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Making financial markets work for the poor

Regaining momentum?

Update on microinsurance in South Africa

11/04/2014

VERSION 1.7 11/04/2014

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List of abbreviations

ASISA	The Association for Savings and Investment South Africa
COB	Conduct of Business
FAIS	Financial Advisory and Intermediary Services Act, 37 of 2002
FSC	Financial Sector Charter
FSB	Financial Services Board
FSLGA	Financial Services Laws General Amendment Act
ICP	Insurance Core Principles
LSM	Living Standards Measure
MI	Microinsurance
NT	National Treasury
SAIA	South African Insurance Association
SAM	Solvency Assessment and Management
SARB	South African Reserve Bank
TCF	Treating Customers Fairly

Executive summary

In 2008, the National Treasury published a discussion paper outlining the future of microinsurance regulation in South Africa. This was followed by a microinsurance policy document published in 2011. At the time, the intention was to establish a separate Microinsurance Act by 2013, with the key goals of enhancing financial inclusion and expanding regulatory reach to informal operators in the microinsurance (particularly, funeral insurance) space. During 2013, the decision was made to no longer pursue standalone microinsurance legislation. Instead microinsurance provisions will be incorporated under the new financial sector regulatory structure to be implemented in South Africa under the so-called "Twin Peaks" framework, with a number of interim measures to start giving effect to microinsurance from 2014 onwards.

Cenfri, on behalf of FinMark Trust[1], embarked on research to assess the local microinsurance environment some five years after the initial discussion document was published. The purpose was to assess the continued relevance of the proposed microinsurance regulatory framework given market trends as well as delays in implementation.

The research was mainly qualitative in nature – exploring issues and trends with individuals from a cross-section of industry stakeholders. To supplement the qualitative research, trends in insurance take-up were explored using FinScope[2] survey data.

Market environment 2008 – 2013

The findings suggest that, underpinned by strong cultural factors, funeral insurance remains the backbone of the microinsurance market. Though the number of insurance policyholders has grown over the period 2008-2013, growth in insurance penetration has not kept up with adult population growth, leading to a slight decrease in overall usage. Furthermore, in the low-income[3] market the number of insurance policy holders has fallen slightly in absolute terms. The overall drop can be explained largely by a decrease in the percentage of people who have only informal cover from a burial society or church, while the percentage of adults with formal cover remained largely constant over the period.

One explanation for the sideways move in insurance penetration is the effect of the 2008/9 financial crisis, which put a dampener on consumer spending, including insurance sales. Another hypothesis suggests that the industry started to position itself for the proposed microinsurance regulatory framework, resulting in a rise in formal usage between 2008 and 2010. Subsequently, however, momentum was lost. Some insurers report having "cleaned up their book". Others note that the launch delay of the microinsurance regulatory framework, along with challenges in the broader economic environment, make it difficult to convince shareholders to prioritise new or uncertain low-income targeted strategies.

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[1] Created with initial funding from UKaid from the Department for International Development, FinMark Trust is an independent trust whose business is controlled by five trustees from countries in Southern Africa. FinMark Trust's purpose is 'Making financial markets work for the poor, by promoting financial inclusion and regional financial integration'. It does this by conducting research to identify the systemic constraints that prevent financial markets from reaching out to these consumers and by advocating for change on the basis of research findings. Thus, FinMark Trust plays a catalytic role, driven by its purpose to start processes of change that ultimately lead to the development of inclusive financial systems that can benefit all consumers.

[2] FinScope is a nationally representative financial inclusion consumer survey rolled out by FinMark Trust in 18 countries to date. For more information, see www.finscope.co.za.

[3] Defined for the purpose of this study as LSM1-7.

Consultations reveal a wide range of strategies vis-à-vis microinsurance – from those with a (perhaps justified) negative view of the environment to those proactively pursuing new opportunities. We present this analysis in the form of a number of categories of business models found in the microinsurance space:

- "**Passive sale innovators**": This model is found within large insurers with an established presence in the microinsurance market, and is based largely on innovations in alternative distribution, in addition to these players' other distribution models. Their growth plateaued and they are reconsidering their low-income strategy in light of broader market developments. They welcome the proposed microinsurance licence, but above all seek regulatory certainty and decisiveness in microinsurance.
- "**Corporate multi-taskers**": This is the name given to banks, mobile network operators or credit retailers involved in microinsurance as distributors or via their own insurer subsidiaries. For most, microinsurance is not core to their business, but they use it to diversify their service offering. They have strong existing brands and networks, meaning that distribution is not a big challenge. While many retailers currently operate under a FAIS exemption for many of their representatives, they welcome the certainty of a uniform "FAIS-light" framework envisaged under the microinsurance regime.
- "**Just get on with its**": Predominantly selling funeral products, players following this business model see the entry-level market as their core business. Some are owned by or linked to funeral provider networks, giving them a large branch infrastructure. Others do not have a branch focus, operating instead with an agent-based distribution network. Yet others harness network or mass marketing channels. They are still experiencing strong growth and this is the business model least concerned with the proposed microinsurance regulatory framework. While some see the microinsurance framework as providing them the opportunity to benefit from the commission regime beyond assistance business, others feel that the prohibition on cash-back benefits will be a constraint, or that they will simply be forced to migrate to the microinsurance space, should assistance business fall away.
- "**Dipping in toes**": This business model is found among established insurers that are new to the microinsurance market. They lack a recognised brand or established distribution network in the low-income end of the market, which makes it difficult to get a foothold. Most players in this category are short term insurers faced with the added challenge of creating a value proposition for asset insurance among a low-income market faced with other budget priorities. The proposed microinsurance framework may help them to provide a bundled product offering that adds asset to funeral cover.
- "**Friendly outsiders**": This model applies to large friendly societies that could potentially be microinsurance licence candidates. They traditionally operate under an exemption to the Long Term Insurance Act that limits the benefits that they can provide. The microinsurance framework will therefore "free them up" to provide a more competitive offering to members. At the same time, it is likely to increase compliance complexity.
- "**Illegal operators**": This model refers to the numerous funeral parlours that provide in-house insurance not underwritten by a licenced insurer. For them, the microinsurance regulatory framework is of little concern and it is likely that, without an effective enforcement strategy, many will continue to operate informally. Enforcement is therefore the biggest regulatory issue with regard to this category.

Regulatory environment 2008 – 2013

The development of the microinsurance regulatory framework occurs against the backdrop of a number of broader regulatory reforms, including Solvency Assessment and Management (SAM), Treating Customers Fairly (TCF), the upcoming Twin Peaks regulatory reforms and a number of other reviews and reforms within the insurance regulatory framework. The general sense from the consultations is that, whether directly or indirectly, the multitude of broader regulatory developments impacts on the incentives of players to go down-market and on the rationale for the microinsurance framework on at least three fronts:

1. Pending regulatory changes create uncertainty, which inhibits strategic business decisions to go down-market in the interim.
2. Increased complexity of the regulatory landscape reduces industry's room for manoeuvre.
3. Increased complexity requires additional layers of compliance.

These impacts result in an enhanced need for a simplified, unified microinsurance space proportionate to the nature, scale and complexity of the risks involved.

In conclusion: will the new plans for the implementation of microinsurance regulation be the catalyst for the microinsurance sector to regain momentum, or will the fact that standalone legislation is no longer being pursued reduce the allure of the framework?

The trends witnessed in terms of insurance usage, supply-side movements and broader regulatory developments together entrench, rather than undermine, the continued relevance of the microinsurance framework. The policy imperative to enhance formalisation and usage in the low-income market remains as strong now as it was in 2008 and the sense from supply-side consultations is that the microinsurance framework will still add value, even more so given broader regulatory trends. However, there is an imperative for microinsurance regulatory change to happen soon, to go hand in hand with an effective enforcement strategy, as well as to create certainty and lead to simplification rather than to add complexity through yet another layer of regulation.

1. Why this document?

Proposals for a microinsurance (MI) regulatory framework in South Africa (SA) have been on the table since 2008, when the National Treasury released a discussion paper on the future of microinsurance regulation (henceforth referred to as the Discussion Paper). This was followed by a microinsurance policy document (henceforth referred to as the Policy Document) in 2011, which entrenched and refined the proposed regulatory framework. However, with implementation yet to take place more than five years down the line, the question arises: are the proposed elements of the regulatory framework still relevant given changes in the market and regulatory environment? This paper takes stock of such recent developments in order to explore the answer to this question.

Purpose. This paper is intended as an update on the SA MI landscape and the changes to the regulatory environment within which the market operates. It serves both as a summary of the last five years in SA MI and as an entry point to further analysis. For an international audience, it serves as a case study of the challenges in bringing an MI regulatory roadmap to implementation.

Methodology. The report provides a 'temperature check' of the state of affairs in the MI market, as well as regarding the pending MI regulatory framework. The text is based primarily on qualitative insights gained from stakeholder interviews with both market and regulatory players. Respondents[4] spanned large and small formal providers across different product areas, industry bodies, market commentators, intermediaries and administrators. Insights from interviews were supplemented with desk-based research, including use of Finmark Trust's FinScope survey. Findings were debated and refined in two industry forums[5].

Structure. The rest of this document is structured as follows:

- *Section 2 presents a supply-side overview of the SA MI market.* It anchors the discussion by outlining the state of the market at the time that the MI regulatory proposals were first developed, before describing subsequent market developments in terms of insurance usage as well as supply-side trends.
- *Section 3 reviews the journey of SA MI regulation.* This section is grounded by an overview of the process towards MI regulation, beginning in 2003, followed by an outline of the proposed MI regulatory framework. It then turns to changes in the broader regulatory landscape that affect the MI market. The section ends by considering the latest plans for the implementation of microinsurance regulation.
- *Section 4 concludes* by assessing the ongoing validity of the original MI regulatory parameters against the market and regulatory trends outlined in the preceding sections. On this basis, it suggests imperatives for MI implementation going forward.

[4] A full list of organisations interviewed in available in Appendix A
[5] The first was hosted on 27 September 2013, the second on 20 March 2014.

2. Microinsurance market picture: from then to now

The analysis this paper presents begins in 2008 with the launch of the Discussion Paper on the Future of Microinsurance Regulation by the National Treasury. It signalled the regulator and policymaker's commitment to the development of this sector by proposing a formalisation path for informal providers and a proportionate regulatory regime for formal providers. This section takes stock of various developments in the microinsurance market from 2008 to date[6] in order to contrast the current picture with the state of the market when the Discussion Paper was launched.

2.1. The state of the market in 2008[7]

Dominated by funeral insurance, the South African MI sector was already large relative to that of its African peers by 2008. At the time, the South African microinsurance target market was defined as low-income individuals who fell within the LSM[8] 1-5 income category. Historically the South African low-income market had been served by informal funeral service providers and burial societies. However, from the 2000s the provider landscape began to evolve with the increasing entrance of formal insurers and smaller dedicated assistance business[9] players. Apart from an increasing recognition of the market potential in the lower-income end of the market by formal players, this growth in formal providers was buoyed by the adoption of the Financial Sector Charter in 2004, which committed the insurance industry to meeting access targets within the low-income market.

