongolian Insurers Association (MIA) is becoming an industry force for recommending and implementing change. Training of insurance intermediaries, while under the purview of the FRC, has been delegated to the MIA.

The Mongolian Brokers' Association is a newly formed organization for the developing broker market—a potential pool of resources to assist in developing capacity.

The Society of Actuaries of Mongolia was formed in 2008 and currently has 10 members. The required training for actuaries is a minimum of 40 hours of training approved by the FRC, in addition to education and experience requirements. This minimal requirement is below international standards.

Due to budget constraints, the society has focused on accreditation and training, than developing itself into a full professional institute and creating actuarial standards of practice. With no fully qualified actuaries currently practicing in Mongolia, guidance on practical applications of the study material is minimal.

The lack of organizational support for consistent education and accreditation standards for the insurance industry is a huge gap for the development of microinsurance. In the absence of qualified professionals, the development of microinsurance will currently have to depend heavily on foreign expertise.

Information Technology Systems Constraints

Insurance companies identified significant information technology and management information systems problems. Most were unable to produce detailed reports on policy-level data, premiums, or claims. Data at the specific product level were generally unavailable. While this possibly reflected a reluctance to share confidential information, it appeared more likely that the information was not readily available in electronic format.

Most insurers still collect premium manually, and the premiums are not necessarily reconciled with the policies issued. Policyholder administration and claims management systems are weak and not linked to financial reporting systems. Reports submitted to the FRC are manually done—although the report forms are in Excel, they are not linked either to the insurers' or FRC's databases, making it very challenging for the FRC to reconcile and compare information both at the insurer and industry level. Government funding for IT maintenance and development is insufficient to improve the operational efficiency of its organizations.

Existing Microinsurance Landscape

Overview of Microinsurance Schemes

To date, only two microinsurance initiatives have been undertaken in Mongolia:

- (i) In 2009, the United Nations Development Programme (UNDP) and the Financial Regulatory Commission (FRC) launched a 3-year project to develop microinsurance capacity in Mongolia. The health insurance product was introduced in July 2010, with the first policies issued in January 2011. A second product is currently being developed.
- (ii) A second microinsurance initiative was initiated by Tenger Insurance (formerly Prime General Insurance) in 2009, supported by a grant from the Microinsurance Innovation Facility of the International Labour Organization (ILO). This product combines personal accident insurance with a hospital cash benefit, and was launched in December 2010.

Included in this discussion is the Index-Based Livestock Insurance (IBLI) pilot, implemented by the World Bank and the Government of Mongolia in 2005. The pilot phase lasted 3 years, and has since been extended. While not strictly a microinsurance product since it is also available also to high-income herders, this project reaches a segment of the population vulnerable to financial risks, and provides lessons on the development and distribution of microinsurance in Mongolia.

Microinsurance Development Projects

United Nations Development Programme Microinsurance Capacity Building Project

The UNDP and the FRC launched the “Capacity Development for the Micro-insurance Market” Project in May 2009. It was developed as a follow up to an insurance needs assessment survey conducted by the UNDP in 2007.

Pilot regions include the Khan-Uul and Nalaihk districts of Ulaanbaatar City, and selected soums of Uvs, Khovskol, Selenge, and Dornod aimags. In late 2009, an in-depth market survey in three of the pilot regions has revealed the following:

- (i) About 51% of the household respondents had monthly income less than the national average.
- (ii) Accident leading to temporarily disability was the largest risk faced by the households surveyed, followed by risk of death of a family member.

- (iii) Participants were not knowledgeable about insurance and insurance products.
- (iv) Insurance coverage for accidental disability, death, and health care showed the highest demand. Interest in property and funeral insurance was low.

The health microinsurance product is a voluntary product that provides coverage for both in-patient and out-patient services, with certain restrictions. In-patient coverage is available for both public and private hospitals and adjustments are made to the benefits if the insured already has state health insurance to cover public hospital admissions. In-patient claims are reimbursed directly to the hospital. Monthly premiums for family coverage (maximum of four members) is MNT6,000 (\$4.80), although generally paid as an annual premium of MNT72,000. Sales of the health microinsurance product began in January 2011 in the pilot regions.

Tenger Insurance and Xac Bank Microinsurance Project

In 2009, Tenger Insurance proposed to develop and pilot two microinsurance products—personal accident insurance and health insurance—and sell them, through Xac Bank branches, to members of the informal economy seeking small business and microfinance loans.²² Project implementation began in October 2009.

Tenger's final product design is a bundled product that includes an accidental death benefit and a hospital cash benefit. The hospital cash benefit is based on similar microinsurance products in other countries—the benefit is a fixed amount per night spent in the hospital, after a 1 or 2 day waiting period has been met, with a maximum number of covered days. The benefit is not tied to the state health insurance coverage; if someone is already covered by the state scheme, the hospital cash benefit is supplementary.

The advantage of this benefit is that the insured person can spend it however they want—the amount is not tied to the services they receive. If they don't need it for medical costs, it can be used to cover transportation costs, or childcare, or replace income lost as a result of being in the hospital.

The product is sold in conjunction with microloans offered by Xac Bank, and will be mandatory for new borrowers during the pilot. Since it is mandatory, and because the market research identified several different family structures and income levels, the pilot will offer three different levels of benefits, as well as single and family coverage options. Part of the pilot evaluation process is to determine which benefit options are most accepted by the target market.

The product was formally launched in December 2010. In April 2011, two branches were added to the pilot, and plans are under way to expand to additional pilot sites in 2011.

By end of March 2011, 136 policies had been issued, 112 single and 24 family policies, with a total gross written premium of MNT5,970,000. Paid claims to the end of March were MNT1,140,000. Total incurred claims at the end of March amounted to MNT1,335,000, equivalent to an incurred claims ratio of 168%.

²² In the interest of full disclosure, the lead author of this report provided this technical assistance and support as a microinsurance fellow hosted by Tenger during 2010, and was involved with the research and product development phases of their microinsurance project.

Index-Based Livestock Insurance Program

The Index-Based Livestock Insurance Program (IBLIP) is a collaborative pilot project in 2005 between the World Bank and the Government of Mongolia. The program's primary objective is to pilot an innovative insurance system to minimize the vulnerability of herders to losses due to severe weather conditions. Compulsory livestock insurance was introduced initially in 1963, but was discontinued with the privatization of the economy in the 1990s.

While not formally designated as "microinsurance," the IBLI program provides access to insurance for a population segment that would otherwise not have access. While many herders would not be considered low-income, they are at risk of losing their assets and income potential during a severe winter (*dzud*). In 2010, approximately 22% of Mongolia's livestock perished due to *dzud*. Without insurance coverage, all herders are vulnerable to financial insecurity from livestock losses.

The IBLI program steadily grew since inception. In 2006/2007, IBLI was piloted in three *aimags*, reaching 2,222 households, or approximately 7.8% of the herder households in those *aimags*. By the 2010–2011 season, the IBLI product had been expanded to nine *aimags*: 6,977 policies were sold, reaching 10.5% of the herder population in the participating *aimags*. Premiums for the 2010–2011 season were MNT416 million.²³

Other Microinsurance-Type Products

A number of insurance products in the market could be considered microinsurance, or easily adapted to meet the needs of the microinsurance market. Though not specifically offered to low-income or vulnerable populations, they meet some of the needs of those populations.

"Financial insurance" offered by nonlife companies includes products to protect banking institutions, businesses, and borrowers from credit and default risk. In general, banks purchase the insurance to cover the risk of nonpayment on loans and the policy is issued to the financial institution rather than the covered borrowers. The type of loans can include salary loans, pension loans (typically borrowing against 6 months of salary or pension benefits), small business loans, and mortgages. Financial insurance provides coverage against nonpayment on the part of the borrower possibly due to death or disability, in addition to unemployment or other causes.

Thus, many of the products categorized as "financial insurance" currently available are providing a form of credit life and credit disability insurance, although they are not designated as such and are sold by nonlife insurance companies. This is an area of interest in the development of microinsurance in Mongolia, as credit insurance policies are often an entry point into the microinsurance market.

Products offered in the property and personal accident and health categories include offerings of small premium, limited risk products that could be relevant for microinsurance. In particular, many companies offer small personal accident policies to protect travelers or students. Organizers of horse races for the traditional Naadam festivities require participants to purchase personal accident coverage. Bus transportation companies

²³ K. Luxbacher and A. Goodland. 2011. *Building Resilience to Extreme Weather: Index-Based Livestock Insurance in Mongolia*. Washington, DC: World Resources Report (<http://www.worldresourcesreport.org>).

also offer an insurance coverage as an optional purchase with the bus ticket. These types of simple personal accident policies are targeted toward the average Mongolian citizen, a market segment that overlaps considerably with what could be considered the microinsurance target market. These provide a useful template for future microinsurance product development.

Ard Insurance, and possibly other companies, also offers apartment damage and liability coverage sold through apartment associations. Typically, the association manages the billing for utilities to all of the apartments in the complex, and can easily add the insurance premium to the utility bill; the association is licensed as an agent to sell the insurance. Once the apartment association opts to include the insurance, coverage is mandatory for all apartment owners in the association.

Emerging Lessons from Microinsurance Projects in Mongolia

- (i) ***There is room for private health microinsurance products in Mongolia, but these need to be carefully integrated with the benefits and structure of the existing public health system.*** While the Government of Mongolia intends to expand its public health coverage, it is unlikely to fully cover all medical expenses. This provides scope for complementary products to cover ancillary expenses for medical care such as transportation, medicines, and treatment in private health care facilities.
- (ii) ***Microinsurance products should be as inclusive as possible, but should also limit antiselection to be sustainable.*** Health insurance products are prone to anti-selection,²⁴ particularly if the coverage allows the policyholder access to a higher level of care such as private clinics without additional premium or co-payment.
- (iii) ***Product design and pricing of health microinsurance products should be done by qualified and experienced actuaries.*** Sufficient data to develop appropriate pricing models are available from the health care sector in Mongolia, but only an experienced professional will be able to perform this work adequately.
- (iv) ***Reimbursement procedures for insured medical expenses should be designed such that incentives for policyholders, insurers, and health care providers are appropriately aligned.*** Reimbursements for services covered under private insurance programs may reduce the reimbursement to the health care facility from the state, and they may have less incentive to treat patients with private coverage, even though those patients might seek a higher level of care as a result of their coverage. Claims for indemnity-type health benefits are difficult for

²⁴ Anti-selection (also known as adverse selection or negative selection) describes a situation wherein an individual's demand for insurance (the propensity to buy insurance and/or the quantity purchased) is positively correlated with the individual's risk of loss (higher risks buy more insurance), and the insurer is unable to allow for this correlation in the price of insurance. This is mainly because of private information known only to the individual (also referred to as information asymmetry), or regulations or social norms, which prevent the insurer from using certain categories of known information to set prices. For example, the insurer may be prohibited from using such information as gender, ethnic origin, genetic test results, or preexisting medical conditions, the last of which amount to a 100% risk of the losses associated with the treatment of such medical condition.

insurance companies to evaluate without specialized training in medical diagnostic codes and procedures, therefore potential for fraud from health care providers with this type of product exists.

- (v) ***Design of microinsurance products needs should consider the trade-off between benefits and price, and incorporate challenges in distribution, premium collection, or service delivery.***
- (vi) ***Cost-effective distribution is a key challenge in Mongolia.*** Mobile banking and its potential to increase insurance penetration and automate premium payments in rural areas is hampered by the requirement that all forms of insurance can be sold only by licensed agents or brokers.
- (vii) ***Based on the expressions of the insurers, it appears doubtful that insurers would be interested in the microinsurance market without donor support or other incentives.*** The understanding of microinsurance from the insurers appears to be that development agencies will and should provide premium subsidies or funds to pay claims. They see microinsurance as a development project, not as part of their core business.
- (viii) ***Perceived conflict of interest when the insurance regulator also acts in a market development capacity, such as the UNDP microinsurance project.*** Without evidence of misconduct, a number of market participants expressed dissatisfaction with the governance structure of the project, and the limited number of insurers selected to participate in the pilot.
- (ix) ***While compulsory coverage for members of a group policy may increase coverage, reduce distribution costs, and reduce the risk of anti-selection; it should be weighed against other considerations.*** Tenger's experience shows it is difficult to make insurance coverage compulsory—bundled with other products such as loans, as customers are averse to such add-ons due to limited funds and mistrust of insurance.

