The Future of Microinsurance Regulation in South Africa

EXTRACT FROM:
NATIONAL TREASURY ROADSHOW PRESENTATION – OCTOBER 2008
STRUCTURE OF PRESENTATION

• Background

• Microinsurance – current market and need for regulation

• The proposed regulatory environment
<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
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<tr>
<td>2003</td>
<td>PCOF hearings on abuses in the funeral benefits industry</td>
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<td>2005</td>
<td>FinMark Trust investigative study into funeral assistance business, entitled “The regulation of assistance business in South Africa”</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>On 7 April joint NT / FSB discussion paper released for public comment, entitled “The Future of Microinsurance Regulation for South Africa”; deadline for comments was 31 July 2008</td>
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CURRENT MARKET

Key features:
- Large voluntary MI market dominated by funeral insurance (40% of LSM1-5)
- Large informal (61%) market
- Potentially large illegal funeral insurance market (40%)
- Low awareness of credit life (conservative estimate 1.75m)
- No significant penetration beyond funeral yet
- All MI underwritten on short-term basis
- Much innovation, but limited success

Source: Eighty20 calculations based on FinScope 2007 (using weightings derived from the Census 2001)
* The definition of LSM used is according to the 2005 algorithm
** Does not imply that respondents in this segment do not have funeral insurance, but that they have a formal life policy
NEED FOR REGULATION

Key issues to address

• **Large informal market** with no protection for consumers
  • Create an appropriate home for burial societies
  • Support formalisation of insurance provision by funeral parlours

• Improve **value and protection** in compulsory credit life space

• Remove **entry barriers** for smaller and mutual insurers (e.g. friendly societies, larger funeral parlours, etc.)

• Market conduct regulation (FAIS) **increases costs but leaves poor unprotected**:
  • Advice limited to high-income market: expensive
  • Tick-box for low-income market: inexpensive but limited success beyond funeral insurance and risk of mis-selling

• Create the space for models to grow and **extend beyond funeral insurance**
PROPOSED REGULATORY ENVIRONMENT

So what do we propose?

1. Product-based approach to reduce risk of microinsurance

2. Reduced entry and compliance requirements in line with lower risk
   • Create space for smaller microinsurers (including mutuals)
   • Create space for innovative intermediary models (including advice-based models)
   • Compliance support

3. Improved enforcement and recourse
1. Proposed **microinsurance definition** to limit risk:

- Benefits capped at R50,000 (inflation linked)
- Term of less than 12 months
- Limited to risk-only
- Covering both life and non-life but with limited risk events
- Simple terms and conditions
PROPOSED REGULATORY ENVIRONMENT

2. Underwriting

- Limited to MI products as defined
- Upfront capital of R3m
- Reserving based on simplified standard model
- Reduced organisational capabilities
- Appropriate corporate governance requirements
- Public companies, friendly societies and cooperatives
- Restricted investments
PROPOSED REGULATORY ENVIRONMENT

Underwriting options and graduation

- Same level of requirements as for formal insurer met by all versions
- LTD requirements based on more LTD risk associated with prod. def.

Graduation based on ability to carry risk
3. Market Conduct – Proposed Requirements

- Simplified product
- Simplified and clear language disclosure
- Category A type intermediary can sell all MI
- Reduced minimum skills level in line with FSB recommendations
- No advice required but encouraged
- Uncapped commissions (voluntary products)
- Enhanced reporting to regulator for monitoring
PROPOSED REGULATORY ENVIRONMENT

4. Enforcement and Recourse

- Improved coordination and collaboration with other government departments
- Utilising apex bodies to extend capacity
- Support for funeral parlours
- Simplified recourse cover also unregulated insurers
- Consumer education and awareness strategies
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END OF PRESENTATION

WHO TO CONTACT?

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WHAT NEW ENVIRONMENT MEANS FOR DIFFERENT PLAYERS
Implications for specific players

Burial Societies, Friendly Societies and Cooperatives

- Creates space for cooperative/mutual insurers but require enhanced regulation of cooperatives and friendly societies
- Burial societies with fewer than a prescribed number of members **AND** have an annual income below a prescribed amount (e.g. the current figure of R100 000) **AND** do not offer guaranteed benefits **may remain exempt** from all insurance regulation
WHAT NEW ENVIRONMENT MEANS FOR YOU II

Funeral Parlours

- Open up space for formalisation
- Parlours **must register as intermediary or microinsurer**
  i.e. creates space for largest parlours to register as microinsurers (may require collaboration or mergers amongst funeral parlours to utilise)
- Improved enforcement and supervision coordinated with other government departments (e.g. tax, health, etc.)
- Initiatives to support registration (e.g. tax amnesty)
WHAT NEW ENVIRONMENT MEANS FOR YOU III

Administrators

- May become microinsurer in their own right
- Simplified intermediary regulation
- Extended category A with reduced entry requirements
- Uncapped commissions (or at least increased levels)
- But improved enforcement and supervision coordinated with other government departments (health, tax, company registration, etc)
- Increased regulatory reporting on commissions, claims ratios, etc.
- Increased pressure to ensure consumer protection
Long-term / Short-term Insurers

- Category A intermediary with reduced skills requirement to sell all MI products
- Non-advice space clarified to reduce compliance risks
- Ability to underwrite life and non-life short-term products in single MI license
- Potentially lower capital if can isolate MI business
- Potentially increased competition from new entrants: pressure on insurers to ensure delivery to distribution partners
- Level playing field: Improved enforcement
- Improved consumer recourse
- Industry benefits from strategies to raise knowledge and awareness
WHAT NEW ENVIRONMENT MEANS FOR YOU

Intermediaries

- Clarify distinction between advice and disclosure: creates the space for lower-cost sales with improved disclosure
- Uncapped commissions (or at least increased levels of) to incentivise innovation, service delivery and improved advice/disclosure
- Extend Category A (or similar) to sell all microinsurance products
- Reduce entry and compliance requirements for Category A (or similar) in line with lower-risk products
- Incentive model that ensures on-going service delivery
- Clarification on the position of burial societies, administrators and others under FAIS
- Improved enforcement of FAIS
- Level playing field (extending enforcement net)
- Pressure on tick-box models to improve disclosure