Box 1. Financial Sector Charter Product Standards

The Financial Sector Charter (henceforth referred to as the Charter) is a voluntary, transformational agreement between the financial sector and other key stakeholders including labour, community government. The Charter came into effect in 2004 and commits the financial sector to the transformation of the broader financial sector through meeting black economic empowerment targets across various pillars. The access to financial services pillar sets out the financial sector's objectives and targets for access to banking, insurance, credit and other financial services for households within the LSM 1 – 5 income category.

In order to fulfil their charter access obligations both the short term and long term insurance industries embarked on collective industry initiatives to develop product standards for no-frills, low-cost, flexible products targeted at the low-income market. In 2006, the South African Insurance Association (SAIA) launched household content and structure insurance product standards, called the "Mzansi" standards (leveraging the brand of the previously launched low-cost bank accounts). The life insurance product standards, branded "Zimele", were launched in 2007 by the then Life Office Association (LOA), now the Association for Savings and Investment SA (ASISA). Ultimately, the standards incentivised the launch of various MI products, especially for the short term insurance

[6] At the time of drafting: late 2013 to early 2014.

[7] Note: all insurance usage figures quoted in this document stem from the FinScope survey. See www.finscope.co.za.

[8] The Living Standard Measure (LSM) is a tool used to segment the wider South African market according to individuals' living standards. It uses location (urban vs. Rural), ownership of household assets and access to services to group individuals into one of ten LSMs through calculation of a composite indicator (Eighty20, 2005). LSM 1 is the lowest LSM, containing the poorest individuals in terms of the composite indicator, while LSM 20 is the highest category and contains the wealthiest individuals if ranked according to the composite indicator (Genesis, 2006)

[s]Assistance policies are defined in the Long Term Insurance Act (1998) as a life policy in the respect of which the aggregate of the value of the policy benefits (other than an annuity) and the amount of premium in return for which an annuity is to be provided does not exceed a specified cap. As at 15 November 2013, the assistance business cap was set at R30,000 (previously 18,000) (Long Term Insurance Act, 1998 – Act 52 of 1998) and (Information Letter 9/2013, FSB) .

industry which had limited experience with the low-income market.

The Charter was revised and gazetted as a Black Economic Empowerment Code in December 2012 under Section 9 of the Broad-Based Black Economic Empowerment Act (52 of 2003). The Financial Sector Code replaces the Charter and is a harmonisation of the Generic Black Economic Empowerment Codes and the Charter.

In line with the gazetting of the Code, the Mzansi product standards have been revised and are now generic industry standards. Under the generic standards product categories have been broadened to include agriculture insurance and commercial lines of insurance targeting cooperatives and small to medium enterprises. The Zimele endorsed policies/products are still in force and used by ASISA insurance members. They will eventually be overtaken by new products or product standards under the Financial Sector Code. However, no timeline has been set in this regard.

Take-up[10]

Strong demand for funeral insurance. In 2008, insurance usage within the low-income market was characterised by a strong demand for funeral insurance, with 16% of the low-income population (LSM 1-5) having some form of *formal* funeral policy. 33%[11] of LSM 1-5 individuals (6.5 million adults) had *any sort* of funeral cover, including informal. Take-up of other insurance products was low and almost negligible in some instances: only 2.2% of LSM 1-5 (428,0000 individuals) had any life cover excluding funeral, 0.04% (8,000 individuals) reported to have credit life[12] and 0.5% (98,000 individuals) had short term insurance. It is clear that outside of funeral insurance, there was low or limited take-up of formal insurance within the South African low-income market

Most funeral cover informal. Of the 6.5 million low-income individuals with any sort of funeral cover, 63% (4.1 million individuals) had informal funeral cover through burial societies and up to a further estimated 28% (1.8 million) had illegal funeral cover obtained from a funeral parlour. Thus, though the demand for funeral cover was well-established at the time, the *formal* funeral insurance market was still nascent.

Multiple policies. Qualitative research[13] confirmed the cultural significance and importance of a decent burial for most South Africans. Funerals are often costly events. One of the upshots is that many people buy multiple policies with both formal and informal providers to ensure that expenses are covered.

Product features

Key features of MI products on the market as quoted in the 2008 Discussion Paper included:

[10] Drawing on the analysis in Bester et al (2008).
[11] All up-take and usage figures used in this document are taken from the FinScope consumer survey. The FinScope survey is a FinMark Trust initiative is an annual nationally representative survey, which measures the usage and perception of financial services. For more information please see: www.finscope.co.za
[12] Note that usage of credit life insurance is most likely severely underreported in a demand-side survey. Many people may not be aware that they have credit insurance or may not regard it as "insurance".
[13] See Bester et al (2008)

- *Simplicity* – most products aimed at the low-income market were "plain vanilla" products, driven partly by Charter-led product standards, as well as by players tailoring products to meet the needs of the low-income market.
- *Short, renewable contract terms* – products sold to the low-income market were generally underwritten on a short term basis, that is, one month or one year renewable.
- *Group underwriting* – most policies were underwritten and priced on a group basis to reduce cost, even if individually sold.
- *Limited benefit values* – MI products (in particular funeral) were characterised by low sum assureds, to which the limits proposed in the Discussion Paper aligned.
- *First loss* – most products on the market, even short term, were underwritten on a first loss or sum assured rather than an indemnity basis.
- *Lower prices* – Increased competition as well as the launch of the Charter product standards resulted in inexpensive products being available. For example: individuals could obtain R10,000 (US$ 930[14]) cover for a monthly premium of R50 (US$ 4.70).

Distribution

No-advice sales. The Financial Advisory and Intermediary Services Act of 2002 (FAIS Act) requires the authorisation of financial service providers and their representatives providing advice or intermediary services. The FAIS Act also regulates the manner in which financial services and products are marketed and sold. The introduction of the act resulted in an increase in the cost of intermediation[15]. The response by industry led to a bifurcation of the market whereby advice is provided to upper-end clients, but the low-income market is mostly served by non-advice models applying tick-of-the-box sales and avoiding verbal disclosure and advice in order to reduce costs[16].

Alternative distribution innovation. The need to limit distribution cost also saw the emergence of innovative distribution models. These innovative models include passive and alternative distribution models, often facilitated by partnerships between insurers and entities such as supermarkets and clothing stores, among others[17]. Thus the introduction of FAIS helped trigger the initial wave of distribution innovation[18].

Box 2. The rise of alternative distribution?

Examples of alternative distribution include the Edcon Hollard partnership where Hollard insurance products are distributed in Edcon stores including Jet and Edgars on a non-advice basis while still encouraging face-to-face sales. Third party agents located in store are utilised to sell products to Edcon clients. During the selling process, clients are informed of the product features, terms and

[14] USD exchange rate – 10.75 as at 10 March 2014

[15] In a survey conducted to asses cost of compliance, financial service providers alluded to the increased cost of advice and advised based selling (Kruger, 2012).

[16] With the legal interpretation of many providers being that, if a sales person does not provide any advice or verbal disclosure, that person is not engaged in intermediary services and therefore does not need to meet the requirements of a financial service provider representative (Bester et al, 2008).

[17] According to Smith et al, 2010, passive distribution is defined as models where there is limited client interaction and verbal disclosure. Thus, the intermediary takes a "passive" role in the sales process. Online. (Available). http://cenfri.org/documents/microinsurance/2010/Update%20on%20innovation%202010/Update%20on%20innovation_Synthesis%20note.pdf (Accessed February 2014).

[18] Smith et al, 2010.

conditions only with no further advice being provided.

Other examples of non-advice based sales include the Pep Hollard funeral insurance cover, Sanlam's iCover and Old Mutual's Pay When You Can. Both Sanlam's iCover and Old Mutual's Pay When You Can products are distributed via Shoprite supermarket.

2.2. Trends 2008-2013

How has the market changed since the regulatory proposals were first formulated? Below, we unpack how insurance usage has evolved since 2008, before turning to recent industry trends.

2.2.1. Usage trends[19]

The following section analyses the South African insurance landscape using FinScope 2008-2013 data in order to, at a high level, convey the consumer trends that the industry has experienced in the last five years.[20] "Usage" is a measure of how many adults self-identify as having an insurance policy.

Overall usage

More persons covered by insurance. Figure 1 shows the absolute increase in number of people with insurance in 2013 versus in 2008, compared to the total increase in the adult population over the same period. Since 2008, overall insurance usage has increased by 1.52m persons (against a 2008 base of 15.67m adults):

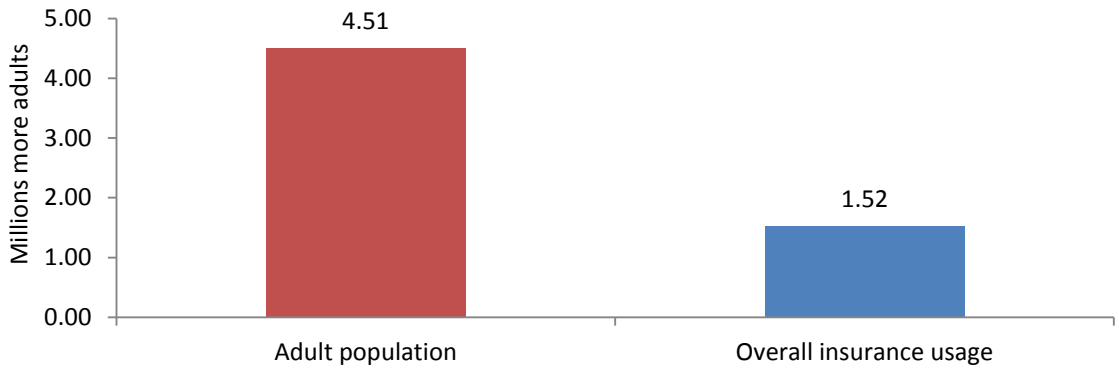

Figure 1: Absolute increase of South African adults 2008 versus 2013, compared to absolute increases in insurance usage

Source: FinScope 2008, 2013

Slight drop in insurance usage relative to adult population. The increase in absolute numbers insured shown above was smaller than the growth in the number of South African adults over the period (2008 base of 31.98m, increase of 4.51m). Thus, as Figure 2 below shows, overall insurance usage *relative to the adult population* fell from 49.0% to 47.1% over the five years.

[19] Note: this document is written primarily for an audience already familiar with microinsurance. Readers less familiar with this context can consult Bester et al (2008) and IAIS (2012) for a complete overview.

[20] The analysis contrasts overall insurance usage to different product categories, in line with the regulatory framework:

- Long-term usage is defined as funeral cover (both formal and informal), credit life insurance, disability insurance, accidental death and disability insurance, dreaded disease insurance, personal accident insurance and life insurance.
- Short-term usage is defined as various forms of asset insurance on the one hand, and other non-life insurance such as travel insurance, taxi commuter insurance, loss of earnings insurance, professional indemnity cover and insurance that pays for any legal fees on the other hand. Asset insurance is further broken down to include household contents, building and property insurance, insurance for hand tools or agricultural equipment, cell phone insurance as well as vehicle or car insurance.
- Health or medical insurance comprises medical aid or schemes and hospital cash plans.