Estimating the Potential Demand for Microinsurance

Levels of income, poverty and employment, and variances in population density between urban and rural areas are relevant socioeconomic issues needed to determine the target market for microinsurance.

Very roughly, the “middle 60%” of Mongolia’s population could qualify as the potential microinsurance market: the very poor would not have the capacity to pay for insurance products, whereas the wealthy 10%–15% would prefer to purchase more traditional high-end products.

With this assumption, the following summary shows the results of focus group discussions, along with analysis from other studies, outlining the potential demand for microinsurance in Mongolia.

Microinsurance Client Profile

The following figure shows the areas where microinsurance market research and pilots have been conducted in the past 2 years, excluding Index-Based Livestock Insurance (IBLI).

Focus Group Research Conducted for Access to Insurance Initiative Diagnostic

A series of 16 focus group discussions were conducted in six different *aimags* from 15 April to 15 May 2011; where a total of 139 persons from different backgrounds were interviewed.

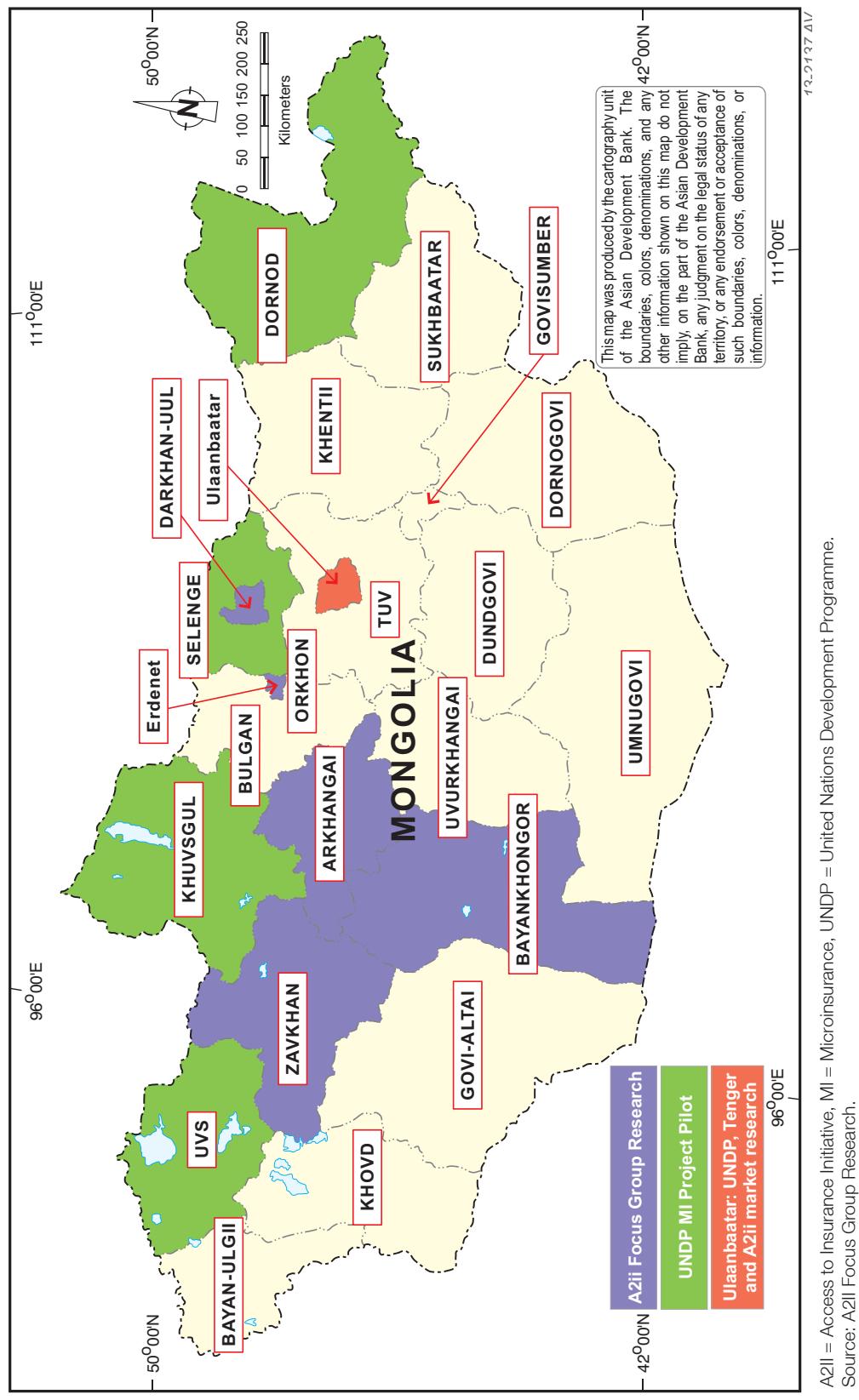
Demographic Profile of Participants

Seventy-four women and 65 men participated in the focus group discussions, representing a population of 587 including all family members. Most of the discussion groups were held outside the capital (mostly in Orkhon [Erdenet] and Darkhan) since earlier studies have been done in Ulaanbaatar. In conducting the group discussions, the authors sought people in the middle economic spectrum—generally employed (although most likely in the informal sector), with an average household income above the subsistence level; as this market is largely underserved by the financial services industry.

The average family size was 4.2, consistent with Tenger findings in 2010 and current figures from the National Statistical Office (NSO).²⁵ Notably, family size was lower than average in Darkhan at 3.8, and Erdenet at 3.5.

²⁵ National Statistical Office of Mongolia. 2009. *Mongolian Statistical Yearbook*. Ulaanbaatar: National Statistics Office.

Figure 2: Map of Mongolia Indicating Microinsurance Market Research and Pilots



A2ii = Access to Insurance Initiative, MI = Microinsurance, UNDP = United Nations Development Programme.

Source: A2ii Focus Group Research.

Income, Expenditures, and Savings

Average **household income**, including benefits received from the government, was approximately MNT442,000 (\$360) per month. Average **monthly household expenses** were approximately 85% of household income. While total household income was roughly the same between urban and rural participants, household expenditures were about 60% higher in urban areas.

Self-reported **savings rates** are low, although higher for women (24%) than for males (14%), and higher for those over 40 years (27%) compared to younger participants (9%). Rural areas reported higher savings rates than urban areas, possibly due to higher expenses in urban areas.

Some participants disclosed that their savings are seasonal, based on cashmere sales, while no one saves for unplanned or unexpected events. Most participants said their expenses were higher than their income, which means they were unable to save and had a regular need for short-term borrowing.

Understanding of Risk

When asked to define risk, the most commonly cited definitions across all groups were the following: (i) financial hardship caused by unplanned issues and/or unplanned expense; (ii) unplanned and sudden incidents to family, friends, or business; (iii) emergence of unpredicted sudden challenges; and (iv) weather and natural disaster.

Weather and natural disasters were mentioned frequently, as weather is an important risk factor in Mongolia for almost all endeavors.

Interestingly, a number of participants identified risk as a positive thing—that risks are there and one can't predict or plan for the future but only manage events if and when they arrive. This perception presents a challenge in convincing Mongolians on the value of insurance.

Illness or disability was identified as the top concern for **individual and family risk**, perceived as the most likely to occur and causing the greatest financial burden. The larger concern appears to be loss of income rather than medical expenses.

Death was identified as the next common risk, followed by accidents, loss of or damage to housing, car, or other property, and natural disasters. Loss of employment was a significant risk in many areas; while loss of livestock was a significant risk in rural areas.

In all discussion groups, disability or illness was seen as more probable and financially stressful than occurrence of death. Death is viewed as a “one-time event” and therefore less costly, whereas loss of income and medical expenses due to disability or illness is an ongoing concern.

The common **business risk** identified was a sudden drop in sales for whatever reason, followed by increases in the cost of business inputs. Bankruptcy was mentioned as a significant risk. However, theft or damage to production goods was rarely mentioned.

For participants in the formal economy, loss of employment was frequently mentioned as an individual or personal risk (rather than a business risk).

Risk Management

Borrowing from family or friends was identified as the primary approach to managing financial risks after their occurrence, followed by borrowing from the bank and selling property or pawning assets. The groups also identified the primary limitations of these methods: (i) borrowing from friends and family puts a heavy burden on them,(ii) bank loans require collateral and/or loan interest is high, and (iii) selling and/or pawning assets reduces overall wealth and results in receiving less of the asset's full value.

Other approaches suggested for risk mitigation included buying insurance, saving, and accumulating assets. Only one group identified insuring their business as an option, although a few mentioned establishing a risk fund for their business.

The primary method identified for preventing risk was to look after one's own health. Given (i) that health risks were the top concern, and (ii) the evident dissatisfaction with the public health system, it is not surprising that this was the case. Health insurance products could include some added value, such as nutrition advice or free medical check-ups.

Community approaches to risk management

There are no organized community groups in Mongolia that provide assistance to families in financial need arising from death or illness. There is a cultural practice of helping each other out if necessary, but this is done informally, and is more common in the countryside. In cases of death or illness, the family and neighbors will help out with whatever funds they have available. If livestock is lost, each member of the extended family will replace an animal to help restart the herd. However, as more and more herders move to Ulaanbaatar, society is becoming more fragmented, and the traditional willingness to help others in need is breaking down.

Four of the discussion groups mentioned the following initiatives in their community:

- (i) A cooperative-style group mentioned by the male focus group participants in Ulaanbaatar provides jobs and increases the income of its members. The group's business operations focus on tree-planting, producing animal fodder, and growing vegetables. The group is self-regulated and meets twice a year to elect a leader and fund treasurer, and make organizational decisions. Membership requires the contribution of MNT10,000 which can be withdrawn, plus the accumulated income, should a member decide to leave.
- (ii) The other three savings associations were all located in Zavkhan *aimag*. The Bayan Borkh cooperative was established in 2008, and focuses on growing vegetables and planting animal fodder. Each member contributes MNT20,000 upon joining, and dividends are distributed based on the labor contributed in planting activities. The cooperative also provides the following benefits to its members: (a) MNT40,000–MNT50,000 for death of a member; (b) MNT35,000 for marriage; and (c) medical expenses benefit of up to MNT50,000.
- (iii) A savings group created by the secondary school teachers in the rural district of Tsagaankhairkhan in Zavkhanaimagwas also identified. Each member contributes MNT10,000 monthly to the fund. Each month, a member can apply

to withdraw up to MNT80,000 from the fund, although it was unclear if there were restrictions on fund withdrawals.

Understanding of Insurance

Overall, 73% of the focus group participants indicated they knew about insurance, at least to some extent, with the following apparent trends:

- Car insurance for damage and driver's liability is the most commonly bought commercial insurance, purchased by about 25%-30% of the participants. Many participants were dissatisfied with insurer practice of selling insurance during the annual vehicle inspection period where owners are coerced into buying insurance to obtain inspection certificate.
- The next most common insurance products were accident insurance, and house or property insurance, usually required by the bank for a mortgage or loan. Approximately 10% of the participants had purchased one or both of these.
- Only 2 out of 139 participants have life insurance. This is not surprising since life insurance products have only been available in 2008 and sales are still modest.

In general, it appeared that many participants were confused about the differences between commercial private insurance and state insurance. Participants in the western rural *aimags* of Zavkhan and Arkhangai preferred the state insurance schemes over private insurance than participants from other areas.

Generally, participants view insurance negatively, with more complaints or negative comments than positive responses. There were also reports on the inadequacy of the coverage and facilities provided by the state health insurance system. Not all services are available in all areas, and not all services or treatments are covered under the state system. Out-of-pocket medical expenses were frequently mentioned as a source of unplanned spending.

