Towards a dedicated microinsurance regulatory framework

South African case study
Background

- Cenfri: insurance theme manager to FinMark Trust
- This presentation:
  - SA pilot study, part of 5-country study for guidelines on RSP
  - SA one of the few countries that has embarked on regulatory process for development of a dedicated microinsurance regime
- Lessons regarding:
  - Structure of regulatory framework & key regulatory questions arising
  - Process: where do you start? How do you go about it?
Overview

- The South African microinsurance market
- Rationale for regulatory review
- The regulatory design process & road ahead
- The Future of Microinsurance Regulation: main recommendations
SA insurance sector context

**High-income end:**
- very high penetration

**Low-income end:**
- underserved by formal market in SA context
- informal sector response

- **To rectify past inequities:**
  - Government transformation and empowerment objectives (B-BBEE)
  - NT & FSB: financial inclusion policy goal
    - Financial Sector Charter
The microinsurance market

**Salient features:**
- 45% of LSM1-5 has insurance (30% of all adults)
- Large voluntary MI market dominated by *funeral* insurance (40% of LSM1-5)
- Mostly informal (61%)
- Potentially large *illegal* funeral insurance market but provided by BSMEs
- Low awareness of *compulsory credit life* (conservative estimate 1.75m)
- Much innovation, but limited success
- All MI underwritten on short-term basis

![Diagram showing distribution of microinsurance market](image)
MI product and distribution innovation

- Intermediation key to extending MI
- Recent innovation includes:
  - **Retailer distribution**
    - Pep/Hollard, Shoprite/HTG/Old Mutual, retail account-based
  - **Cell phone distribution**
    - Discovery Pre-Paid Funeral Plan, Hollard “My funeral Card”, Metropolitan Cover2Go
  - **Group-based distribution**
    - African Life/ZCC, Hollard affinity groups, etc
- Based on non-advice “tick-box” selling of voluntary products through new channels other than traditional broker
- Innovation due partly to market forces, partly to FSC & FAIS interplay
Overview

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- The regulatory design process & road ahead
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Rationale for regulatory review

1. Consumer abuse, need for formalisation, enforcement
   - Limited consumer awareness, trust
   - Large informal market with no protection for consumers
     - Funeral parlours: formalisation, enforcement
     - Credit life: improved value and protection

2. Remove regulatory barriers, facilitate market development
   - Need for low premiums, innovative products & models
   - Market conduct regulation increases costs, leaves poor vulnerable
     - Advice limited to high-income market
     - Tick-box for low-income market: ltd success beyond funeral insurance and risk of misselling
   - Create the space for models to grow beyond funeral insurance
   - Institutional regulation:
     - Need for facilitation of new entrants
     - Remove entry barriers for smaller and mutual insurers (e.g. Friendly societies; larger funeral parlours)
Rationale for regulatory review

1. Consumer abuse, formalisation enforcement

   - Large informal market with no protection for consumers
   - Formalisation, enforcement
   - Credit life: improved value and protection

2. Consumer conduct regulation increases costs, leaves poor vulnerable

   - Advice limited to high-income market
   - Tick-box for low-income market: ltd success beyond funeral insurance and risk of misselling
   - Create the space for models to grow and extend beyond funeral

Need for coherent regulatory framework to provide for all providers of MI on a level playing field:

   - Institutionalisation:
     - Need for facilitation of new entrants
     - Remove entry barriers for smaller and mutual insurers (e.g. Friendly societies; larger funeral parlours)
## The regulatory design process

<table>
<thead>
<tr>
<th>Year</th>
<th>Event Description</th>
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<tbody>
<tr>
<td>2003</td>
<td>PCOF hearings on abuses in the funeral benefits industry</td>
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<td>2005</td>
<td>FMT study into funeral assistance business</td>
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<td>Joint NT/FSB task team set up to direct the assistance business reform process (PCOF updated to these developments)</td>
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<td>2006</td>
<td>Project extended beyond funeral assistance business to consider all microinsurance</td>
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<td>2007</td>
<td>Inter-department forum to ensure alignment across government</td>
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<td>2008</td>
<td>Joint NT/FSB discussion paper released for public comment</td>
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<td>2008</td>
<td>Submission of comments on discussion paper</td>
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<td></td>
<td>Awareness-building roadshow</td>
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<td></td>
<td>Further submissions post-roadshow</td>
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<td>2009</td>
<td>Regulatory proposals to be updated (actuarial, legal review), released for public comment</td>
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<td></td>
<td>Possibility: second national roadshow</td>
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<td>2010</td>
<td>Draft legislation tabled to parliament</td>
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<td>2010/11</td>
<td>Implementation</td>
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Main elements of the proposed regulatory framework

- **National Treasury Discussion Paper**: “The future of microinsurance regulation”

- **Product risk-based approach**:
  1. Define MI products within regulation to limit risk
  2. Tailor regulation to lower risk:
     - Underwriting
     - Market conduct/intermediation
     - Institutional requirements
  3. Improve consumer protection, recourse, enforcement (with compliance support for funeral parlours)
Proposed regulatory framework: micro-insurance definition

Proposed definition to limit market conduct and prudential risk:

- Starting point: benefits capped at R50,000 (~$6,000)
- Term of less than 12 months
- Limited to risk-only
- Allowing both life and non-life underwriting in a single entity
- Simple terms and conditions
MI institutional forms allowed: public companies, friendly societies, cooperatives, with cross-cutting minimum set of corporate governance requirements

Dedicated MI license one of a range of options for providing MI:
Proposed regulatory framework: underwriting & intermediation requirements

### Prudential requirements:
- Limited to MI products as defined
- Upfront capital of R3m (~$0.4m)
  - vs. current: ~$1.2m life, ~$600k non-life
- Reserving based on simplified standard model
- Reduced organisational capabilities
- Restricted investments

### Market conduct requirements:
- Similar regime to current funeral insurance intermediaries:
  - Reduced minimum skills level in favour of training requirements
  - No advice required (but incentivised through commissions)
  - Simplified and clear language disclosure
  - Uncapped commissions
  - Reporting to regulator for monitoring
Lessons and road ahead

1. **Consumer abuse, formalisation, enforcement**

   - Large informal market with no protection for consumers
     - Funeral parlours: formalisation, enforcement
     - Credit life: improved value and protection

2. **Remove regulatory barriers, facilitate market development**

   - **Market conduct regulation** increases costs, leaves poor vulnerable
     - Advice limited to high-income market
     - Tick-box for low-income market: ltd success beyond funeral insurance and risk of misselling
     - Create the space for models to grow and extend beyond funeral insurance

**Does the proposed framework meet its objectives?**

**How to define exact parameters?**

**How to ensure take-up?**

**Importance of public consultation**

**Importance of holistic approach**

**Institutional regulation:**

- Need for facilitation of new entrants
- Remove entry barriers for smaller and mutual insurers (e.g. Friendly societies; larger funeral parlours)
Thank you!

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