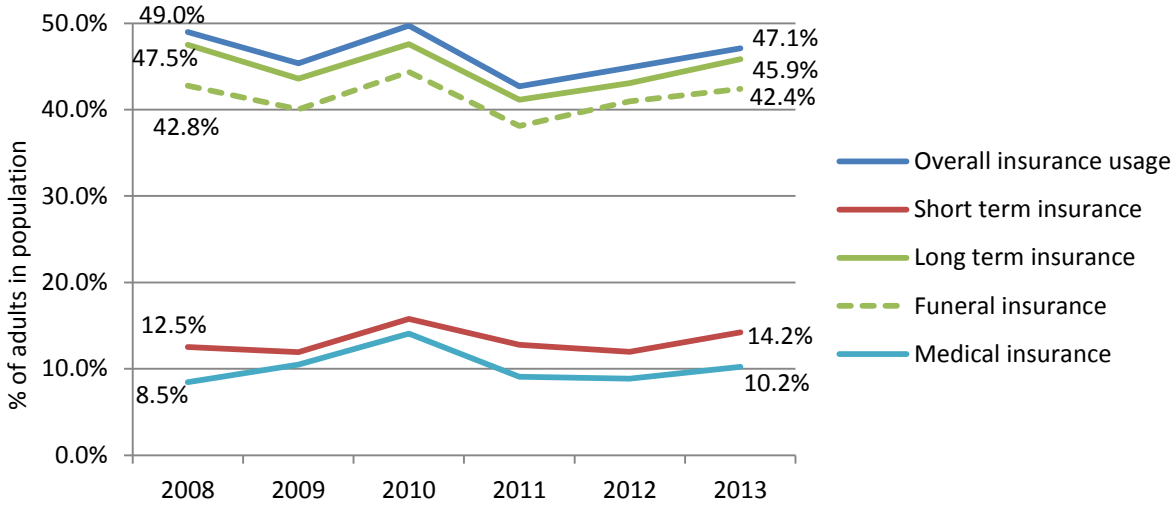

Figure 2: Ratio of adults with various forms of insurance in South Africa 2008-2013.

[Note: Though funeral insurance is indicated separately, the long term insurance and total insurance lines both include funeral insurance. Categories do not add up to total usage figure as some consumers have multiple categories of insurance]

Source: FinScope 2008-2013

Funeral insurance dominates. Virtually all insurance consumers (97.3%) have long term insurance. This relationship is driven by funeral cover – 90.0% of insurance clients bought funeral cover in 2013.

Short term and medical insurance usage increased marginally relative to the adult population. While long term insurance usage fell at almost the same rate as overall insurance usage, other categories performed better. In 2008, 12.5% of adults had short term insurance, rising to 14.2% in 2013. Similarly, medical insurance covered 10.2% of the adult population in 2013, in comparison to 8.5% in 2008. The increase in medical insurance can partly be ascribed to the rise in hospital cash plan insurance[21]. The data shows that most of this increase is driven by people who have more than one type of cover.

No definitive evidence of formalisation of usage. Figure 3 shows that adults with some or all of their insurance from formal providers increased from 33.7% in 2008 to 37.0% in 2013. The ratio of adults that have cover solely from informal providers[22] decreased from 15.2% to 10.1%[23]. In absolute terms, 2.96m more adults had insurance from formal sources in 2013 compared to 2008, while 1.24m fewer adults had only informal cover in 2013 compared to

[21] This trend is discussed in greater detail in two studies commissioned by the FinMark Trust: The Corporate Research Consultancy (Cape) (2013) *A Demand-Side Perspective On Hospital Cash Plans In South Africa* (http://cenfri.org/events/a-demand-side-perspective-to-hospital-cash-plans-in-south-africa) ; and B. Childs & D. Erasmus (2012) *Focus Note: South African Market for Hospital Cash Plan Insurance* (http://cenfri.org/k2/item/109-review-of-the-south-african-market-for-hospital-cash-plan-insurance)

[22] Formal insurance is supplied by a company registered by the insurance regulator, while informal insurance is supplied by an organisation not registered to provide insurance. In FinScope data, informal insurance refers to funeral cover provided by a provider such as a spaza shop, stokvel, neighbourhood organisation or burial society. It therefore does not include informal insurance provided by a funeral parlour without underwriting by a licensed insurer.

[23] Note that the formal and informal figures provided here cannot be summed to total usage, as a significant proportion of people have formal as well as informal cover. The figures indicated here are the totals for each category and do not take account of the overlap.

2008. These results appear not to be a sign of a deeper structural change, though, but rather of year-on-ear volatility, as the general trend for both lines is sideways:

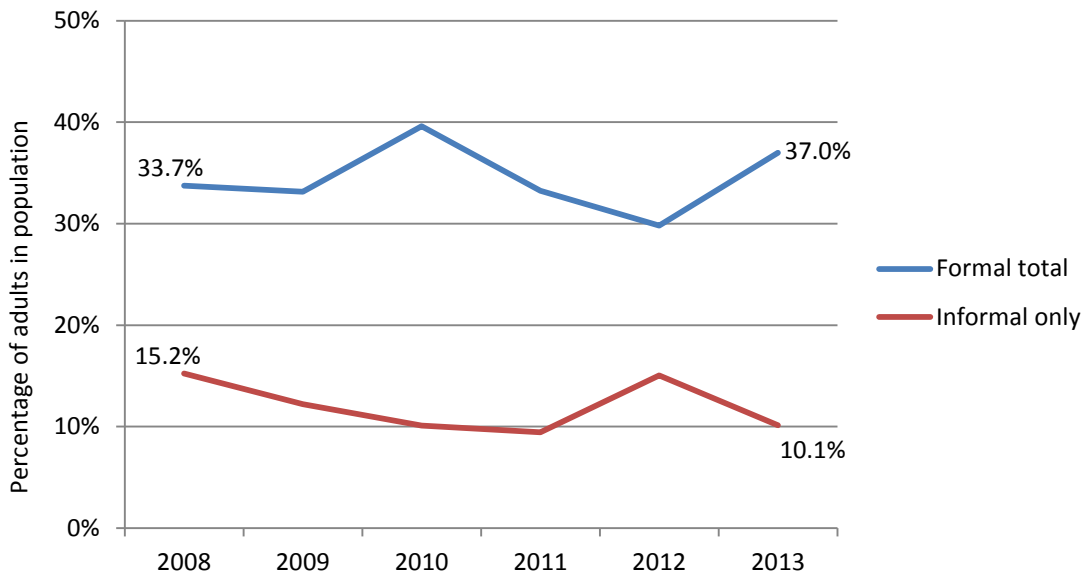

Figure 3: Ratio of adults with formal insurance and ratio of adults with only informal insurance 2008-2013[24]

Source: FinScope 2008-2013

Formal category likely overstated in the data. It should be noted that the way in which the FinScope questionnaire is structured means that the formal category above includes cover by funeral parlours. Analysis of cover through funeral parlours using demand-side data like FinScope is problematic because consumers tend not to know whether their funeral parlour has underwriting or not – the characteristic that defines insurance as formal in this study – or may even confuse cover from a funeral parlour with that from a burial society[25]. As a consequence, the "total formal" category in the graph above is likely to contain a significant proportion of informal cover, hence hiding informal market dynamics.

12.1% of adults had some or all of their cover from a funeral parlour in 2013, compared to 9.2% in 2008. Many of them also have cover from an insurer. When considering those for whom funeral parlour cover is their only type of insurance outside of burial societies, the percentage reduces to 6.4% of adults in 2013, compared to 4.8% in 2008. What percentage of this would be informal is not clear. A 2008 study estimated up to 50% of all funeral parlour cover to be informal[26].

[24] Note: total formal figures include those individuals who have formal cover, but also some sort of informal cover.
[25] As shown by studies like Cenfri (2013) *The nature of informality in the South African funeral services market - implications for policymakers and regulators* (http://cenfri.org/microinsurance/the-nature-of-informality-in-the-south-african-funeral-services-market-implications-for-policymakers-and-regulators)
[26] Bester et al, 2008.

Usage in the low-income market[27]

Marginally fewer low-income persons have insurance. Figure 4 below shows that 90,000 fewer adults in LSMs 1-7 had insurance in 2013 compared to 2008, in contrast to the number of adults in the category having grown by 2.27 million individuals:

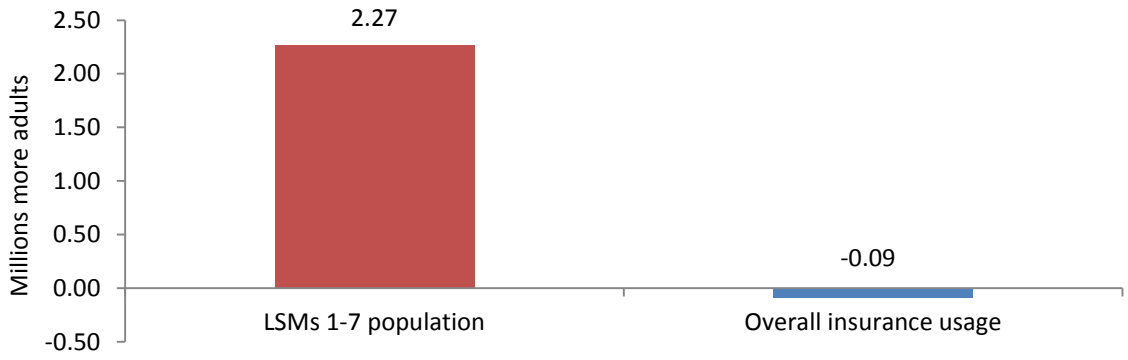

Figure 4: Absolute increase of South African low-income adults 2008 versus 2013, compared to absolute increases in insurance usage

Source: FinScope 2008, 2013

Decline in low-income usage as proportion of low-income population. Figure 5 shows that insurance usage in the LSM1-7 market decreased from 44.5% to 40.7% of LSM1-7 adults, with all product categories showing a decline. This suggests that efforts by the insurance industry to increase penetration in the low-income market have not been successful over the period in question.

[27] Note that the concept of the low-income market has broadened over time, from the LSM1-5 population as initially included in the Financial Sector Charter, to LSM1-7. This is in recognition of the fact that many of those in the lower middle income market are also unserved by insurance.

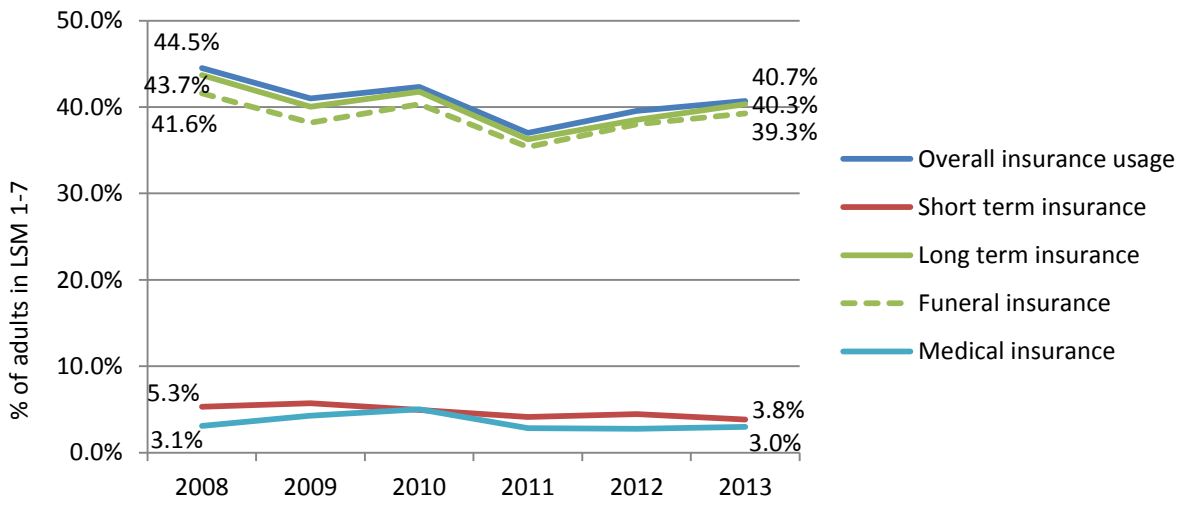

Figure 5: Low-income insurance usage in South Africa 2008-2013

[Note: Though funeral insurance is indicated separately, the long term insurance and total insurance lines both include funeral insurance. Categories do not add up to total usage figure as some consumers have multiple categories of insurance]

Source: FinScope 2008-2013

Funeral dominates low-income usage. Funeral cover remains the single biggest usage category in the low-income market. More than 96% of low-income respondents buying insurance have some kind of funeral cover.