Additional Demand-Side Research

Aside from the market research conducted for the UNDP microinsurance and Tenger Insurance projects, Xac Bank also conducted a study in 2009 for its Progress Out of Poverty report.²⁶ As Xac Bank targets a similar client base as microinsurance, the results are quite useful. The Xac Bank study found that 27% of their microloans were distributed to those in the poor category, and 59% in the upper poor category. They were able to conclude that their products meet the needs of their target group. This would be a useful analysis to construct for both the existing and future microinsurance projects in Mongolia. In 2010, ADB, in cooperation with the Adventist Development and Relief Agency and the Mongolia National Cooperator's Association,²⁷ conducted a review of financial literacy levels among members of savings and credit cooperatives (SCC).²⁸ The primary conclusions were that SCC members are familiar with the basics of household budgets, but face challenges in financial management resulting to frequent borrowing. Members

²⁶ Xac Bank. 2010. *Progress Out of Poverty Index for Xac Bank Micro Clients*. Ulaanbaatar: Xac Bank.

²⁷ See <http://www.ica.coop/al-ica/articles/132/1/New-Member-Mongolia-National-Co-operator039s-Association-MNCA-from-Mongolia/Page1.html>

²⁸ A. Batchuluun.2010. *Financial Literacy among Members of Savings and Credit Cooperatives and the General Population in Mongolia*. Ulaanbaatar.

of the general population were also found to have a very low level of financial literacy and negative attitudes toward household budgeting.

Cultural Aspects

Certain aspects of Mongolian culture are relevant to the development of microinsurance. Traditional Mongolian culture prohibits discussion of death and potential negative risk events in the superstitious belief that “talking about them will bring them.” Not only does this discourage advance planning and risk management, it makes it difficult to market the concept of life or funeral insurance. Mongolian culture generally does not emphasize forward planning or risk management practices: (i) most Mongolian companies do not see the value of insurance for their liabilities or employees,(ii) individuals do not see value in insurance for themselves, and (iii) herders do not plan for extra hay even though they are well aware of the risk of *dzud*. Help from relatives and neighbors in times of loss also discourages active risk management.

Legacies from the communist economic system include both a distrust of insurance, and a sense of entitlement to government support and social welfare. Many opined that “insurance is a tax,” where they pay premiums but do not receive any benefits.

These make insurance hard to sell in Mongolia. Cultural taboos against discussing potential bad events make it difficult convincing people of the benefits of insurance. Prior negative experiences with insurance have deepened mistrust. The financial consequences associated with death have more to do with losing that person’s income and other support to the family, than the cost of the funeral. In some cases, claim on insurance recovery during or after any event takes a long time, which further discourages demand for life insurance products. Unless they include a different focus such as savings, the perceived need for insurance is unlikely to be high in the immediate future, although financial education may increase this over time.

Potential Demand for Microinsurance in Mongolia

Current Microinsurance Usage

Existing products include (i) the health microinsurance products offered by Mongol Insurance, Nomin Insurance, and Bodi Insurance through the UNDP microinsurance project; (ii) the health and accident coverage offered through Tenger’s microinsurance product; and (iii) the index-based livestock insurance offered through the IBLIP program. With the limited insurance data, only general assumptions about the current usage of insurance by the target market could be made: (i) insurance coverage from the three pilot projects reaches approximately 1% of the total number of households in Mongolia; and (ii) if about half of the personal accident and property policies were included in the microinsurance category, then total coverage could reach approximately 5% of the current population.

Microinsurance Client Profile

The findings on risks, risk mitigation strategies, and understanding of insurance are similar across all studies. In general: (i) health risks are identified as the primary risk by this

market,(ii) financial risks are managed primarily after the event by borrowing funds or selling assets,(iii) community risk management efforts limited,(iv) lack of financial education and understanding of insurance is a significant barrier,(v) microinsurance products are more likely to be successful if bundled with a tangible benefit other than insurance coverage, and (vi) cultural aspects including marketing play a significant role in promoting demand for certain types of insurance products.

Estimating Potential Demand

New and innovative insurance products are needed for this market segment that could provide the following benefits: (i) medical expenses; (ii) disability benefits; and (iii) property insurance, and savings-type life insurance products, with a death benefit included. However, need is not synonymous with demand, and there is little evidence of existing demand within the market.

No significant informal market shows unmet demand for insurance products. While focus group participants expressed either lack of knowledge or lack of satisfaction with respect to insurance, few identified insurance as a potential approach to managing their financial risk.

As many have expressed their desire for additional information and training on insurance, it is reasonable to conclude that demand for microinsurance products will need to be **created** in Mongolia to develop sustainable programs.

The authors estimate a maximum target market of 430,000 households, or approximately 1.6 million people. A reasonable assumption is that neither the poorest 25% of the population, nor the wealthiest 15%, would be included as part of the potential microinsurance market.

On average, 38% of the population had income below the minimum subsistence level in 2009, but this varies from region to region, and poverty incidence should have improved due to the introduction of monthly payments to every Mongolian from the Human Development Fund. The results from the focus group discussions indicate that those with household incomes around the average, and just above the minimum subsistence level would still have sufficient disposable income to purchase low premium microinsurance products. However, the poorest 25% are presumably unable to afford even a minimal premium.

Given the significant challenges in reaching the rural population, it would make sense to focus first on reaching the urban population. Existing groups within a community, such as cooperatives, associations, teachers, or borrowers would seem to be the easiest market to reach, within both urban and rural settings. Covering 35% of the “target market” in urban populations would mean insuring approximately 90,000 households, which represents just over 12% of the total population. This would be a significant increase over current coverage levels, and might be achievable in the near term.

Despite rather optimistic assumptions, these numbers are still very low due to Mongolia’s low population. It would be difficult to develop sustainable microinsurance programs without sufficient economies of scale. These challenges require the expansion of distribution options including mobile technologies.

Regulation, Supervision, and Policy

The enabling environment for microinsurance development in Mongolia consists of three main pillars: (i) government policies relating to the financial sector, (ii) the insurance regulatory framework, and (iii) insurance supervisory systems.

Political System and Legal Environment

A significant factor in the Mongolian context is its recent transition, in 1990, from a communist government to a multiparty democracy. The executive, legislative, and judicial branches of the government, as well as the election process, have all undergone major changes. New legislation was required and adopted in many areas, and much of it has been subsequently revised. New regulatory authorities were created, and the appropriate legislation and regulations adopted. This evolution has progressed at a rapid pace, which inevitably left gaps and weaknesses yet to be remedied. On the whole, the political and legal system has stabilized over the past few years.

The head of state in Mongolia is the president, elected through popular vote, who shares power with the prime minister. The prime minister nominates the members of the cabinet, who must be approved by the legislature. Legislative power rests with the parliament, which has 76 elected members. Judicial power rests exclusively with the courts, consisting of the supreme court, as well as *aimag*, capital city, *soum*, and district courts.

The prime minister is the head of the government, and directs the economic, social, and cultural development of the country in observance of state laws.

Mongolia's "civil law" system is influenced by ancient Roman, Russian, and German legal systems. In addition to the constitution, adopted in 1992, the primary laws relevant to the financial sector include the Civil Code (2002), the Company Law (1999), the Law on Insurance (2004), the Law on Insurance Intermediaries (2004), the Law on the Legal Status of the FRC (2006), and the Law on Banking (amended 2010). The Law on Non-Banking Financial Institutions, Law on Cooperatives, and Law on Taxation also have some bearing. The legislation in general provides that regulations and additional guidance are adopted by the relevant regulatory authority as necessary, rather than at the legislative level.

The process of creating and passing new legislation in Mongolia is complex and lengthy, as shown in Appendix 7. Given the case, the current government feels that legal consistency should be maintained by not amending laws that have only been recently enacted. Therefore, if changes to the regulatory environment are desired to facilitate microinsurance growth, changes within the regulations or guidelines should be looked into first. However, there may be cases where it would be preferable to amend the primary legislation, regardless of the cumbersome process.

Financial Sector Authorities

In the Mongolian context, the following authorities are relevant for microinsurance market development:

The **Ministry of Finance (MOF)** is in charge of overall financial sector policy and oversees the Bank of Mongolia. It is open to promoting the development of the insurance sector.

The **Bank of Mongolia (BOM)** regulates and supervises commercial banks. Relative to insurance, the BOM regulates intermediaries such as banks, and automated payment systems, including electronic transfer of funds.

The **Financial Regulatory Commission (FRC)** regulates and supervises nonbanking financial institutions, including SCCs, non-deposit-taking lenders, capital markets, and insurance companies. The FRC ensures stability of financial markets, regulates financial services, monitors the implementation of relevant legislation, and protects the rights of investors and clients of the financial markets.²⁹ It has three sector-specific departments: Insurance Market Development, Securities Market Development, and the Microfinance Department, as well as five cross-sector departments. It issues insurance regulations and is responsible for licensing insurers, agents, brokers, loss adjusters, and actuaries. An independent five-member supervisory board is mandated to consider public feedback and provide policy inputs to the FRC.

Insurance Development Policies

Included in Mongolia's **National Development Strategy** based on the Millennium Development Goals, and approved by parliament in 2007, is a 14-year policy for supporting human development with emphasis on health and social insurance, as well as creating a favorable environment for long-term insurance market.

The **Government Action Plan 2008–2012** was approved by parliament in 2008 and the following aspects of insurance policy are included: (i) increase the impact of the insurance market on social life by fostering its development, (ii) create a legal environment for life insurance for individuals, and (iii) create a legal environment that will allow the use of the remainder of the social insurance fund for long-term investment purposes by supporting the independent functioning of the social insurance fund and introducing new management.

The Government of Mongolia has been implementing its **Economic Growth Support and Poverty Reduction Strategy** since September 2003. The insurance-related policies reflected in this strategy are mainly focused on improving the legal environment, ensuring optimal monitoring and management of insurance company assets, expanding products and coverage of insurance, and reinforcing international standards.

Toward the end of 2010, the FRC published the draft **Medium Term Strategy Plan for Insurance Sector Development**. The strategy encompasses broad aspects of insurance sector development in the insurance regulations and looks into related policy spheres

²⁹ Law on the Legal Status of the FRC (2005), Article 4.1.

including tax and social protection issues. According to the FRC, the strategy is not yet finalized and the availability of funding support for implementation remains unclear.

Though all of these aim to promote insurance market development in some way, none include a clear structure for coordinated action across public and private stakeholders and implementation has been shallow.

Access to Financial Services

The minister of finance, governor of the BOM, and chair of the FRC are members of the Financial Stability Committee. Issues of increasing access to financial services in the underserved population are part of the committee's mandate, but are not a primary focus. With Mongolia's banking crisis in the recent past, the priority has been ensuring banks' stability to prevent a collapse of the economy. The development of the nonbanking sector has therefore received limited priority from a policy standpoint.

Consumer education on financial services, including insurance, has so far been a low priority for policymakers and regulatory authorities. The Microfinance Initiative for Asia report has confirmed that while policymakers have started to discuss consumer education issues in recognition of its value for insurance market development, relevant agencies such as the Ministry of Education or the MOF are not yet actively engaged in consumer education or financial consumer protection.

Insurance Laws and Regulations

General Legislation

- The **Constitution of Mongolia (1992)** is the basis for all legislation in Mongolia.
- Chapter 43 of the **Civil Code of Mongolia (2002)** governs insurance contracts. Thirteen clauses regulate details of the insurance relationship between the contracting parties, including: insurance policies; types and forms of insurance; guarantees, liability for insurance premium, and insurance agents' rights. It also outlines what must be disclosed in the insurance contract including the sum insured, policy duration, renewal conditions, and premium payment schedule.
- The **Law on Companies (1999)** applies to all companies that are incorporated in Mongolia, including commercial banks, nonbanking financial institutions, insurance companies, institutional agents, and brokers.

Insurance Sector Legislation

- The **Law on Insurance (2004)** regulates all insurance activities, except those regulated specifically by other laws. It provides (i) definitions of insurance classes and forms, (ii) rights and duties of the insurer and insured, (iii) regulation and licensing of insurance companies, (iv) capitalization and solvency, (v) accounting and auditing, (vi) roles and responsibilities of actuaries, (vii) regulation and licensing of reinsurance, and (viii) the right of the FRC to collect data and impose sanctions. Details of these provisions are contained in regulations and guidance notes issued separately by the FRC.

- The **Law on Intermediaries/Law on Insurance Professionals (2004)**³⁰ regulates the legal status, activities, and licensing requirements of insurance brokers, insurance agents, and loss adjusters; as well as rules for market conduct.