Compulsory credit insurance understated in data. Though this is not reflected in the data, the second biggest microinsurance market is likely to be consumer credit insurance. It is provided through credit retailers and microlenders and is driven by its compulsory nature[28], with voluntary add-ons or riders. FinScope (2013) data indicate only 0.7% of adults to have credit insurance. This is likely to be a vast underestimation – a fact that may be explained by low awareness of cover among those with consumer credit insurance.

Short term microinsurance limited. As the analysis in Section 2.2.2 will show, recent years have seen the emergence or growth of short term products relevant to the low-income market in amongst others cell phone insurance, housing insurance and legal insurance. Despite these developments, overall usage of short term insurance in the low-income market has decreased from 5.3% of LSM1-7 adults in 2008 to 3.8% in 2013.

Formal usage remains static. Figure 6 considers usage of formal versus informal-only insurance in the low-income market. The percentage of low-income adults with insurance from formal providers is lower than in the general population. Looking over time, the ratio of low-income adults with all or some of their cover from formal providers has increased slightly (in 2008, 28.4% of low-income adults; in 2013, 28.3%). The ratio of low-income adults with only informal cover, on the other hand, decreased from 17.9% to 12.4%:

[28]Section 106 of the National Credit Act allows credit providers to require consumers to take out mandatory credit life insurance on their outstanding loan balance, but requires that the consumer be given the right to waive the policy offered by the credit provider in favour of a policy of his/her choice. Furthermore, it states that a credit provider may not demand that a consumer purchase insurance that is "unreasonable" or that "has an unreasonable cost to the consumer, having regard to the actual risk and liabilities involved in the credit agreement".

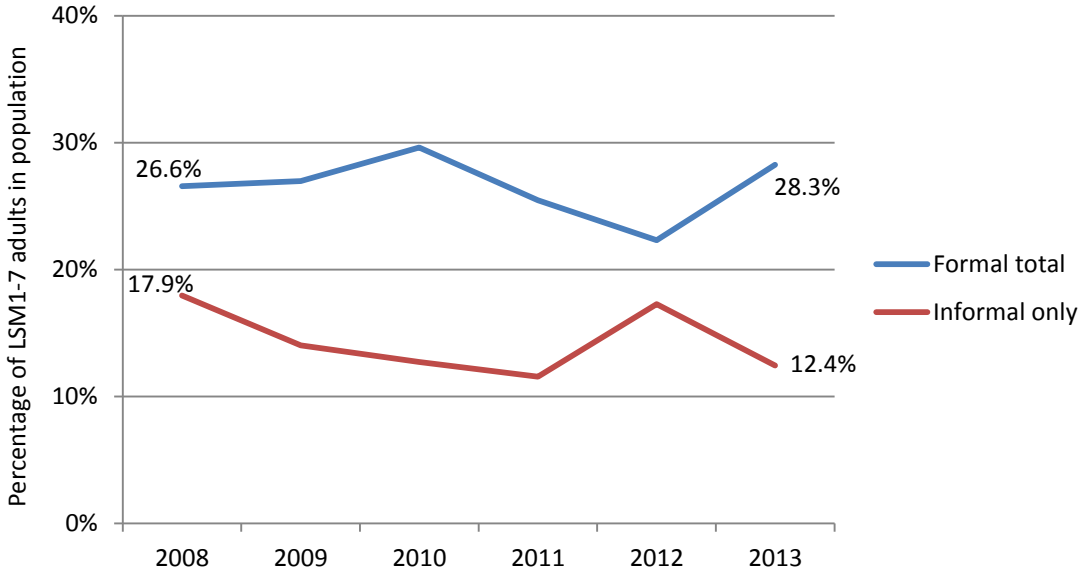

Figure 6: Ratio of LSM 1-7 adults with formal insurance and ratio of LSM 1-7 adults with only informal insurance 2008-2013

Source: FinScope 2008-2013

Ratio of low-income persons buying exclusively informal insurance has declined. Figure 7 shows how the overlaps between formal and informal usage in the low-income market have changed between 2008 and 2013. In 2008, 16.8% of low-income adults had *only* formal insurance, while 17.9% had exclusively informal cover and 9.8% had both. In 2013, this picture changed to fewer people having only informal cover (12.4% of low-income adults), slightly more having exclusively formal insurance (17.6%) and about 10.7% buying formal and informal cover simultaneously:

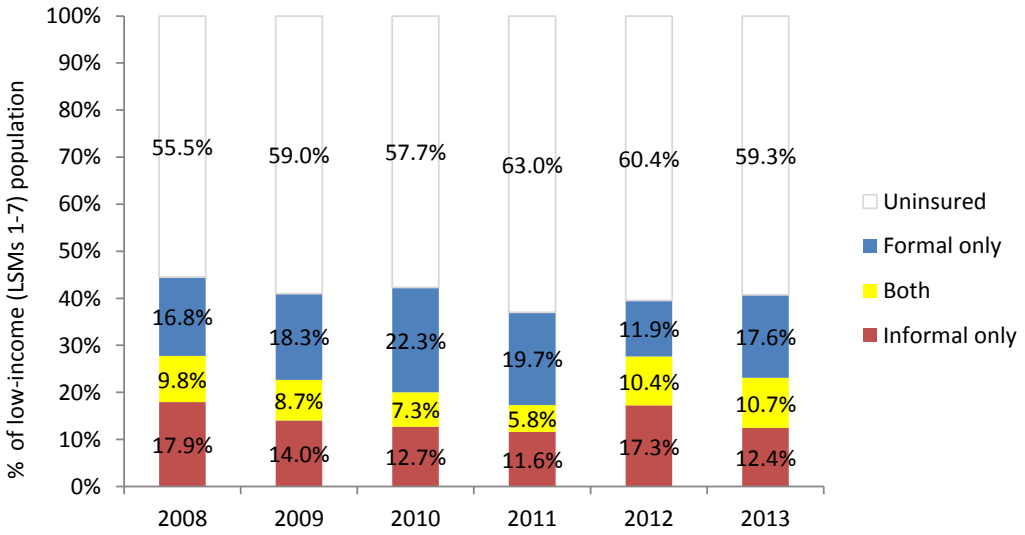

Figure 7: Overlap of informal and formal provision in South African low-income (LSMs 1-7) market, 2008-2013

Source: FinScope 2008-2013

Overall, then, it would seem that the policy imperative contained in the 2008 Discussion Document to increase usage in the low-income market and to enhance formalisation of usage remains in place: while the proportion of those with only informal cover is down slightly, low-income market usage has moved largely sideways over the period in question.

2.2.2. Supply side trends

Industry consultations showed that impressions of the market, operational strategies and responses to the MI framework differ between market participants. In order to make sense of these different impressions, this paper groups the market into a number of categories representing different business models. These categories are not perfectly discrete, but are aimed at stimulating insights and debate on themes and trends in the market[29]. In some instances, more than one business model may even apply to different operations of a single company.

The section below identifies six broad categories of business models, dubbed as:

- "Passive sale innovators";
- "Corporate multi-taskers";
- "Just get on with its";
- "Dipping in toes";
- "Friendly outsiders"; and
- "Illegal operators"

2.2.2.1. Passive sale innovators

Mostly large, established insurers, entering MI market. This group consists of large, established insurance brands with long investment horizons. Before the publication of the MI Discussion Paper of 2008, they were identified as keen to enter the South African MI market and as being open to developing innovative approaches. The proposed MI regulatory framework would encourage them to expand their reach to those previously not served by the financial services sector.

Focus on funeral. Most focus on funeral products in driving low-income market expansion, and have developed a range of funeral add-on products[30]. They emphasise the need to simplify products and reduce costs, including by underwriting on a group basis.

Distribution key. Players comment that the cost of individual MI sales prices products out of the market. They therefore prioritise distribution innovation to bring down costs, for example by utilising groups, retailers and cell phones in intermediation, as well as through innovations in technology, administration systems and marketing methods. These considerations, coupled with the impact of intermediation regulation, shifted the industry's focus in MI towards client-initiated ("passive") and non-advice sales.[31]

[29] Note that, as consultations could not be arranged with the full spectrum of players, these themes do not necessarily hold true for *all* market participants, but can be seen as indicative.
[30] These add-ons include cover for the cost of groceries, meat, tent, airtime, transport of mourners and transporting the body between provinces.
[31] In other words, insurers avoid all verbal disclosure/interaction in order for sales personnel not to act as "intermediaries" as defined in FAIS (which would require them to be FAIS-registered and meeting all the requirements). More information on these

Loss of momentum. Industry consultations for this paper suggest that, with a few exceptions, these players now operate with less energy in the MI market than initially. There is a view that the group funeral market has matured and a number of innovative passive-sale products have been removed from the market. Companies continue to explore face-to-face sales, 3rd party agent sales, call centres and affinity groups as distribution channels. Efforts are made to increase sales, but MI product usage (especially in passive sales) has by and large flatlined and/or never achieved the desired scale. In the words of one interviewee: "clients willing to try it have tried it". Insurers are therefore faced with a conundrum: passive sales are most viable from a cost perspective, but experience suggests that active, face-to-face sales are needed to achieve significant further usage.

Interviewees agreed that the following contributed to the loss of momentum:

- *Economic slowdown.* Players comment that this affects them via two transmission channels. Firstly, general incomes in South Africa have been under pressure. This pressure is greatest in the low-income market, which MI is intended to target. For many low-income consumers, insurance is unfamiliar and of lesser importance than other products, and hence in periods of growing financial distress, the buying of insurance falls by the wayside. The second transmission channel operates by way of shareholder pressure on insurance company management. In times of economic slowdown, shareholders become more cautious and expect management to deliver predictable and safe returns. Managers respond by focussing on their core offering, which means that new ventures in MI become of lesser importance. Large brands become more wary of negative publicity which may harm their core revenue sources. In the words of one interviewee, "firms do not have the headspace to do the difficult. The focus is inward and upmarket".
- *Regulatory uncertainty.* Some players hesitate to commit to new strategies before the regulatory environment settles. The regulatory framework governing MI has been publically discussed since 2008, and gained additional momentum when the National Treasury set up industry working groups in 2012. Players are however frustrated by the subsequent loss of momentum; they reported not understanding where current delays come from or how long they will persist. In addition, the review of the financial services regulatory landscape more broadly (see Section 3.3) promises fundamental changes to the operating environment of insurance companies. Before the full extent of the implications of such reforms is clearer, they are hesitant to invest in new or uncertain ventures.
- *More conservative reserving.* One result of the ongoing regulatory reforms is a greater emphasis on building up sufficient capital in line with a company's risk profile. Improved capital efficiency and retained earnings are normally at odds with venturing into new, potentially uncertain, markets. Furthermore, major regulatory developments may divert attention and resources from new product initiatives such as MI.