Insurance Regulations and Guidance

Supplementary to the primary legislation, the FRC promulgates regulations and guidance for the insurance industry. Regulations have the force of law, whereas guidance is generally more informative than prescriptive. The regulations serve to clarify the provisions in the Law on Insurance and Law on Insurance Intermediaries, and are more frequently and easily amended than primary legislation as they can be directly adopted by the FRC.

Currently, over 45 active pieces of insurance regulation and guidance govern the full spectrum of insurance-related activities, including the following: (i) classification categories of voluntary insurance for general and long-term insurers; (ii) premium calculations for short-term and long-term insurance; (iii) forms and contents of regulatory financial reports by insurers and intermediaries; (iv) solvency and capital requirements; (v) licensing and training requirements for insurance intermediaries; (vi) ethical code of conduct for insurance intermediaries; (vii) licensing of actuaries; (viii) asset allocation, investments, and investment controls, for both general and long-term insurers; (ix) allocation and control of reserve funds; (x) auditing and internal controls; (xi) “Fit and proper” guidelines for governing persons of insurance companies; (xii) regulations for foreign insurers and intermediaries operating in Mongolia; (xiii) regulations for liquidating or refinancing insurance companies; and (xiv) regulation of FRC onsite audits as well as offsite supervision.

The FRC continues to review and amend the regulations and guidance notes as necessary, with over a dozen new or revised regulations adopted in the past year.

Non-Insurance Legislation with Relevance to Insurance and/or Microinsurance

- The **Law on Banking** was amended in 2010, allowing banks and their affiliates and subsidiary companies to act as insurance brokers (Article 6.2).
- The **Non-Banking Financial Institutions Law (2002)** and supplementary regulations for NBFIs govern the activities of nonbanking financial institutions not otherwise regulated by sector-specific legislation. Neither the existing legislation nor the proposed draft legislation allows microcredit institutions, guarantee funds, or other NBFIs regulated under this legislation to sell insurance.³¹
- The **Cooperative Law (1998, amended 2010)** regulates all cooperatives, including SCCs and does not allow cooperatives to sell or market insurance. The new draft law for SCCs has no provisions allowing SCCs to act as insurance intermediaries.
- The **General Law of Taxation in Mongolia (1993)** contains provisions relating to taxation of insurance companies and exemptions of insurance premiums from

³⁰ The translation from the FRC website is “Law on Mongolia on Insurance Intermediaries.” However, if properly translated, the title should read “Law on Insurance Professionals” as it also includes regulation and licensing of loss adjusters in addition to agents and brokers.

³¹ The activities allowed in Article 7.1 do not include insurance intermediation, and the law further states that activities not specifically allowed are disallowed.

taxable income. This did not indicate any significant tax burden that might inhibit the growth or profitability of microinsurance.

Microinsurance Implications

Mongolia does not have specific microinsurance regulation, and the insurance regulatory environment does not specifically consider microinsurance clients, providers, or intermediaries specialized in microinsurance. While there is no official definition of microinsurance, the FRC internally considers policies with an annual premium of less than MNT10,000 (\$8) as microinsurance policies. This appears to be an arbitrary level, and is not pegged to any specific target market or product features. However, as there are no separate categories for reporting or regulating microinsurance, this distinction has no implications. Without separate reporting on microinsurance products, the FRC is unable to monitor claims ratios, service levels, or complaints on these products.

This study identified a number of gaps in the Mongolian insurance regulatory framework that have potential implications for microinsurance provision or innovation. These gaps relate primarily to insurance intermediation and distribution channels, the definition and classification of insurance products, and consumer protection.

Regulation of Insurance Intermediation

There are three main aspects where intermediation regulation may inhibit microinsurance: (i) by restricting the banks' brokerage function, (ii) by restricting the ability of NBFIs to act as intermediaries, and (iii) by not clearly creating a space for alternative distribution channels.

Banks are allowed to act as brokers but not as agents.³² The 2010 amendment to the Banking Law allows banks to act as insurance brokers. The Bank of Mongolia is required to issue a “no objection” letter before a broker is granted license by the FRC. The process for coordinating the licensing, regulation, and supervision responsibilities between the FRC and BOM is unclear. While a bank (or a branch or subsidiary) can be licensed only as a broker, bank employees can be licensed and contracted as individual agents.

Banks are prevented from acting as a broker for an insurance company if they share ownership.³³ This is a clarification of previous legislation that restricted any person or organization with greater than 10% ownership in an insurance company from acting as an intermediary for that company. This restricted microinsurance distribution options for at least one of the main players in the microfinance and/or banking sector: Xac Bank, which is currently the distribution partner for Tenger Insurance’s microinsurance product, is unable to leverage this distribution partnership since the regulation prevents it from being a licensed agent due to its shared ownership structure with Tenger. While bank staff can be licensed as agents, it is cumbersome and expensive. It is also unclear if a bank related to an insurance company would be allowed an insurance broker license to offer products from unrelated insurance companies, since the licensing regulations are silent on that point.

³² In the generally accepted international definition, a broker is a person or institution that acts on behalf of the client seeking insurance. An agent is the person or institution who acts on behalf of the insurance company.

³³ FRC Resolution No. 45 (2011); FRC Resolution No. 61 (2008).

Nonbanking financial institutions other than insurance companies cannot sell or market insurance. In many countries, microfinance institutions (MFIs) and credit and savings cooperatives are the prevalent distributors of microinsurance products, since they are closely connected to the target market. In Mongolia, MFIs are not currently allowed to act as insurance agents or brokers.

Only licensed agents and brokers are allowed to sell insurance, and the licensing and training requirements may be too onerous to permit alternative distribution channels. Training was delegated to the Mongolia Insurers Association in 2008. The initial training requirement of 16 hours is not too difficult for a microinsurance intermediary.

Definition and Classification of Insurance

The legal provisions defining insurance are unclear or contradicting in some aspects:

- (i) **Inconsistencies in definitions.** Insurance³⁴ appears only to include indemnity-type products, where compensation is paid for losses that have occurred as the result of an insured event. This is inconsistent with insurance products that have benefits not directly tied to losses, such as investment or savings type products. Yet these forms of insurance are allowed in Mongolia.
- (ii) **Loose distinction between life and nonlife insurance.** The delineation between life and nonlife insurance products is not clear, as the available translation of the Law on Insurance refers to “long-term insurance” and “general insurance.” Given that an insurer can be licensed only for one category, the products that they are allowed to offer under each category should be more clearly specified. For example, 1-year credit life insurance would be considered a short-term product, yet this is not an allowable insurance product for an insurer with a “general” insurance license. Similarly, health and medical insurance appears to be allowable under both categories, although not considered “long-term” insurance.
- (iii) **Inadequate definitions of “compulsory” and “voluntary” insurance.** Insurance classification into “compulsory” and “voluntary” in the Civil Code³⁵ narrowly considers the situation of group insurance coverage or credit life insurance—where the choice to purchase insurance is optional, but the coverage is automatic for group members. For example, microinsurance providers in other countries have partnered with MFIs to offer mandatory life or health insurance for borrowers. Loan approval in this case is contingent upon the borrower buying insurance. The policy is often a “group insurance” policy for the MFI, with coverage certificates for the borrowers.
- (iv) However, “compulsory” insurance in Mongolia only allows for insurance required by the government, such as the proposed drivers’ liability law. All other insurance is therefore “voluntary,” and strict interpretation of the banking regulations indicates that borrowers cannot be compelled to take insurance since such coverage must be voluntary. In practice, most banks in Mongolia require mortgage holders and other borrowers to buy insurance, so there appears to be inconsistency between different areas of regulatory jurisdiction and market practice.

³⁴ Law on Insurance (2004), Article 4.

³⁵ Chapter 43, Article 432.1–433.3 of the Civil Code.

- (v) **Inadequate regulations governing group insurance.** There is no definition of “group” insurance or provisions governing the principles of group insurance contracts. Separate reporting of group insurance contracts is not required by the FRC, making it difficult to adequately supervise and analyze this insurance. Group insurance has been a cost-effective method of distribution for low-premium insurance in other countries, and lowers the risks of anti-selection.
- (vi) **No composite products allowed.** Restricting insurance providers to a single type of license (long term or general) forbids bundled products that offer life and nonlife benefits in a single product. For example, a credit insurance product that offered both life insurance and property insurance on a mortgage would not be allowed without involving two separate insurers.

Regulations Relating to Consumer Protection

Ensuring ethical and professional practices of insurers is a key objective of insurance regulation, especially for insurance involving long-term financial commitments. Prompt and fair claims servicing is also important for low-income policyholders and potential microinsurance clients.

Focus group discussions have indicated that potential clients lack sufficient knowledge and understanding of insurance, which may make their insurance decisions difficult. Aside from complaints on poor service quality, a common perception is that insurers frequently do not honor claims, or that the difficult process discourages clients from claiming.

In 2009, the UNDP Microinsurance Capacity Building Project identified the following concerns on claims practices:

- Traditional claims handling procedures may be burdensome for microinsurance: required documents for claims include the statement of a loss-adjuster, which can be too expensive;
- The interpretation of “premium payment by regular installments” (Civil Code 437.2) leads to insurers scaling down their claims payment proportionate to the installments that have been paid, which is wrong and inconsistent with general insurance principles.

These situations destroy trust, possibly the most important ingredient of a sound insurance market.

Consumer Protection Regulation

The FRC has a clear mandate to protect insurance consumers;³⁶ however, existing regulations to protect insurance clients are weak:

- There are no clear insurance consumer protection rules in the Banking Law (2010) or the Consumer Protection Law (2003).
- The Law on Insurance³⁷ provides that “contractual relations between insurers and insured persons shall be regulated by the Civil Code.” The Civil Code³⁸ regulates

³⁶ Law on the Legal Status of the FRC (2005), Article 4.41.

³⁷ Law on Insurance (2004), Article 3.2.

³⁸ Civil Code of Mongolia (2002), Article 431.

insurance contracts and includes minimal standards for policy contracts and minimum disclosure to clients. The policy contract does not have to indicate where or how to make a claim, how to contact the insurance company, or how to make a complaint. There are no guidelines for policy benefit illustrations, as might be required for long-term insurance policies.

Notably, participants complain of the lack of a neutral mediator between clients and insurers on disputes over misleading sales practices, unfair loss assessments, or denied claims. Currently, disputes may be taken to the FRC but frequently have no authority other than refer the claimant to the courts.

Market Conduct Regulation

The existing insurance regulation includes limited requirements for ethical market conduct. It also includes sanctions and penalties for its violation, but none are specifically related to market conduct.³⁹ Increased market conduct requirements can have both positive and adverse effects on microinsurance. Improved disclosure to clients may lead to better understanding and satisfaction with their insurance, while higher expenses for the insurer translate to higher premiums.

The FRC has no specific sanction power over market misconduct, and the primary recourse is the publication of the insurer's performance. Annually, the FRC posts a list of the "top" insurers, which includes assessments on market conduct, among others.

Beneficiaries and Insurable Interest

Insurance legislation usually contains provisions on "insurable interest," where the policyholder must have some financial relationship to the insured person or asset. While Civil Code provisions address what or who can be the object of an insurance contract,⁴⁰ there appears no specific provisions on insurable interest.

Regulations on beneficiaries of insurance proceeds protect the policyholder, the beneficiary, and in some cases, the insurance company. In life insurance and pensions, there are often regulations around allowable beneficiaries, particularly for married persons. The Civil Code does not include regulations on beneficiaries.⁴¹

Privacy Regulation

Mongolia adopted privacy legislation in 1995 that protects individuals' personal data. The Law on Insurance provides that insurance companies must not disclose personal data without the insured's consent,⁴² although no specific guidance is provided. The primary concern in microinsurance is how to balance efforts in creating administration systems and processes that sufficiently protect client data with the costs.

³⁹ Law on Insurance (2004), Articles 58 and 59; FRC Resolution 137 (2007), Code of Ethics; Law on Insurance Intermediaries (2004), Articles 9, 16, and 28.

⁴⁰ Article 431 of the Civil Code states that "the subject of the insurance contract can be property, citizen's life, health, and other non-material interests not contradicting the law."

⁴¹ Article 441 of the Civil Code includes regulations regarding insurance purchased with respect to a "third party," but it is unclear from the context if this provision relates to beneficiaries or insurable interest. The authors have no other references to beneficiaries in the legislation.