Given this environment, *Passive sale innovators* focus on other activities rather than launching aggressive new low-income market strategies, including:

- *Improve what you have*. Efforts are being made to clean up the MI insurance book to ensure higher profitability in existing groups. One player admitted to having cut their

developments is available in Smith et al(2010) Reaching the client: Update on microinsurance innovation in South Africa. (http://cenfri.org/k2/item/46-update-on-microinsurance-innovation-in-south-africa-2010).

book by half over the last five years to ensure acceptable claim ratios. In addition, players are exploring ways of reducing the cost of administration (including through consolidation of systems in 3rd party offerings, which achieve economies of scale across numerous companies) and through increased use of data mining. Product development mostly focuses on improving service, especially the speed of benefit payments.

- *Increase the size of the pie*. Among some players, management is combining its attention on MI with the development of new business lines in Africa and other emerging markets. This speaks to shareholders' desire for diversified revenue streams, including in faster-growing markets than South Africa.

Seeking regulatory decisiveness in MI. *Passive sale innovators* are keen for clarity on the MI regulatory framework and welcome the proposed MI licence as set out in the 2011 MI Policy Document. In particular, they want to consolidate their existing product offerings, reduce distribution costs and innovate across current long term and short term insurance demarcation lines. Their main concern is that regulatory decisions are made and clarity provided as soon as possible so that they can marshal their internal resources for a MI strategy. Most players recognise the opportunity that exists in the South African MI market.

2.2.2.2. Corporate multi-taskers

Insurance non-core to product offering. These players operate in a number of different markets, with insurance a non-core part of their product or service portfolio. Corporate multi-taskers include banks, mobile network operators and retailers with large credit books. They tend to have access to a captive or existing client base and use insurance as a means to complement their existing revenue streams. As a consequence, distribution is not a major challenge for these players, as they already have an existing client relationship to leverage as well as an existing distribution network. For many of these operators, insurance is a means of accessing a larger share of the wallet of their customer. Existing customer relationships allow for data mining of their target market.

Credit retailers using credit insurance hook to cross-sell other cover. For credit retailers in particular, selling microinsurance – and other financial services – appears a major trend. Some are partnering with insurers or operating via a cell captive, while others have set up their own insurance subsidiaries. Credit providers and credit retailers' first line product is consumer credit insurance, which is mandatory when buying on credit. This relationship can then be used to cross-sell other products like funeral cover via passive sales, call centres, face-to-face individual sales by store employees or through FAIS-accredited 3rd party agents in store. To lessen the compliance cost, most retailers opt to not offer advice in store, but instead ask their customers to speak to a FAIS-accredited call centre agent.

Seeking long term partnership with low-income customers. Interviewees in this category note that the low-income market, if treated well, can be very loyal to a brand, supporting the operators' drive to cross-sell new product offerings. Some companies state that they are looking for an early entry with customers when they are still poor, and then to climb up the income ladder with clients, flexing the service offering to meet the customer's changing needs.

MI regulation of special interest to credit retailers. Corporate multi-taskers are generally welcoming of a new framework for MI regulation. Banks and mobile network operators over

the short- to medium-term are looking to maximise their sales into the upper- and middle-end of the market, before MI is likely to become a key priority. In contrast, credit retailers have their eyes firmly fixed on the MI market and are keen to innovate across the long term and short term product divides as well to leverage the proposed "FAIS-light" regime in their sales efforts[32]. Some industry interviewees suggested that the "easy" credit insurance revenues may come under threat in the near future due to a government review of operating practices. Should this occur, credit retailers and banks want to be in position to maintain their revenue levels through cross-selling of other types of insurance products.

2.2.2.3. Just Get On With Its

Entrenched low-income market presence. Predominantly selling funeral products and funeral add-ons, these players already operate mainly in the low-income/entry-level market. They see it as their core business, not as a market that they have to move into. Some are owned by or linked to funeral provider networks, giving them a large branch infrastructure. Others do not have a branch focus, operating instead with an agent-based distribution network that focuses on points of client aggregation, such as the queue at state benefit pay points. Yet others harness network or mass marketing channels.

Strong growth. While *Passive sale innovators* with their group and passive distribution methods experience the funeral market as mature, *Just get on with it* players see it as a lively market. They are growing strongly and appear to have developed a winning strategy in current market conditions, with one respondent explaining that they are planning to expand their branch footprint fourfold between 2013 and 2016. Another interviewee noted their bullish rollout: though they had written 30% more policies by August 2013 than in the previous year, they were still behind target. One of the reasons for their fast growth may be that they tend to be unlisted, which frees them from shareholder distraction.

Deep and wide distribution networks facilitate customer–centric focus. They are able to sell face-to-face to preconfigured target markets such as state benefit claimants, civil servants and union members, as well as to the public at large through call centres and other means. Many have strong relationships with aggregated groups and all carry strong, trusted brands. Beyond the strength of their distribution networks, they use a deep knowledge of the customer to speak to the clients' needs – with an explicit repeat mention of the speed of benefit payment. By physically operating in the community, many players overcome some of the market-specific challenges: one respondent commented that 70% of their policyholders pay their premium in cash.

Challenged by economic slowdown and informal competition. Despite these expressed positives, these players also explicitly mention the economic slowdown as a brake to their expansion because incomes are particularly squeezed in the low-income sector. Whereas *Passive sale innovators* see an overactive regulator as a barrier, the *Just get on with it* players are most concerned with the need for formalisation. Their challenge is competing with informal players, who do not carry a compliance cost and hence do not compete on a level playing field. In the words of one of the players, "funeral parlours are easy to open – anyone with a retrenchment package opens one." One respondent estimated that 70% of the funeral market remains informal, and that this was where most of the abuse in the

[32] See discussion in Section **Error! Reference source not found.**.

market was occurring – but that this was beyond the enforcement reach of the insurance regulator.

MI regulatory landscape not front of mind. *Just get on with its* is the category least enthusiastic about a dedicated MI licence. They have found a niche to operate in and are confident of their established business models and ability to take advantage of new opportunities. Some interviewees mentioned that the regulatory parameters as set out in the 2011 Policy Document would allow them to expand their product offering beyond assistance business and to benefit from commission deregulation on a broader product suite, whereas others see themselves as being forced to migrate to the MI framework, should assistance business fall away. Yet others find the fact that no cash back/savings option will be allowed under the proposed MI regime as a core reason why they would not want to operate under it.

2.2.2.4. Dipping In Toes

New MI players lacking distribution network. These players differ from those in the categories above mainly in their lack of an existing MI distribution network or recognisable MI brand, due to the fact that they are not traditionally active in MI. In order to gain a foothold in the market, they are building on the ownership of an unsullied brand and the ability to process claims quickly. They are looking to win clients from existing suppliers and are seeking partnerships to reach new customers.

Short term players looking to establish name and value proposition in low-income market. Most of these players operate in the short term market. For them, the challenge is twofold: introducing a new brand and introducing a new product. Thus they are deploying a medium- to long term strategy of consumer education and brand building. These players have little experience of operating in the low income market, and are not present in significant numbers or with significant volumes of policies.

Low-income market new to short term products. One respondent noted that rural areas increasingly have a need for short term insurance given the expansion of electricity networks and the associated purchase of appliances[33]. However, the same respondent found that "culturally, asset protection is not important. Paying for a funeral is key […] if something happens to assets, people just start over".

MI regulation seen as opportunity. The consulted players in this category expressed their interest in the refashioning of regulation in the MI sector. They recognised that the 2011 policy framework would allow them to shake up existing market players through innovative products. Short term insurance companies see an opportunity in building familiarity with short term insurance by linking it to long term products.

2.2.2.5. Informal players

The informal market can be segmented into two categories:

[33] This trend is confirmed by the 2013 FinScope survey. See slide 11 of the launch presentation: http://www.finmark.org.za/wp-content/uploads/pubs/Pres_FSSA_2013_excluding-videos2.pdf

- *Informal groups:* burial societies conducting mutual or community-based risk pooling. They either provide informal, unguaranteed cover or are registered as friendly societies under exemption to the Long Term Insurance Act. For the purpose of this analysis, we do not consider those small, informal burial societies pooling risks at community level without guaranteeing benefits, but only focus on the registered friendly societies as potential MI licence candidates. We call these the "*Friendly outsiders*".
- *Illegal insurance providers* in the form of self-insuring but unregulated funeral parlours[34]. We refer to these as the "*Illegal operators*". Note that many funeral parlours also provide cover underwritten by a licensed insurer. They are then intermediaries and would be classified in one of the other segments above.

Friendly outsiders

Historic carve-out. Registered friendly societies have been in place since the Friendly Societies Act was passed in 1956. They play an important role in providing various benefits, including maternity benefits, annuities and funeral benefits, to members with a pre-existing common bond. They currently operate under an exemption to the Long Term Insurance Act, with benefits offered being capped at R7,500. Certain thresholds apply beyond which friendly societies are required to submit financial statements and periodic actuarial valuations to the Registrar. There is currently limited prudential supervision of such societies.

Some going strongly, some struggle to remain relevant. Some friendly societies have grown strongly and operate much like mutual insurers. For example, a large church-affiliated burial society in 2012 had 70,000 principal members and about 240,000 lives covered in total[35]. It operates efficient systems and holds substantial capital. Others, however, have floundered. In one instance, a burial society decreased from 3,000 members (about 24,000 lives covered) in its heyday, to reportedly around 1,000 members today. Reasons quoted include poor advice regarding obtaining underwriting, which then did not suit the flexible, member support-oriented nature of the burial society, leading to lapses which the society had to cover[36]. They also face growing competition from formal insurers able to offer larger benefits than the threshold benefit for friendly societies, in some instances at more competitive prices. While they play an important community role, provide flexible terms and are attuned to member needs, their position is therefore at risk. One of the purposes of the proposed MI regulatory framework is to empower such organisations by explicitly allowing them into the MI regulatory fold.

Potential difficulties integrating into the new proposed framework. Under the MI Policy Document, it is proposed that the Friendly Societies Act falls away and that friendly societies migrate to the cooperatives framework from an institutional point of view. If they provide guaranteed insurance benefits or exceed the proposed minimum threshold size of 2,500 members, they would then either need to obtain an MI licence, or be underwritten by a licenced insurer. A regulatory impact analysis conducted on a large burial society registered as a friendly society suggests that this may be problematic on a few fronts, most notably

[34] Bester et al (2008). Making Insurance Work for the Poor – SA note p8 (http://cenfri.org/microinsurance/making-insurance-markets-work-for-the-poor-policy-regulation-and-supervision-2008

[35] For more information, please see Bowman (2012) OAC MI Readiness Assessment commissioned by FinMark Trust.

[36] Whereas the insurer only allowed a 30 day grace period before a policy lapses, the society's constitution allows for three months grace.

FAIS, due to the organisation's large regional distribution network. The plight of friendly societies more broadly is also still under regulatory consideration.

Illegal operators

Community presence. These operators are generally small, but in aggregate cover a significant proportion of consumers[37]. They are local and deeply integrated into the community, selling policies face-to-face.

Tarnished by abuses. As Section 0 will show, informal players have been at the centre of investigations into abuses in the funeral insurance market. Such abusive practices can be categorised as follows[38]:

1. So-called "suitcase undertakers" collect monies from clients, then disappear without honouring the promise of a claim.

2. Funeral services are provided, with benefits defined in terms of the aggregate funeral services, to which a Rand value is attached. However, there is no option of a cash payment as required by law. This makes it difficult for the consumer to know and compare the true value of offerings amongst the various potential providers.

3. Product terms and conditions are not disclosed in full. This is normally exacerbated by no reporting to the supervisor, failure to keep requisite records of sales transactions and internal processes, and deploying unregistered sales personnel who do not meet fit and proper requirements.

Formalisation not of interest to many. With regards to the MI Policy Document, these players are the focus of the planned formalisation drive. Research suggests that many funeral parlours would not be able to formalise, as separation of the insurance business from the funeral business would not be possible in the current business model whereby insurance premiums are used to subsidise the operating costs of the funeral business.[39]. Consultations suggest that the need to formalise is not a concern for most informal players, though, as they are not aware of any changes to the regulatory framework. The need to become FAIS compliant is much more front-of-mind than the pending MI regulatory framework. For other categories of players and the regulator, the relation of the MI policy framework to informal players is at the crux of the debate.

Formalisation eases linkages to rest of industry. Many formal competitors see the forced formalisation of informal competitors as a requirement for a sustainable, non-abusive MI industry that operates on a level playing field. Some companies in the *Passive sale innovators* and *Dipping in toes* categories see an opportunity in partnering with funeral parlours as distribution channels. In the current framework, these companies are hesitant to enter into such agreements due to the regulatory risk of being held accountable for the

[37] Note that the FinScope figures for informal insurance – 46.5% of insurance consumers in 2013 – cover largely burial societies. Many survey respondents are likely to include funeral parlour cover under formal insurance. Thus it is not possible to accurately estimate the percentage of people with cover from a funeral parlour.
[38] As documented in Gibson (2011)
[39] As investigated in greater detail in Cenfri (2013) The nature of informality in the South African funeral services market – implications for policymakers and regulators (http://cenfri.org/microinsurance/the-nature-of-informality-in-the-south-african-funeral-services-market-implications-for-policymakers-and-regulators)

informal counterparts' actions. Formalisation is needed to address shareholder wariness of regulatory backlash.

2.3. What do the trends imply for MI?

It is clear from the analysis above that, though there have been a number of developments in the microinsurance market in recent years, there have been no significant "game changers":

Scope for microinsurance growth remains strong. Analysis of the usage data shows that 40.7% of the low-income population currently have insurance cover and that the vast majority of that cover lies in funeral insurance. Short term and medical insurance is bought by the few (3.8% and 3.0%, respectively). The conclusion is thus that much room for growth remains in the low-income market, especially outside of funeral insurance. All respondents for this study recognised the strategic opportunity in serving the low-income market.

MI remains funeral-dominated. The culture-induced dominance of funeral insurance in the usage figures is matched by the focus on funeral cover in the product offering on the market. This enhances competition in the funeral insurance market. The situation is summarised by one interviewee as: "It's not a question of whether they will buy funeral cover. The question is whether they will pick your product over someone else's."

Tweaks in product design. Respondents agreed that little fundamental product innovation has proven successful over the last five years. Instead, the core funeral or consumer credit insurance product is being enhanced with additional optional features. One industry participant referred to this as "window-dressing" the product. Often, these additional features include tangible benefits that are valued by the market.

Innovations outside of funeral face challenges. There have been innovations in terms of asset, legal and hospital cash plan products. Where hospital cash plan insurance is concerned, growth has been steady, but regulatory uncertainty regarding the demarcation between insurance and medical schemes (see the discussion in Section 3.3) has kept some players back. Growth in legal insurance meanwhile is reportedly weighed down because insurance regulation is not well suited to the specific characteristics of the product[40].

It has proven difficult to translate asset insurance innovation into usage. This may be due to the absence of a cultural driver for such insurance products, meaning that short short term insurance does not enjoy the same budget priority for cash-strapped individuals. Consumer awareness and trust is also lower outside of funeral insurance. Furthermore, the terms and conditions of a short term policy are more complex to understand than a standard funeral policy.

S*igns of consolidation and outsourcing.* Industry interviews confirmed a widespread understanding of the need to lower operating costs and raise efficiencies in order to meet

[40] See the in-depth investigation in Eighty20 Consulting (2013). Legal Expenses Insurance. Study conducted for FinMark Trust. It notes that: "…providers highlighted that [prudential] requirements of the Short Term Insurance Act […] are onerous and arguably overly cautious given the mechanisms that are embedded into contracts to limit the liability of the insurer. They highlighted that loss ratios are generally lower, the risk spread is far wider and the individual claim exposure more limited than is the case with short-term insurance generally. Providers also highlighted that the requirements for registration are onerous, and that the costs involved in establishing and complying with regulations are high."

the needs of the low-income market. Some players have consolidated partially to achieve this goal. In order to take advantage of the pressure for increased efficiencies, back-office function outsourcing companies play an increasingly important role.

Fast and predictable claims payment key. Funeral insurance customers buy multiple policies partially because they expect that not all policies will necessarily pay out[41], or pay out fast enough. Numerous respondents pointed out that the low-income market values a product that pays quickly and predictably. Speed defines providers' credibility and builds loyalty.

Interest in offering composite products. Most providers interviewed are interested in having greater flexibility in designing insurance products across the long term and short term divide or even beyond. This would take the shape of combining funeral with short term products, or even with credit and savings products. These products could flex and grow more readily with the customers' changing needs as their incomes and lifestyles change.

Cross-cutting challenge in distribution and premium collection. Distribution remains a challenge across player types and product markets. The need for a simplified, appropriate intermediation regime to facilitate active sales was emphasised across the board (see the discussion in Section 0). Where groups or existing infrastructure cannot be leveraged for distribution and/or policy administration purposes – and prospective individual policyholders do not have bank accounts – premium collection and persistency are particularly challenging. Insurers are then dependent on customers to "push" payment, rather than "pulling" it through, for example, a payroll deduction.

[41] A further reason given for clients buying multiple polices relates to funeral cost. Assistance business benefits were limited to R18,000 per policy until late in 2013. Consumers as a consequence bought more than one policy to cover the cost of a funeral. This limit has now been raised to R30,000 and it is of interest to see if these will result in a reduction of policies in the market.

3. Regulatory developments

In Section 0 we reviewed the current state of the South African MI market and contrasted it with the picture at the time that the MI regulatory proposals were first published. Now the attention turns to the key regulatory developments over the past five years to form an updated picture of the broader regulatory landscape of relevance to MI. We start off by discussing the process towards the development of MI regulation. This is followed by a summary of the main tenets of the proposed MI regulatory framework as outlined in the 2011 Policy Document (first introduced in 2008 in the Discussion Paper). We then consider what has happened since: first we look at ancillary regulatory developments of relevance to the microinsurance market; then we consider the developments on the microinsurance regulatory front since 2011 and the latest plans for implementation.

3.1. The process towards microinsurance regulation

In this section we highlight key MI regulatory events in South Africa. **Error! Reference source not found.** shows the timeline of key events that impact on the MI regulatory landscape:

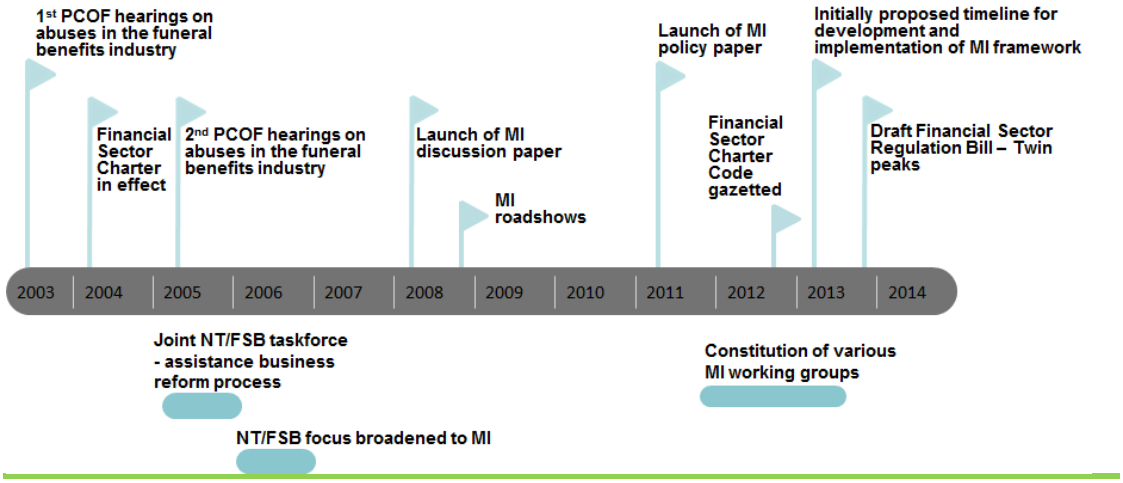

Figure 8: Timeline of key events in MI regulatory landscape

Source: Various

Concerns about abuses in funeral industry as initial trigger. In 2003, hearings concerning abuses in the funeral industry were held by the Parliamentary Committee on Finance (PCOF). This was followed by a second round of hearings in 2005. Consequently the National Treasury and Financial Services Board formed a joint task force to review consumer abuses in the market and direct assistance business industry reform. In 2006 the scope of the joint task force's review was extended and broadened to include a review of the MI sector as a whole[42]. This came in recognition of the broader need to facilitate inclusive market development.

Discussion Paper outlines MI regulatory framework. In April 2008, the National Treasury released a discussion paper titled "The Future of Microinsurance Regulation in South Africa", which proposed a dedicated microinsurance regulatory framework. The Discussion Paper

[42] See Gibson (2011)

proposed a formalisation path for informal microinsurance providers, while providing concessions for formal entities seeking to enter the space. Following the release of the Discussion Paper, the National Treasury held countrywide roadshows to test the proposals with both formal and informal providers. This was then followed by a final round of public stakeholder engagements and consultations in 2010.

Policy Document entrenches plans for dedicated MI framework. In July 2011,the National Treasury published a microinsurance policy document which built on and fleshed out the proposed regulatory framework first set forth in the Discussion Paper. The Policy Document also outlined a timeline for the implementation and promulgation of a standalone Microinsurance Act. Following the release of the Policy Document, public-private working groups responsible for determining final provisions on various elements of the then forthcoming Microinsurance Act were constituted in 2012.

It was initially intended that the draft Microinsurance Bill be tabled before Parliament in 2013, with implementation in 2014. In Section 3.3 we discuss the new plans for the implementation of the microinsurance regulatory framework.