⁴² Law on Insurance (2004), Article 9.

Further Regulatory Issues with Potential Impact on Microinsurance Development

Terminology and Translation Issues

There are no standard insurance terms or translations in use within the Mongolian insurance industry. A complete and standardized insurance glossary is not available to ensure that everyone has the same understanding of insurance terminology and uses appropriate wording for financial reporting and translations. In many cases, specialized insurance and actuarial terms do not originally exist in Mongolian. It is difficult therefore for foreign advisors to help review or draft insurance legislation, and for the Mongolian authorities to correctly interpret and implement external recommendations.

Regulation of Foreign Insurers and Reinsurance

Participation of foreign insurers in Mongolia's insurance market is currently limited. While foreign insurers and intermediaries are subject to the same regulations as domestic companies, the additional requirements⁴³ make it an unattractive opportunity. It could be beneficial to liberalize the regulations, allowing foreign insurers easier access to the market. Joint ventures between foreign insurers with known expertise in the microinsurance market and domestic distribution channels in Mongolia such as banks or MFIs would increase opportunities for knowledge transfer and advancement of the microinsurance market. Regulations should enable such arrangements without undue constraints.

Similarly, since there are no domestic reinsurers in Mongolia, there is currently a big amount of reinsurance with foreign reinsurers, including fronting arrangements. Amendments to the existing regulations to curtail these fronting arrangements would need to be carefully executed so as not to prohibit genuine risk transfer arrangements. Reinsurance for certain types of microinsurance products is desirable, to provide sufficient security for the benefits. It should not be disallowed in the future if and when reinsurance regulations are amended.

Telecommunications Regulation

Regulation of the mobile banking sector is still not developed, although new legislation is pending. A key project under the e-Government Master Plan is a bill on e-signatures. A temporary regulation was issued by the FRC in 2009⁴⁴ to allow e-banking services, but there are constraints with permitting e-signatures, and account registration in person is still required. Also, there is no regulation yet that ensures secure mobile banking and other electronic transactions. Legislation is under development for electronic governance, electronic transactions, and information security. The two existing mobile payment initiatives are operating within the limits of the temporary circular, while the regulatory environment is being developed.

Supervision and Capacity

Supervisory Approach

Currently, the insurance law obliges the FRC to (i) prescribe the methodology for premium calculations, (ii) approve reinsurance arrangements, and (iii) approve and supervise

⁴³ FRC Regulation 102, 2008.

⁴⁴ FRC Resolution No. 255, 2009.

business plans of insurers. In accordance with these requirements, insurers file their premium rates, reinsurance arrangements, and business plans with the FRC.

While the practice of the FRC in terms of product registration and approval is within these guidelines, it is not consistently implemented across the insurance market in Mongolia. Insurers have indicated that the process for product licensing and approval appears to be unplanned. In addition, there are instances of regulatory forbearance that have been challenged, such as allowing the general insurance companies to offer products that include an element of credit life insurance.

Regulatory Process

Industry representatives felt that consultations done before the introduction of new regulations are inadequate, but improving. The FRC is now required to consult with the industry before issuing new regulations, as provided in a 2010 regulation.⁴⁵ The FRC conducted consultations through the Mongolian Insurers Association (MIA) since its formation in 2008.⁴⁶ It seeks input from the MIA on industry-wide issues; where the MIA submits a unified industry view to the FRC. The FRC has also started annual dialogues with MIA members on industry performance and challenges. However, industry participants felt that a more intense consultation process would be beneficial.

The director of the FRC's Insurance Department has been willing to discuss microinsurance regulations that are unclear, inconsistent, or not covered by current law or regulations.

While adhering to the principle of appropriate supervision, some issues are recognized as not well defined in the current law and that new practices can be permitted as long as they are not in direct conflict with the existing legislation. This implies a reasonable level of forbearance on the part of the FRC, as it allows for some experimentation and dialogue on microinsurance development before formalizing new regulations or amendments.

Capacity Challenges

In its brief existence, the FRC has made significant strides in issuing regulations on insurance operations, supervising performance, and promoting professionalism in the insurance industry. However, the FRC is still a young authority and faces a number of organizational challenges such as continuity, funding, and staffing.

Continuity. The chair and six commissioners of the FRC are appointed by parliament for 5-year terms, which may be extended for a second term. The chair of the FRC is nominated by the chair of the parliament of Mongolia. The other six commissioners are nominated by the parliamentary standing committee on economics (two), the parliamentary standing committees on budget and law (one each), the governor of the Central Bank (one), and the cabinet member in charge of financial matters (one). The chair and commissioners nominated by the parliament are full time members of the FRC; while the remaining commissioners are nonstaff members of the FRC. As the terms of appointment are not staggered, there is a potential danger of loss of continuity within the FRC when all commissioners are due for renomination. Although the most recent re-

⁴⁵ FRC Resolution No. 119, 2010.

⁴⁶ See http://www.sonpo.or.jp/en/news/2010/1012_01.html

nomination period (June 2011) saw three former commissioners reappointed, including the chair, there is no guarantee that this will always be the case.

Funding. The FRC's Insurance Market Department (i) encourages market stability, (ii) grants and revokes licenses, (iii) organizes insurance training, (iv) develops accounting standards, (v) analyzes risks and provides statistics, and (vi) conducts inspections.

The FRC does not have financial independence and has to observe the Ministry of Finance (MOF) guidelines on fund allocation. About 30%–40% of its funding comes from collected regulatory fees, although these are channeled to the MOF, which in turn provides funding to FRC from the state budget. Also, the FRC observes the salary scale adopted for the civil service, restricting their capability to appoint sufficient staff and pay market salaries for actuaries or lawyers.

Retaining and developing a sufficient pool of qualified staff. The FRC's Insurance Department has a budgeted headcount of 13 in addition to the director, but four staff members are currently on maternity leave⁴⁷ and one is studying abroad. It is also critical for the FRC to employ staff with sufficient professional qualifications. Unfortunately, qualified professionals are scarce in Mongolia and the FRC is competing with private companies capable of providing better compensation and opportunities for advancement.

Actuarial calculation of premiums and reserves is required in a well-developed insurance industry but members of the local actuarial profession lack the education and experience to adequately carry out those calculations and develop appropriate standards of practice. Actuarial employees at the FRC also lack the technical capacity and experience to assess the accuracy, reasonableness, and appropriateness of the actuarial calculations provided by the insurers.

Inadequate technical capacity within the industry and the regulator inhibits opportunities for innovative and sustainable microinsurance products. As microinsurance product development typically requires adaptations of traditional actuarial pricing techniques, a thorough grounding in these topics is necessary for regulators to be able to understand and approve product features and premiums.

In connection with the efforts of the FRC to build its technical capacity, a training needs assessment is under way as part of a 2-year capacity building project for all departments within the FRC, sponsored by the Government of Luxembourg.⁴⁸ The in-country representative of this project was included in the diagnostic workshops to ensure consistency of the capacity building recommendations and support.

Systems Capacity

While the FRC has significantly improved its data collection process, regulatory reporting continues to be done manually and is insufficient for detailed industry analysis. The FRC collects quarterly and annual financial and business information from the insurers, but the manual process limits the usefulness of the collected data.

⁴⁷ In Mongolia, the allowed duration of maternity leave is up to 2 years.

⁴⁸ This is an entirely separate project from the UNDP microinsurance capacity building project, which also received funding from the Government of Luxembourg.

The European Bank for Reconstruction and Development has an ongoing project for an online database and reporting system throughout the FRC since 2011.⁴⁹ The project will improve the FRC's (i) ability to collect insurance data, (ii) ability to collate data across all entities regulated by the FRC's various departments, and (iii) the ability of those entities to submit data electronically. It should also improve the FRC's ability to review and reconcile data, and provide timely feedback. This will enable the FRC to focus on supervision and implementation of regulations instead. It will also enable cross-industry comparisons and detailed analysis of the microinsurance market.

⁴⁹ Open-source financial data collection software known as FinA.

Key Drivers for the Microinsurance Market in Mongolia

“**D**rivers” in this context are circumstances, organizations, or structures that either enable or inhibit the growth of the microinsurance market. These build the foundation on which microinsurance can grow in the future, and form the basis for the subsequent recommendations and potential implementation strategies.

Donor Engagement

At present, the most important driver for microinsurance in Mongolia is donor involvement. All existing formal microinsurance projects have significant elements of donor support, funding, and intervention. Given the industry’s profit orientation and insurance market underdevelopment, it will be unlikely for microinsurance to develop on its own in Mongolia. Donor support has brought research, capacity building, awareness and key pilot projects. Consequently, interest in microinsurance is currently high among industry participants since it is seen as a source of donor funding.

However, donor involvement can also be a limiting factor; such as in cases where projects are narrowly focused or create conflicts of interest, or if capacity building requirements are not based on a thorough needs analysis. Also, donor engagement focused on microinsurance could distort the rational allocation of scarce national resources toward insurance market development.

As defined in the German Federal Ministry for Economic Cooperation and Development (BMZ) Position Paper on Microinsurance,⁵⁰ sustainable microinsurance is characterized by the following features: (i) financial viability, i.e., insurers and intermediaries operate efficiently and in the medium term without external support, thereby guaranteeing a sustainable offer; (ii) demand orientation, i.e., microinsurance is developed and marketed according to demand and verifiably improves the life situation of the persons insured; and (iii) breadth of outreach, i.e., large sections of the population has access to microinsurance.

Policy and Regulatory Considerations

Policy and regulatory factors are not major obstacles, although limitations on the available distribution options do pose challenges for developing sustainable microinsurance programs. Despite these challenges, there are **no onerous regulatory barriers** to the development of microinsurance.

However, there are no unique provisions or structures within the policy and regulatory environment that enable the expansion of microinsurance either. Opportunity exists

⁵⁰ BMZ. 2009. *Security at Little Cost: Microinsurance in Financial Systems Development*. Bonn: Federal Ministry for Economic Cooperation and Development.

for policy and regulatory change to become an enabling driver, but it needs to be exercised.

The overall weak policy and regulatory framework and the lack of capacity of the FRC, Bank of Mongolia (BOM), and the Ministry of Finance (MOF) remain as barriers.

Inhibiting Factors

Socioeconomic factors, as well as geography and culture, play a significant inhibiting role for microinsurance in Mongolia:

- (i) As noted earlier, ***Mongolia experiences a high level of poverty***, particularly in certain regions. This obviously limits the capacity to pay for insurance for much of the population. Microinsurance products need to be designed with this capacity in mind, and in order for such low premium products to be sustainable, distribution needs to be wide enough to achieve economies of scale. However, the ***large distances and difficult terrain, as well as a very low density rural population, are significant challenges*** to cost-effective distribution in rural areas. Developments in technology and removal of regulatory barriers to allow new distribution channels may not be sufficient to overcome such challenges.
- (ii) Cultural issues impact demand from the underserved market. ***Consumer understanding and trust in insurance is low***, especially as a result of the former socialist insurance systems. Taboos against discussing death or other negative events create reluctance to purchase insurance, even with the recognition that such products may be beneficial. Development of cost-effective microinsurance products that meet the real needs of the market will not in itself be sufficient to overcome the inherent bias against insurance.
- (iii) The government's stated role and intention to provide increased social welfare benefits and make the social insurance system mandatory for all citizens, plus the realities of the existing health care system, make it difficult to develop commercial health insurance products that are complementary to the state system. It appears that the Ministry of Health is not supportive of private insurers entering the health insurance market. However, simple microinsurance products can provide complementary benefits or savings-type benefits to manage health-related costs not covered by public health insurance.

Insurers' attitude and capacities are another major constraining factor:

- (i) ***Unique challenges exist in terms of premium collection and irregular income patterns*** within the target market. Premiums are typically paid up front on an annual basis, both in the corporate and retail markets. There appears to be little in the way of automated premium collection facilities, for example, the ability to deduct regular monthly premiums on an automated basis. Even for insurance offered through banks (for example, credit insurance on loans or property insurance on mortgages), the annual premiums are typically paid up front as a deduction from the loan proceeds.
- (ii) In many areas it is ***difficult to contact insurance clients*** on a regular basis: they may not use banking or other financial services regularly, and there is no residential postal service in Mongolia. Many potential clients will not have regular

periodic income, and may, in fact, prefer to make an annual premium payment at a time when funds are available. For microinsurance products, these constraints are even more relevant.