3.2. Contents of the proposed MI regulatory framework

This section provides an overview of the proposed MI regulatory framework as outlined in the 2011 Policy Document.

Formalisation and market development as key objectives. The policy framework lists the following objectives:

- Extending access to a variety of appropriate, good-value microinsurance products for the low-income market, thereby supporting financial inclusion.
- Enhancing consumer protection in the low-income space.
- Reducing barriers to entry and creating a formalisation path for informal providers resulting in the formalised provision of insurance products.
- Creating a regulatory regime for formal players that seek to downscale operations and enter the low-income space.

Insurance appropriate to the low-income market. The Policy Document defines MI as insurance products that are accessible to and utilised by low-income households. This definition of MI seeks to achieve two goals: firstly to reflect the features of products targeting the low-income market; and secondly to limit the prudential risk associated with this class of products in order to warrant simpler regulatory requirements. In addition, MI products should simple enough to be distributed by a wide range of providers.

Product parameters to limit risk. The Policy Document calls for a generic definition of MI rather than a list of specific products. It proposes the following parameters for products to qualify as MI:

- Products to be underwritten on a risk only basis with no surrender value.
- All policy benefits should be on a sum assured or a first loss basis where the insurer provides a defined benefit against a defined event, rather than providing indemnity

cover that indemnifies losses and pays benefits according to the value of the loss suffered.

- Defined benefit caps with R50,000 (US$ 4,650) per insured life, per insurer related to a death event, R100,000 (US$ 9,350) per insurer per contract period for asset cover and R50,000(US$ 4,650) per insured person, per insurer, for other benefits.
- Maximum renewable contract term of no more than 12 months.

File-and-use product review. All products should be submitted to the FSB on a file-and-use basis. There is no obligation on the Registrar to review each submitted product in detail and products may be launched if no objection is received within 60 calendar days after filing.

Dedicated MI licence. The Policy Document proposes the development of a stand-alone Microinsurance Act under which dedicated MI licenses would be issued. Licensed MI providers (microinsurers) would be able to write all types of risk products (i.e. products that do no incorporate a savings component) under the Short Term and Long Term Insurance Acts, but would not be permitted to write policies under the Medical Schemes Act (131 of 1998).

Separation of business. The Policy Document stipulates that entities must be registered as microinsurers in order to provide MI in South Africa. Institutions wishing to register as microinsurers without prior registration under the existing insurance laws are permitted to do so either as public or private companies. Existing insurers that seek to register as microinsurers need to apply for a separate licence and register as a public company. Registered microinsurers can only conduct the business of microinsurance, requiring clear separation from other business operations such as the provision of credit or funeral services.

Door opened for member-based organisations. The Policy Document proposes that member-based organisations, such as burial societies and co-operatives can register as microinsurers, as can friendly societies once they move to the cooperative regulatory regime. Member-based entities that do not provide guaranteed benefits or that have a membership below the designated threshold of 2,500 members do not need to acquire a microinsurance licence; neither do those that obtain underwriting from a licensed insurer.

Prudential requirements to encourage formalisation. The Policy Document proposes a minimum capital requirement for microinsurers of R3 million (US$279,100). Potential registrants operating in the informal space will have three years to become fully compliant with the registration requirements, including building up the required R3 million (US$ 279,100) in capital from an initial base of R1.5 million (US$ 140,000). In addition, the proposal is for MI to be excluded from the forthcoming Solvency Assessment and Management (SAM) framework as the MI capital and reserving requirements will serve to create a separate prudential regulatory model suited to the risk profile of microinsurers. Microinsurers would not be required to appoint a full time actuary or statutory actuary as no statutory actuarial valuation of microinsurance products is required. However, actuarial sign-off will be needed on pricing.

Intermediation requirements to encourage face-to-face selling. The Policy Document recommends a lighter approach for intermediation regulation, including revisiting the FAIS qualification requirements and providing for simplified contents and procedures regarding the provision of advice. By lowering intermediation requirements, the policy framework

seeks to encourage and catalyse face-to-face selling, verbal disclosure and basic advice into the low-income market as an additional means of consumer protection. This is in line with the FAIS Act's overall objective, which seeks to balance consumer protection with the cost of regulation[43].

Commission regime to encourage verbal disclosure and face-to-face selling. MI products typically have low premiums, implying that the commission required to sell these products viably may be high relative to the premium, especially should verbal disclosure or advice be included. Thus, the Policy Document proposed an uncapped commission structure which will be composed of two parts: an as-and-when component, which will be a fixed portion of the premium paid; and a once-off policy initiation fee. In order to ward off abusive market prices, commission levels would be monitored by the FSB and providers would also be required to disclose commission rates as part of the file –and-use process.

3.3. Broader regulatory developments of relevance to MI

The period since the Policy Document was released has been a very eventful time for the policymaker and the regulator, with a re-engineering of the entire regulatory landscape on the cards. In this section we discuss the most significant recent regulatory developments, as well as pipeline plans for regulation that may, broadly speaking, have a bearing on the MI market.

While there have been various developments within the regulatory space, the introduction of the Twin Peaks financial regulatory model, and the implementation of the Treating Customers Fairly framework and the risk based solvency regime (Solvency Assessment and Management Programme or SAM) that go along with it, will possibly have the most significant overarching impact on the insurance sector.

Twin Peaks heralds new financial regulatory landscape. Following the aftermath of the global financial crisis, there has been increasing attention globally on revising financial regulatory models as a means of strengthening the integrity of the financial sector. The most significant development in this regard in South Africa is the introduction of the Twin Peaks financial regulatory model, which provides a comprehensive framework for the regulation of the financial sector. Under the Twin Peaks model, regulation and supervision is demarcated into prudential and market conduct spheres. In December 2013, the National Treasury released the draft Financial Sector Regulation Bill, which serves as the overarching legislation guiding the implementation of the Twin Peaks model.

Overhaul of financial sector regulation. According to the draft Financial Sector Regulation Bill, the implementation of Twin Peaks reform will be spread over two phases:

- *First phase: regulatory structures*. During the first phase, two regulatory authorities will be established: (i) a new regulatory authority housed within the South African Reserve Bank (SARB), responsible for the financial safety, integrity and soundness of the financial sector; and (ii) a new market conduct authority housed within the Financial Services Board – responsible for regulating the manner in which financial service providers

[43] See Benetton (2005). As the discussion in Section 0 will show, the FSB has already started to carve out some space for the distribution of simpler products on the intermediation front. However, a broader rethink of appropriate fit and proper requirements in the MI space is still underway.

conduct their business. Apart from re-assigning responsibility for implementation of legislation to the two regulators, minor changes will be made to existing financial sector legislation to allow operation under the new regulatory structures.

- *Second phase: legislation*. In the second phase, existing financial sector legislation will be gradually amended or replaced with laws that more appropriately align with the Twin Peaks framework.

New solvency regime. SAM is the South African equivalent of the European Solvency II risk-based solvency regime for the prudential regulation of both short short term and long term insurers[44]. The FSB began work on SAM in 2009 with full implementation planned for 2016. It will introduce a risk-based solvency and management regime.

Insurance Bill to reflect new solvency regime and updated ICPs. In the insurance sphere, Twin Peaks will see the current Long term and Short Term Insurance Acts replaced by a new act. The forthcoming draft Insurance Bill will introduce the new solvency regime under SAM and will also reflect the revised international Insurance Core Principles (ICPs)[45]. The Insurance Bill will have a prudential focus with market conduct being dealt with in a separate piece of legislation. The release of the draft Bill for comment is planned for the third quarter of 2014 with the final draft to be tabled before parliament in 2015[46].

Treating Customers Fairly to be embedded in business practices. Treating Customers Fairly (TCF) is an outcomes-based framework that seeks to ensure the fair treatment of customers across the product life cycle. It is the primary framework to be used by the FSB to fulfil its mandate as market conduct regulator. Under TCF, financial institutions, including insurers, are required to revise their governance, product development and client interaction practices. TCF will be implemented alongside Twin Peaks on an incremental basis through various regulatory changes and reviews[47].

Conduct of Business framework. An overarching Act on Conduct of Business will be developed as the market conduct framework under the Twin Peaks financial regulatory model. It will replace the existing FAIS market conduct legislation and will apply to the entire financial sector. As at October 2013, the FSB was "currently reviewing its framework for COB supervision in preparation for the implementation of the Twin Peaks market conduct mandate"[48]. In the interim, existing FAIS exemptions will continue to be in force until further notice.

In addition to the Twin Peaks-related reforms, a number of further regulatory developments or plans, as summarised in Table 1, are relevant[49]. The expected implications of each regulatory impact is classified according to two criteria: immediacy and depth of impact for the provision of microinsurance, using information gained from supply-side consultations. The classification does not relate to whether the impact of the regulation is positive or negative for the supply of microinsurance, but simply shows the degree to which it is "front of mind" for the MI industry at large or for a specific subset of players. On this basis, the

[44] See: http://www.risk.net/insurance-risk/news/2264360/unprepared-insurers-delay-south-africas-riskbased-solvency-regime.
[45] Issued by the International Association of Insurance Supervisors (IAIS)
[46] See Ferreira and Dixon (2013)
[47] See Jackson (2013)
[48] Jackson (2013)
[49] Note that this is not an exhaustive list of all regulatory developments, but those rendered by the consultations for this report as most relevant.

regulatory developments are grouped into three categories: (i) most immediate and/or front of mind for most players (green); (ii) less immediate, or front of mind only for a sub-set of players (orange); and (iii) less likely to lead to immediate or front of mind impacts (red).

For an expanded outline of each of the regulatory developments, please see Appendix B.

Regulatory development	Summary	Implementation timelines	Industry implications
Various exemptions and amendments to fit and proper requirements under the FAIS Act	Various existing FAIS exemptions and fit and proper requirement amendments are of relevance to low-income market provision: 1. Category A - Funeral insurance: representatives only need to be able to read, write and calculate. 2. Category B1A - risk only and B2A - risk and savings products only: representatives under both categories are not required to write Regulatory Exam 1 but will be required to write a separate exam, which is yet to be implemented. (Credit life insurance intermediaries typically fall under category B1A).	Implemented and on-going.	Exemptions taken up by a large number of representatives. Uncertainty concerning length of exemption impacts on entry and retention of staff, as well as companies' operating models. Deeper issue around the fact that a regulatory exam is still the vehicle of choice, as many regard an examination not to be feasible for the type of representative in question – even if they are good sales representatives. Wariness and uncertainty about FAIS is by far the most commonly mentioned concern in consultations with industry.
Financial Services Laws General Amendment (FSLGA) Act, 45 of 2013	Addresses outstanding amendments to financial sector regulation across 11 laws. Extends powers & circumstances to the Registrar and removes requirement that the Registrar must obtain prior approval of Minister for certain actions.	Enacted.	The more direct powers of the Registrar pave the way for the FSB to affect MI framework in a timeous fashion through product standards, etc. Some players express concern that this Act gives the FSB the powers of "judge, jury and executioner". Definition of business of a medical scheme paves the way for revised draft Demarcation Regulations.
Information Letter 9/2013: Revised assistance business caps	Increased the assistance business benefit caps from R18,000 to R30,000	In place since November 2013	Goes some way towards addressing market realities, but demand for higher proposed MI caps remain.