- (iii) The ***lack of capacity at the insurer level limits the potential to develop and market microinsurance***. Given the experience of microinsurance pilots to date, insurance providers may be more reluctant to participate in the microinsurance market without donor support. Low profit margins for microinsurance products provide little incentive to invest in expansion of this market. Lack of technical capacity within insurance organizations limits their ability to design and deliver innovative and sustainable microinsurance products.

Enabling Conditions

Mongolia's economy is expected to grow significantly over the coming years due to developments in the mining industry. Increases in government revenues and spending should improve the provision of services to the poor, including social welfare transfers. An example is the monthly "motherland" payment to each citizen that was initiated in 2011. This potentially increases the capacity of the target segment to pay for microinsurance products.

Increased migration of rural herder families to Ulaanbaatar and other urban centers adds to the number of people easily reached through traditional distribution channels. Urban populations also have greater access to financial services and consumer education programs

As a result of the monthly "motherland" payments, ***a large percentage of the population now has a formal bank account***. Having a bank account with a guaranteed stream of future deposits facilitates the granting of small short-term loans, and has potential to expand the distribution of microinsurance products and the capacity to purchase them. Consumer education could also be initiated in bank branches.

Finally, the ***rapid development and availability of technology increases*** the potential for alternate distribution models. High mobile phone penetration and development of mobile payment platforms appear to be promising directions for low-cost distribution models in Mongolia.

Recommendations

The development of Mongolia's microinsurance market depends on the overall development of the wider insurance market, as indicated in the preceding analysis. It is difficult to develop the microinsurance market without a viable life insurance sector or a strong retail insurance focus in the nonlife sector. Consequently, the authors believe that FRC's focus should be to develop the broader insurance market, ensuring that microinsurance initiatives are supported by such development rather than constrained.

The following recommendations outline action areas that could support microinsurance in the near term, including general insurance market recommendations that will contribute to the development of microinsurance in Mongolia.

Recommendation 1: Strengthen access to insurance through the formulation of a coordinated financial inclusion policy.

- Form an Access to Insurance Working Group between Bank of Mongolia (BOM), Ministry of Finance (MOF), and the Financial Regulatory Commission (FRC) that will formulate a national strategy to promote access to insurance and/or microinsurance, in coordination with stakeholders and development agencies. Consider putting in place a similar structure to develop mobile banking. Notably, the FRC has already created an insurance working group that could help serve this purpose.
- Initiate a dialogue between the Ministry of Health, the Ministry of Social Welfare, and the insurance industry to integrate public and private insurance benefits. Define appropriate roles, policies, and funding obligations; and ensure microinsurance products complement the existing social welfare system.
- Develop a strategy for consumer education initiatives involving both government agencies and the private sector.

Recommendation 2: Develop a strategic approach to promote access to insurance, and outline a regulatory course of action for the FRC.

- Identify areas to expand the FRC's role as a driver of market development for microinsurance (e.g., through coordination of microinsurance policy work).
- Identify short, medium, and long-term goals for a microinsurance regulatory approach and integrate microinsurance into the FRC's Medium-Term Strategy Plan on Insurance Sector Development.
- Balance distribution modes and product delivery with protecting clients rights by regulating the market conduct and claims procedures.

- Clearly separate the activities of the FRC relative to regulating and supervising the insurance market; and those related to microinsurance market development, such as its participation in the management of UNDP's microinsurance capacity building project.

Recommendation 3: Industry participants should develop sustainable microinsurance programs based on market research and good business case.

- Initial focus should be on urban areas, and to apply lessons learned when expanding to rural areas. Microinsurance products should focus on health insurance products designed to complement the social health insurance scheme, and bundled products offering both life and nonlife benefits.
- Explore technology potential for cost-effective premium collection and claims payment through partnerships with microinsurance technology providers in other countries.

Recommendation 4: Ease regulations on insurance intermediaries.

- Allow all regulated financial institutions to act as insurance agents and brokers. Permit other nonbanking financial institutions such as savings and credit cooperatives, agricultural cooperatives, microfinance institutions (MFIs), and loan collateral programs to act as insurance intermediaries.
- Develop a coordinated approach to licensing of intermediaries within the FRC (Insurance and nonbanking financial institution departments) and with the BOM.
- Consider expanding other intermediary channels such as retail shops, apartment associations, post offices, among others, and the appropriate licensing requirements for such channels.

Recommendation 5: Expand regulations to create options for insurance providers and intermediaries to foster innovation in product development, distribution, and sustainable business models.

- Ensure regulations are flexible enough to allow experimentation—such as bundling insurance products with retail products or nonfinancial services—in addressing challenges. Allow innovation in sales and marketing such as mobile payment systems.
- Ensure existing or new regulations do not restrict access to foreign participants in the insurance or reinsurance markets. Explore options for different institutional structures for insurance providers, such as mutual organizations.

Recommendation 6: Define microinsurance products that would be allowable under both life and nonlife classifications. Clarify and maintain consistency in the definitions and insurance classification in laws and regulations.

- Health insurance products are already allowed under both life and nonlife insurance categories. Short-term, low benefit, and low-risk life insurance products can be developed for the microinsurance market and sold in combination with other benefits such as health coverage.

- Revise the definition of insurance and life insurance business as recommended in the Insurance Core Principles (ICP) Assessment.
- Revise the classification of insurance business for clarity and consistent application of prudential requirements.
- Include “group” policies in the definition of insurance in laws and regulations.
- Consolidate proposed revisions to primary legislation for inclusion in future amendments.

Recommendation 7: Improve regulations and supervisory practices on consumer protection.

Key ICP recommendations included the following:

- Assess the implementation of requirements for “know-your-client” practices and the proper analysis of clients’ needs to support their insurance purchase decisions.
- Expand supervision to ensure that insurers are liable for the conduct of their agents.
- Introduce a proper disclosure regime for marketing materials, proposals, benefit illustrations, and policy documents.

The following additional recommendations were made during the interim workshop:

- Review insurers’ policies and procedures on complaints handling and develop an industry-wide dispute resolution mechanism, such as an ombudsperson.
- Review current requirements for claims documentation and evaluate the potential for simplified claims procedures.
- Develop an easily accessible client service department within the FRC for consumer education and protection.

Recommendation 8: Develop a capacity building strategy for the FRC.

- Review the FRC’s staffing requirements. Develop a medium-term capacity building program; including training courses, exchange visits, and international exposure or secondments, if possible. Obtain additional funding for training.
- Delegate training, accreditation, and licensing of insurance professionals to their respective professional associations.
- Fill short-term capacity gaps with foreign nationals and external secondments (internships, exchange programs, etc.). Work with the insurance industry to bring in experts for training and assistance.
- Ensure that FRC has the required number of skilled professionals such as actuaries and accountants duly accredited for their roles according to international best practices.

Recommendation 9: Standardize insurance terminology and translations used in the industry.

- Produce a standard glossary using international insurance terminology, and implement standard Mongolian translations to and from English. Notably, the Mongolian Insurers Association had already initiated this and the project is on track to produce a final version in 2011.
- Conduct information sessions with industry to ensure agreement and consistency.
- Commission new translations of all insurance laws, regulations, and guidelines to ensure consistency of interpretation and use.

Recommendation 10: Assist the Mongolian Society of Actuaries to develop the actuarial profession in Mongolia in collaboration with the International Actuarial Association (IAA).

- Request the IAA to hold an industry-wide seminar in Mongolia on the role of the actuary.
- Conduct IAA training seminars with international assistance and trainers; potentially adopt the corresponding examinations as an interim accreditation for actuaries in Mongolia.
- Work with the IAA Fund Asia Subcommittee to develop actuarial standards of practice for the Mongolian actuarial profession.

Notably, the Society of Actuaries arranged for the IAA to hold a seminar on the “Role of the Actuary” in Ulaanbaatar in November 2011. Discussions are underway for an initial set of training modules assuming adequate funding can be secured.

Recommendation 11: Assist the Mongolian Insurers Association to develop an independent Insurance Training Institute

- Explore funding sources through membership fees and international development agencies.
- Consult the Institute for Global Insurance Education (www.igie.org) for advice and curriculum development. Evaluate the feasibility of having an independent institute collaborating with existing organizations such as the bank training institute or universities.
- Conduct specific training sessions on microinsurance: (i) Identify training needs of insurers in cooperation with MIA, (ii) Introduce and train stakeholders on key principles of microinsurance, and (iii) Liaise with the microinsurance network for training courses and modules.

Recommendation 12: Implement an online database management system within the FRC's Insurance Department.

- Complete the development and definition of metadata for insurance with assistance from an experienced insurance professional.

- Encourage insurance companies to develop systems that will automatically produce data consistent with FRC database format.

Recommendation 13: Development organizations need to ensure their programs support capacity development without skewing the development of the overall insurance market.

- Development agencies need to balance their involvement and coordinate their efforts—encouraging private sector engagement alongside.
- Ensure social insurance schemes work as well as they can. Making private distribution work for public social insurance can be a useful approach to improving risk mitigation for the poor without distorting the development of the commercial market.

Moving Forward

The final outcome of the diagnostic process will be a road map shared with the Financial Regulatory Commission (FRC) and the sponsoring donor organizations, outlining priorities and potential immediate gains. This road map will be developed in a final stakeholder workshop, and in consultation with the FRC.

High priority areas with the potential to deliver immediate results include the following: (i) allow all currently regulated financial institutions to act as insurance agents and brokers; (ii) ensure regulations do not limit options for innovative product development, including the ability to bundle insurance products with non-insurance services; (iii) create a simple definition for microinsurance products; (iv) focus pilots in areas with higher population concentrations and more developed distribution channels; and (v) implement capacity building, education, and training.

APPENDIX 1

Financial Regulatory Commission Resolution No. 16 (2009)— Allowable Insurance Categories

- 1.0 Regular insurance:
 - 1.1. Accident, medical expense insurance
 - 1.2. Property insurance
 - 1.3. Car insurance
 - 1.4. Cargo insurance
 - 1.5. Construction insurance
 - 1.6. Agriculture insurance
 - 1.7. Livestock insurance
 - 1.8. Aircraft insurance
 - 1.9. Driver's liability insurance
 - 1.10. Liability insurance
 - 1.11. Financial insurance
- 2.0 Life insurance:
 - 2.1. Term life insurance
 - 2.2. Whole life insurance
 - 2.3. Endowment
 - 2.4. Pension insurance
 - 2.5. Health insurance
 - 2.6. Annuity Insurance

APPENDIX 2

Law on Insurance (2004), Article 8, Insurance Payments

- 8.1. The insurer, according to the conditions specified in the law and contract and based on documents specified in provision 8.4, shall make the insurance payment.
- 8.2. When stipulated in the insurance contract the insurance payment can be paid directly to a third party who has suffered loss due to the fault of an insured person.
- 8.3. If an insurance event occurs after the death of an insured person, insurance payment shall be paid to his/her legal assessors or assessor by inheritance.
- 8.4. Insurance payment shall be made based on the following documents:
 - 8.4.1. application of insured person;
 - 8.4.2. insurance policy (original copy);
 - 8.4.3. assessment act on loss written by loss adjuster;
 - 8.4.4. where required, a concluding statement from a professional organization.
- 8.5. Insurer may refuse to make insurance payment in full or partially on the following grounds:
 - 8.5.1. insured person deliberately caused a loss, or created the conditions or environment to precipitate that;
 - 8.5.2. insured person gave wrong information to insurer on the insured item, or forged insurance documents;
 - 8.5.3. loss occurred due to reason which was not specified in the insurance contract;
 - 8.5.4. insured person received compensation from person who caused him/her loss;
 - 8.5.5. other grounds specified in the law.
- 8.6. The insurer shall precisely specify the grounds for refusal to make insurance payment and notify the insured person of this in written form.
- 8.7. If specified in the insurance contract the right of the insured person to claim loss from a guilty person shall cover insurance payment and related expenses.

APPENDIX 3

The Responsible Finance Framework¹

1. What is responsible finance?

Responsible finance is the delivery of retail financial services in a transparent and equitable fashion. The focus is on products, processes, and policies that avoid harmful or unfair treatment, appropriately balance customers' interests with those of providers, and achieve the social mission of microfinance. In the broadest sense, it is about balancing concern for people, profit, and the planet.

2. Whose responsibility is it?

Financial services providers are at the front line of implementing responsible finance. At a minimum, even single bottom line institutions should ensure client protection and fair treatment. Other actors in financial inclusion—among them industry associations and networks, consumer organizations, policy makers, regulators, and funders—also have a role to play in promoting best practices in microfinance. Irresponsible practices in the microfinance sector affect the reputation and effectiveness of all these actors. The onus to uphold responsible finance therefore extends beyond retail providers to these other industry stakeholders.

3. What strategies and measures promote responsible finance?

Three lead strategies promote responsible finance improvements in financial services for the poor:

- **Consumer protection regulation.** As the only actor with the power to establish legal standards, governments have considerable power to incentivize good practices. Governments should aim for clear, easily enforceable regulations that balance adequate consumer protection and fair treatment with continued access and innovation.
- **Industry codes of conduct and standards.** From individual providers to industry associations and networks, the ability of the industry to monitor and improve its efforts in responsible finance is vital to effective consumer protection and upholding industry-wide standards of practice.
- **Initiatives to improve consumer awareness and financial capability.** Consumers and advocates can be effective watchdogs for improper practices. Financial capability programs for consumers and channels to register complaints and report abuses are two ways to engage consumers proactively in responsible finance.

These three strategies strengthen incentives or create consequences for behavior that is not sufficiently responsible. They are mutually reinforcing.

¹ Adapted from Consultative Group to Assist the Poor. www.cgap.org

APPENDIX 4

The Insurance Core Principles of the International Association of Insurance Supervisors (2011)¹

ICP 1—Objectives, Powers and Responsibilities of the Supervisor

The authority (or authorities) responsible for insurance supervision and the objectives of insurance supervision are clearly defined.

ICP 2—Supervisor

The supervisor, in the exercise of its functions and powers:

- is operationally independent, accountable, and transparent
- protects confidential information
- has appropriate legal protection
- has adequate resources
- meets high professional standards

ICP 3—Information Exchange and Confidentiality Requirements

The supervisor exchanges information with other relevant supervisors and authorities subject to confidentiality, purpose, and use requirements.

ICP 4—Licensing

A legal entity that intends to engage in insurance activities must be licensed before it can operate within a jurisdiction. The requirements and procedures for licensing must be clear, objective and public, and be consistently applied.

ICP 5—Suitability of Persons

The supervisor requires board members, senior management, key persons in control functions, and significant owners of an insurer to be and remain suitable to fulfill their respective roles.

ICP 6—Changes in Control and Portfolio Transfers

Supervisory approval is required for proposals to acquire significant ownership or an interest in an insurer that results in that person (legal or natural), directly or indirectly, alone or with an associate, exercising control over the insurer. The same applies to portfolio transfers or mergers of insurers.

¹ Adopted on 1 October 2011 and amended on 12 October 2012 with new ICP 9.

ICP 7—Corporate Governance

The supervisor requires insurers to establish and implement a corporate governance framework that provides for sound and prudent management and oversight of the insurer's business and adequately recognizes and protects the interests of policyholders.

ICP 8—Risk Management and Internal Controls

The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters, and internal audit.

ICP 9—Supervisory Review and Reporting

The supervisor takes a risk-based approach to supervision that uses both off-site monitoring and onsite inspections to examine the business of each insurer, evaluate its condition, risk profile and conduct, the quality and effectiveness of its corporate governance and its compliance with relevant legislation and supervisory requirements. The supervisor obtains the necessary information to conduct effective supervision of insurers and evaluate the insurance market.

ICP 10—Preventive and Corrective Measures

The supervisor takes preventive and corrective measures that are timely, suitable, and necessary to achieve the objectives of insurance supervision.

ICP 11—Enforcement

The supervisor enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.

ICP 12—Winding-up and Exit from the Market

The legislation defines a range of options for the exit of insurance legal entities from the market. It defines insolvency and establishes the criteria and procedure for dealing with insolvency of insurance legal entities. In the event of winding-up proceedings of insurance legal entities, the legal framework gives priority to the protection of policyholders and aims at minimizing disruption to the timely provision of benefits to policyholders.

ICP 13—Reinsurance and Other Forms of Risk Transfer

The supervisor sets standards for the use of reinsurance and other forms of risk transfer, ensuring that insurers adequately control and transparently report their risk transfer programs. The supervisor takes into account the nature of reinsurance business when supervising reinsurers based in its jurisdiction.

ICP 14—Valuation

The supervisor establishes requirements for the valuation of assets and liabilities for solvency purposes.

ICP 15—Investment

The supervisor establishes requirements for solvency purposes on the investment activities of insurers in order to address the risks faced by insurers.

ICP 16—Enterprise Risk Management for Solvency Purposes

The supervisor establishes enterprise risk management requirements for solvency purposes that require insurers to address all relevant and material risks.

ICP 17—Capital Adequacy

The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.

ICP 18—Intermediaries

The supervisor sets and enforces requirements for the conduct of insurance intermediaries, to ensure that they conduct business in a professional and transparent manner.

ICP 19—Conduct of Business

The supervisor sets requirements for the conduct of the business of insurance to ensure customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.

ICP 20—Public Disclosure

The supervisor requires insurers to disclose relevant, comprehensive, and adequate information on a timely basis in order to give policyholders and market participants a clear view of their business activities, performance, and financial position. This is expected to enhance market discipline and understanding of the risks to which an insurer is exposed and the manner in which those risks are managed.

ICP 21—Countering Fraud in Insurance

The supervisor requires that insurers and intermediaries take effective measures to deter, prevent, detect, report, and remedy fraud in insurance.

ICP 22—Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)

The supervisor requires insurers and intermediaries to take effective measures to combat money laundering and the financing of terrorism. In addition, the supervisor takes effective measures to combat money laundering and the financing of terrorism.

ICP 23—Group-Wide Supervision

The supervisor supervises insurers on a legal entity and group-wide basis.

ICP 24—Macroprudential Surveillance and Insurance Supervision

The supervisor identifies, monitors, and analyzes market and financial developments and other environmental factors that may impact insurers and insurance markets and uses this information in the supervision of individual insurers. Such tasks should, where appropriate, use information from, and insights gained by, other national authorities.

ICP 25—Supervisory Cooperation and Coordination

The supervisor cooperates and coordinates with other relevant supervisors and authorities subject to confidentiality requirements.

ICP 26—Cross-border Cooperation and Coordination on Crisis Management

The supervisor cooperates and coordinates with other relevant supervisors and authorities such that a cross-border crisis involving a specific insurer can be managed effectively.

APPENDIX 5

Focus Group Research: Income, Expenditures, and Savings

The average **household income** of those participating in the focus groups, including benefits received from the government, was approximately MNT442,000 (\$360) per month. Information on household income from all sources was not estimated or collected consistently across the focus groups, so this is a rough guide. In general, reported household income and personal income is lower for the female participants, which may reflect a certain percentage of households headed by females with only one income earner, or differences in estimating household income between genders. This average is notably higher than the average rural household income from 2009 (approximately MNT350,000), but this also reflects increases due to inflation and new government transfers. Given that 49% of rural households are deemed under the minimum subsistence level, the average income of participants is expected to be slightly higher than the rural average. However, it is not significantly higher and indicates that this population is still vulnerable to financial repercussions of any risk event.

Average monthly household expenses were estimated at MNT332,000 (approximately \$270). This indicates an average ratio of expenses to total household income of 85%. However, there is a significant variance in this ratio between males and females (76% for males, 94% for females). Data analysis suggests that this may be due to difference in estimations between men and women rather than actual differences in expenditures, since we were recording total household income and expenditures. Women reported higher estimates for monthly household expenses than men across region and age group categories, which could show that they have more control over how the funds are spent in the household.

Focus groups in the rural *aimag* of Bayankhongor reported a higher average income than in other regions, which suggests that these participants were in a higher income bracket compared to participants from other regions. The following are rough conclusions within the limitations of the data:

Total household income is about the same between urban and rural areas, whereas total expenditures are approximately 60% higher in urban areas. The ratio of monthly expenses to household income is near or over 100% in urban areas (ranging from 90%–158%, with an average of 118%), and ranges from 43%–98% in rural areas (with an average of 64%). The subgroups with the highest ratio of expenses to income were males over 40 in Ulaanbaatar (158%) and females under 40 in Orkhon/Erdenet (150%). These variances likely reflect both an increased cost of living in urban centers, and different expectations from city dwellers. For example, the young women from Erdenet reported typical expenditures for internet use, training seminars, beauty products, and brand name clothing that were not reflected in the other discussion groups.

Most common expenses included housing/rent, electricity, tuition and school materials, transportation/car expenses, food/grocery, and illness or death of a relative or friend. These results are consistent with the National Statistics Office household survey data from 2009.

Self-reported **savings** rates vary significantly by gender: 24% of females have savings compared to only 14% of males. Variances by age group are even more significant: 27% for those over 40 years compared to only 9% for those under 40. Not surprisingly, rural areas report higher savings rates than urban areas (24% compared to 13%). Many participants commented that their expenses were higher than their income, which means that, not only were they unable to save, they had a regular need for short-term borrowing.

Figure A5.1: Household Income and Expenses, by Aimag

Aimag	Average Personal Income (MNT/month)	Average Total Household Income, including state benefits (MNT/month)	Average Monthly Expenses (MNT/month)	Average Ratio of Expenses to Total Income (%)	No. with Savings	No. in Focus Group Discussion	Average Family Size
Arkhanga	145,280	360,550	250,733	75.20	8	30	4.5
Bayankhongor	279,160	628,960	355,200	62.10	5	25	4.3
Darkhan-Uul	200,389	398,722	327,556	93.11	3	18	3.8
Orkhon	216,682	468,727	453,964	115.57	0	22	3.5
Ulanbaatar	290,188	428,750	535,000	148.53	4	16	4.5
Zavkhan	180,857	376,071	189,429	52.47	7	28	4.5
Total	211,643	441,867	332,009	85.41	27	139	4.2

Note: *aimag* = province.

Source: A2II focus group research.

Figure A5.2: Household Income and Expenses by Age and Gender

Age Group and Gender	Average Personal Income (MNT/month)	Average Total Household Income, including State Benefits (MNT/month)	Average Monthly Expenses (MNT/month)	Average Ratio of Expenses to Total Income (%)	No. with Savings	No. in Focus Group Discussions	Average Family Size
18–40 years							
Female	216,148	411,481	358,519	105.25	4	27	3.4
Male	224,433	476,600	320,560	72.83	1	30	4.2
40+ years							
Female	178,455	416,053	336,638	87.13	14	47	4.5
Male	241,771	470,200	315,154	78.60	8	35	4.5
Total	211,643	441,867	332,009	85.41	27	139	4.2

Note: *aimag* = province.

Source: A2II focus group research.

APPENDIX 6

United Nations Development Programme Microinsurance Project Demand Study

The United Nations Development Programme's (UNDP) microinsurance capacity building project included a comprehensive quantitative demand study conducted at the beginning of the project period.¹ The study sought to profile the potential microinsurance client, including their understanding of risks and insurance, affordability of insurance premiums, and constraints on access to insurance. The study covered the pilot regions of Khan-Uul, Nalaikh, and Selenge, and included interviews with 500 people. It also included an analysis of distribution and delivery channels. The primary results of the study are provided below.

Information on Households Surveyed

- Thirty-four percent of the households surveyed had a monthly income of less than MNT100,000 and 77% had disposable income of less than MNT5,000 per month; 51% of the households surveyed were below the mean national average income.
- Sixty-nine point two percent of households have more than one source of income.
- Twenty-six percent of households included someone who had lost his/her job in the last 3 years; 1.6% had someone who had suffered bankruptcy in the past 3 years.
- Nine percent were affected by fire in which 8% had lost all assets; 17% were affected by severe weather.
- Forty-five point two percent of households surveyed were headed by females; 26.4% were widowed; 8.4% were divorced; and 12.6% were aged over 65 years.
- Twenty percent of households included someone with a disability and 29.2% included a family member with a chronic illness.
- Accident leading to temporary disability was the largest risk faced by households surveyed, followed by risk of death of a family member due to natural causes, death of the breadwinner, accidental and/or unexpected death and accidents leading to permanent disability.

Knowledge of Insurance

- Households surveyed were not knowledgeable about insurance and insurance products. Most households did not know about livestock insurance, accident and/or disability insurance, life insurance or property insurance; 87% were aware of health insurance.

¹ M. U. Ahmed. 2009. *In-Depth Survey on the Insurance Industry in Mongolia and the Potential Market for Microinsurance*. Ulaanbaatar: UNDP.

- Seventy-nine point four percent of households responded that they have or had insurance coverage in the past 5 years while 20.6% of the households have not had insurance at any time. Of the households that have had insurance in the past 5 years, 41.6% currently have insurance coverage while 37.6% have discontinued their coverage.
- Of the households that have or had insurance in the past 5 years, 87% held health insurance, 3.2% held property insurance, and 1.8% held accident and/or disability insurance, and 8% held other types of insurance; 37.8% of the households paid for their own health insurance, 2.2% paid for their own property insurance, and 0.8% paid for their own accident/disability insurance.
- Of the households that did not have insurance in the last 5 years, 45% had never thought about it as being a risk protection mechanism, while 17% would like to get more information about insurance; 11% did not know where to buy insurance and 6% thought insurance was very expensive. Lack of awareness and misinformation appear to be the main reasons for not having insurance.

Product Development

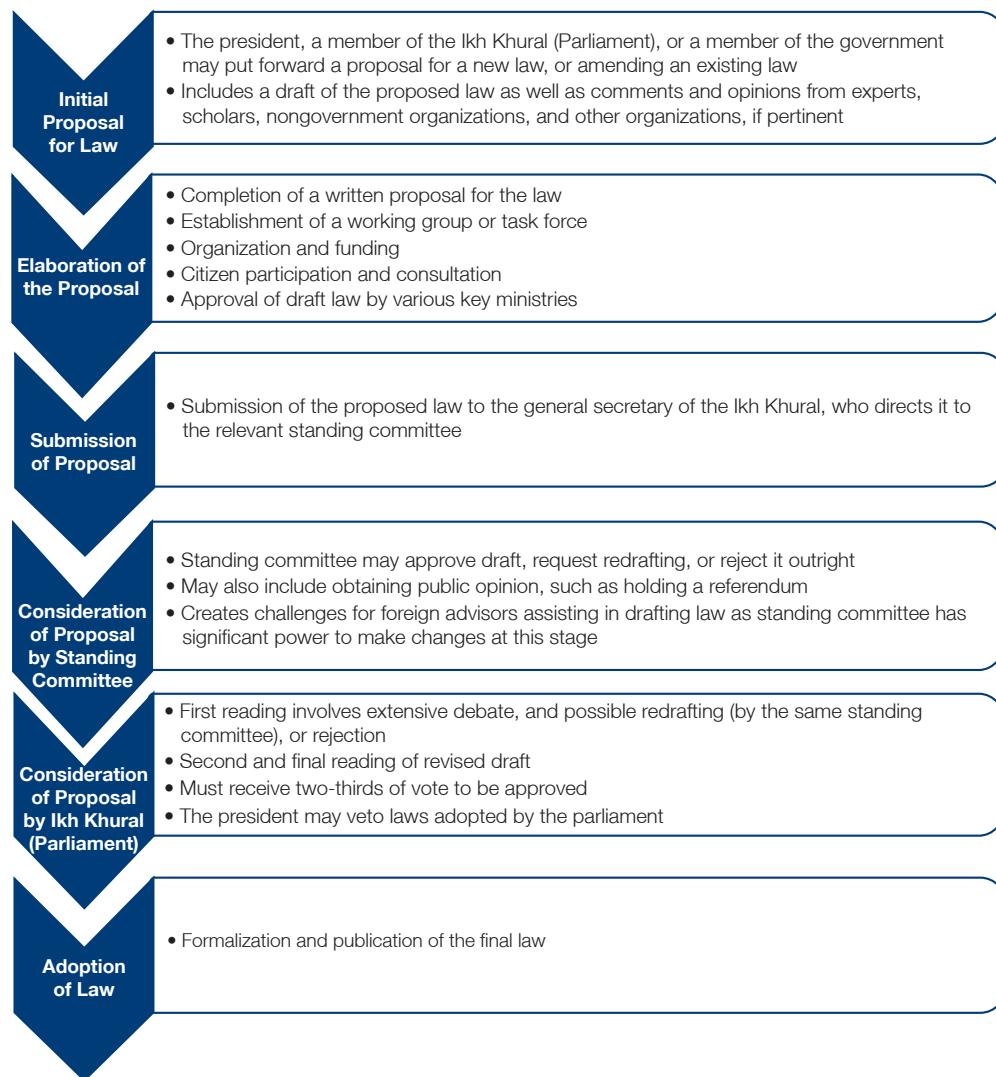
- The households surveyed require insurance coverage against accidental disability, death, and health care. Interest in property and funeral insurance was low.
- For the pilot project, health insurance and life insurance would have sufficient demand: 83.2% of the households surveyed were willing to purchase the health insurance concept product and 52.6% were willing to purchase the life insurance concept product.

Insurance Delivery Partners

- The customer base, location, branch network, and existing distribution infrastructure of Savings and Credit Cooperatives (SCCs) make them attractive partners for the delivery of insurance and collection of premiums. It is recommended that the project explores the possibility of establishing a partnership between them and the insurance provider and reward the SCCs for their services within the existing insurance regulations.
- If the SCCs cannot be accommodated within the current regulation, the project should persuade the Financial Regulatory Commission to introduce new rules under the existing regulations to facilitate such payment for microinsurance services.

APPENDIX 7

The Law Making Process in Mongolia



Source: Open Society Forum. 2009. *Making Laws in Mongolia – A Guidebook for Citizens*. Ulanbaatar: Admon Publishing.

APPENDIX 8

Comparative Results from Microinsurance Focus Group Discussions in Swaziland¹

The following provides insights from another country with small population. The insights are not always comparable (e.g., HIV/AIDS is more prevalent in Southern Africa), but they are nevertheless valuable indications for product features, regulations, or consumer education.

When asked what would make insurance more attractive to them (apart from affordability, which was highlighted as core), the respondents emphasized the following:

More information. Several respondents claimed they had lack of information about insurance and that they wished to be educated; with the information directly coming from the insurance company and not via a broker or representative. The perception is that these “sales people” do not have their best interests at heart.

Reasonable premiums. Insurance would only be attractive if the premiums are very low and, if possible, not a fixed amount per month.

Need for grace periods. Respondents found it difficult to understand why insurers do not have ways of assisting individuals through some special arrangement when payment is impossible.

Comprehensive benefits. There was a sense that benefits should completely cover the costs related to the event or problem to avoid further worry or stress. For instance, in case of death and a funeral, the benefits must cover all the related expenses such as the coffin and food.

No medical examination. The concept of undergoing a medical examination before qualifying for a policy did not appeal to respondents. They were particularly averse to undergoing an HIV/AIDS test.

Some cash-back reward. The idea of a cash-back benefit was appealing to respondents. For these low-income individuals, the perception that the insurance policy is also a form of saving is important.

Provision for extended family needs. Some male respondents felt that insurance in its current form does not cater to the needs of an African man who is responsible for an extended family.

¹ Access to Insurance Initiative (A2II) Swaziland Country Diagnostic, July 2011.

Waiting periods. The waiting period before the policy becomes valid was an unattractive element of insurance. It was felt that long periods of paying a monthly premium and not being covered was not viable for those with low income. Interestingly, respondents in the first instance understood that there was a waiting period and what it entailed.

Insurance tailored to the needs of the low-income market. Respondents argued that insurance companies did not understand the particular needs of poor people and that the products should be customized specifically to these needs.

Transparency and aversion to commissions. Transparency was considered essential to make insurance more attractive for the target market. It need not be a large company, but it has to be credible. In addition, they do not want brokers, since they perceive that they pay for the brokers. The belief was that the company must pay their own employees to sell insurance, while the premiums of the individual should go toward his/her own benefit.

APPENDIX 9

Examples of International Responses to Microinsurance Policy, Regulation, and Supervision

The following table summarizes international precedents in the definition of microinsurance to ensure low-income targeting, as well as key aspects of the applicable regulatory regime (as of end 2009):

	India	Philippines	South Africa (Proposed)	Peru	Mexico
Maximum premium	(...)	\$25.5 per month (set as maximum % of daily minimum wage)	(...)	2007 Resolution: A monthly premium of up to \$3.3 Monetary definition was removed by Oct 2009 resolution	For asset insurance, a monthly premium of up to 1.5 times the daily minimum salary (\$7)
Benefit limits	Nonlife: maximum \$740; minimum \$123 (exception for family health and accident: \$247) Life: maximum \$1,230 (exception endowment and health: \$740); \$123 minimum (family health and accident: \$247)	\$4,256 (set as maximum % of daily minimum wage)—limit defined for life only Recommended: \$6,226 all microinsurance	Current: \$2,400 funeral \$900 friendly societies	2007 Resolution: Up to \$3,300 Monetary def. removed by Oct 2009 resolution	For personal insurance an amount up to four times (groups insurance three times per member) the annual minimum salary, which amounts to \$6,840 (Groups \$5,130)
	Nonlife: not applicable (exception personal accident: >5, <17)			(...)	(...)
Age of entry	Life: >18, <60 Nonlife: not applicable (exception personal accident: >5, <17)	(...)	(...)	(...)	(...)
Term limits	Nonlife: 1 year Life: >5, <15 years (exception health insurance: >1, <7)	(...)	maximum 1 year	(...)	1 year renewable, except where linked to credit

continued on next page

Table *continued*

	India	Philippines	South Africa (Proposed)	Peru	Mexico
Product features	Simplicity, available in vernacular language	Product must clearly set out details, be easy to understand, with simple documentation requirements. Premium collection must coincide with cash flow/not be onerous to target market	Simplicity and disclosure requirements, including need for a recourse channel	For individual policies: a simplified policy For group coverage: certificates or summary policies No deductibles and exclusions 30 day grace period Claims to be paid within 10 days	Contracts must be clear, precise and simple Certain mandatory, simplified consumer protection clauses to be included in the contract Simple premium payment mechanisms Limited exclusions 30 days grace period
Demarcation	Composite life and nonlife microinsurance products allowed, but separate insurers must underwrite the risk	Life and nonlife microinsurance policies possible; only life has maximum benefit limits	Life/nonlife demarcation removed for microinsurance	Applies to any insurance type	Applies to life, personal accident, asset, and health
Market conduct aspects	Commission cap of 10%–20% of premium, depending on premium payment method. This is higher than the 60% (over 5 years) for full insurers. Reduced training requirements for microinsurance agents.	No concessions	Uncapped commissions for microinsurance, paid on an "as and when" basis Reduced training/qualification for those selling only microinsurance	Insurer-agent model for microinsurance, with MFIs, cooperatives and other groups as agents, versus broker model	Range of intermediaries expanded beyond brokers and agents Reduced training requirements
Institutional and/or prudential aspects	No prudential tier for microinsurance; distribution through qualifying nonprofit microinsurance agents	Microinsurance concessions only apply to registered Mutual Benefit Associations with more than 5,000 members and that provide exclusively microinsurance	Public companies, cooperatives, and friendly societies may become micro-insurers	No concessions	No concessions

MFI = microfinance institution, Oct = October.

Sources: IAIS-MIN Joint Working Group on Microinsurance 2008; SBS 2007; GTZ 2008; Aguilera Verduzco, 2007.

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Access to Finance

Developing the Microinsurance Market in Mongolia

Mongolia experienced a challenging transition from socialist economy to market economy from 1990 onwards. Its commercial insurance market is still at its infancy, with gross written premiums in 2013 amounting to only 0.54% of gross domestic production. ADB undertook this technical assistance study to support microinsurance development in Mongolia.

The study provides an overview of the development of Mongolia's insurance market in general and the microinsurance segment in particular, then identifies gaps in the insurance regulatory framework that need to be bridged to expand microinsurance coverage to more households.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to approximately two-thirds of the world's poor: 1.6 billion people who live on less than \$2 a day, with 733 million struggling on less than \$1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

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