Regulatory development	Summary	Implementation timelines	Industry implications
Binder regulations	The binder regulations define the type of entity that can enter into a binder agreement with an insurer and the functions that it can fulfil. Non-mandated intermediaries and underwriting managers are the only entity that can enter into binder agreements.	In place since 2012. Implementation marked by the release of various information letters: 1. 8/2012 2. 3/2013, 3. 6/2013 and 4. Information request letter 7/2013	Those with binder agreements are not allowed to go directly to the public, must use brokers. This adds an additional layer of cost to the distribution chain.
Guidelines concerning co-administration agreements (part of Binder Agreements Review).	FSB issued an information letter in October 2013 providing guidelines concerning co-administration that requires insurers to amend current co-administration agreements to ensure alignment with the regulatory framework and to refrain from entering into additional co-administration agreements	FSB to release draft document incorporating industry comments on the information letter.	Insurers cannot enter into additional agreements until further notice. Insurers required to ensure current agreements are aligned with regulatory framework. While large players welcome this development as a way of levelling the playing field, smaller players with closer links to funeral parlours will bear the majority of the impact.
Consumer credit insurance review	Review of consumer credit insurance market and regulatory proposals	Discussion document forthcoming	Proposals likely to impact on consumer credit insurance models. Industry players widely expressed that they expect claim ratios to increase after the review is complete.
Directive 159 A.i: Outsourcing directive	Directive 159.A.i concerning outsourcing arrangements was issued in 2012. The directive defines outsourcing as an arrangement between an insurer and another person. The directive prescribes a risk based approach to outsourcing that does not compromise fair treatment of customers.	Directive issued in 2012	More policies and procedures may increase costs. The directive requires insurers with outsourcing arrangements to have: 1. An outsourcing policy 2. Internal review and approval processes 3. Written contracts 4. Management and regular review.
Retail Distribution Review	Aims to ensure that distribution models and practices support fair outcomes for customers.	Forthcoming	Likely to impact on remuneration structures.
Revised draft demarcation regulations and revisions to	The revised draft demarcation regulations will specify a matrix of products, which will be allowed to be sold as health policies (for long term	Press release October 2013. Revised draft regulations forthcoming 2014	Will delineate the space in which insurers can play in the health insurance market. Likely to add

Regulatory development	Summary	Implementation timelines	Industry implications
definition of business of medical aid scheme in FSLGA Act	insurance) and accident and health policies (for short short term insurance). Restrictions will be imposed on the marketing of health insurance policies to ensure that the public clearly understands that the policy is not a substitute for a medical scheme. The FSGLA Act also revises the definition of the business of a medical scheme as basis for the demarcation.		reporting requirements and regulatory complexity, but also to pave the way for innovation regarding e.g. hospital cash plans in light of the new regulatory certainty regarding demarcation.
Guidelines on advertising and marketing	Seek to stipulate principles that will be applied to white labelling, endorsements, cash back bonuses and value judgements and subjective assessments by insurers.	Forthcoming	Will require insurers to revise current advertising and marketing practices to ensure compliance.
Assistance business group scheme review (ASISA initiative)	Redefinition of policyholders within the policyholder protection rules under the Long Term Insurance Act. Will require all rights and duties due to policyholders to be done on an individual basis rather than via group structures.	Forthcoming	May impact economies of scale derived from distribution via group structures and increase cost of serving the low-income market. This development appears to be less front-of-mind in consultations, perhaps because it is an industry rather than a regulatory initiative.
Introduction of policyholder protection scheme	In 2013, the FSB issued a call for contributions to industry associations soliciting comments concerning the introduction of a Policyholder Protection Scheme in South Africa.	No specific timelines have been communicated.	May increase the cost of compliance as insurers will be required to put additional measures in place.
Third party cell captive review	Review of the current landscape of cell captive arrangements. Regulatory proposals include: a. Cell captive insurance to be conducted under a dedicated insurance licence b. Existing arrangements must be converted to a dedicated insurance licence with a minimum share capital of R1 million c. Third-party cell captive insurance arrangements may only be entered into with a	Discussion paper published 2013. Regulation forthcoming.	May increase costs.

Regulatory development	Summary	Implementation timelines	Industry implications
	binder holder. d. Ongoing monitoring of cell agreements by the registrar to ensure compliance.		

Table 1. Summary of selected recent regulatory developments

Source: Various

A number of developments indicated in the table may have a direct impact on MI business models, including the binder regulations, the co-administration agreements guidelines, the consumer credit insurance review, the cell captives review and the demarcation between health insurance and medical schemes. Beyond the details of any specific regulatory development, however, the consultations indicate that the *combined implication* on industry of the range of regulatory developments is likely to be three-fold:

- *Increased regulatory complexity*. The various regulatory developments mean that insurers need to navigate an increasingly complex regulatory landscape, with many moving parts.
- *Increased compliance requirements*. Additional and revised regulatory requirements imply increased layers of compliance. These require changes to current compliance procedures and potentially increase operational costs for current players or entry costs for new players.
- *Regulatory uncertainty*. The expectations concerning various pieces of forthcoming legislation create a sense of regulatory uncertainty in the market that may impact on innovation.

As the discussion in Section 4 will show, these likely impacts reconfirm the demand for MI regulation, envisaged as a unified, simplified regulatory framework for MI provision that will lower prudential, operating and intermediation costs proportionate to the nature, scale and complexity of the risks involved. It also underlines the need for regulatory certainty where MI is concerned.

3.4. Updated MI regulatory roadmap

As indicated in Section 0, the intention was initially to draft a Microinsurance Act that would be implemented by 2014.

Twin Peaks prompts change in implementation plans. As Twin Peaks will entail an overhaul of the entire financial regulatory framework, it also has implications for what legislative vehicle(s) will be practical for MI. In 2013, the decision was taken to no longer develop a standalone MI Act, but rather to incorporate MI in the prudential and market conduct frameworks to be developed under the Twin Peaks framework.

Interim measures to minimise delays. As the implementation of this legislation is likely to take time, the concern is that the MI regulatory framework, already more than five years in the making, will be further delayed. Recognising the imperative to regain momentum in MI, the FSB will as an interim measure regulate and supervise the provision of MI through

product standards contained in policyholder protection rules, capital requirements adopted through board notices and provisions for intermediation and advice under the FAIS framework (Ferreira & Dixon, 2013). The National Treasury and the FSB plan to release an MI roadmap to update the market of these developments and plans.

New format, same contents. The National Treasury and the FSB have confirmed that, despite the change in implementation plans and mode, they remain committed to the MI regulatory framework and that the main tenets thereof remain unaltered from the 2011 Policy Document.

4. Is the proposed MI framework still relevant?

This document has outlined a number of market and regulatory trends since the development of the proposed MI regulatory framework. The central question it sought to answer is: does the original framework still fit the new realities? The market and regulatory updates above suggest that this is largely still the case, but that the lagging timelines are likely to have had a negative impact.

Imperative for deeper market penetration unaltered. There have been no structural changes in insurance usage since the 2008 Discussion Paper. Thus the imperative to increase the penetration of the formal insurance market remains.

Supply-side and regulatory trends strengthen need for MI framework. On the supply-side, the majority of those consulted for this study confirmed that they would want to obtain an MI licence. The increasing regulatory complexity and compliance cost in the market at large has meant that the need for a "simpler" space with manageable compliance costs has become even more pronounced. Particularly attractive is the flexibility that the MI framework promises for innovation in terms of composite long term and short term products, the envisaged commission regime, as well as the proposed creation of a unified "FAIS-light" intermediation framework that is in line with the realities of sales representatives in the low-premium market (see below).

Proposed MI parameters remain relevant. The consultations confirmed the continued relevance of the proposed R50,000 cap for life and other non-asset risk events. However, concerns were expressed regarding the R100,000 cap on asset insurance, as the new access standards under the Financial Sector Code of 2012 include provision for a maximum sum assured of R350,000 for homeowner's insurance and up to R500,000 for premise insurance for Black SMEs[50]. Another concern raised is the fact that no cash-back component will be allowed under the proposed MI regime. This will require a number of MI products currently on the market to either be redesigned or not to fall under the ambit of the MI regulatory framework. Furthermore, the implementation of the MI regime would need to go hand in hand with a review of the potential impact – and consequential amendments where necessary – of a number of regulatory developments in the broader landscape as highlighted in Table 1, Section 3.3.

Cautionary note on FAIS. There is a hope (and a cynical wariness) on the part of commentators that the MI framework will reduce the regulatory cost component in distribution. Many see the future as being face-to-face distribution and require such reduced

[50] Financial Sector Code, Gazette No. 35914 of 26 November 2012

cost to expand access. At the same time, many financial service providers, especially credit retailers, currently operate under a FAIS exemption whereby their sales staff are temporarily exempted from the FAIS regulatory examination until such time as a dedicated regulatory exam is developed. Likewise, assistance business representatives are only required to be able to read, write and calculate. The regulators have therefore already taken pragmatic steps to facilitate intermediation in areas where FAIS compliance has proven most difficult.

If this is already the case, why is an MI FAIS framework then still necessary? The attraction of the MI FAIS framework lies in the creation of a unified framework applicable to the sale of MI products, as well as regulatory certainty (while the current exemptions are helpful, there is uncertainty on the timing and contents of the regulatory examination that will be developed). However, a deeper issue is also at stake here, namely whether a regulatory examination is the most appropriate vehicle for ensuring fit-and-proper sales representatives in MI. Consultations suggest that many competent sales staff simply do not have the frame of reference to be exam-ready, regardless of the contents. A core element in determining the success of the MI regulatory framework will hence be a) whether to pursue a regulatory exam and, if so, b) the exact contents of the exam.

Enforcement as Achilles heel? The need for enforcement of the framework in order to ensure formalisation of those currently operating in contravention of legislation was reiterated time and again in the consultations. Industry participants expressed concern at the un-level playing field with informal providers. They recognise the distribution potential of informal channels such as funeral parlours, but are reluctant to leverage informal entities for distribution purposes, fearing that they'd be held accountable for their actions.

Research into the realities of informal players confirms that enforcement may be the most critical challenge to the success of the MI regulatory framework. Many funeral parlours are in the first instance not aware of the pending microinsurance regulatory framework and its implications. Closer inspection of their business models also suggests that formalisation in general, and in particular the separation of their insurance and funeral businesses, as well as full FAIS compliance, will be a prohibitive challenge for many in their current guise.

Changes in MI regulatory approach impact market decisions. The discussion in Section 3.4 shows that the change in tack has been for pragmatic reasons, rather than due to an ideological or content shift. However, the upshot has been that the implementation of the MI framework has stalled and, despite the interim measures, full implementation is likely to take time. This hiatus has created some uncertainty in the market. Along with the general economic slowdown and the compliance "distractions" due to various other regulatory developments, this has meant that some players have been hesitant to move where MI is concerned and that low-income market innovation has slowed down.

The need to regain momentum, ensure coherence. The consultations revealed a preference for a single piece of enabling MI regulation, but this is now no longer possible. The risk of the new approach is that MI will be a patchwork of provisions across various pieces of legislation and subordinate legislation, and that its full implementation will be further delayed. Consultations show that demand for the microinsurance regulatory framework is alive and well. However, implementation must happen soon and in a coherent way. The regulator must also be seen to have the requisite enforcement "teeth". If not, the impact of more than five years of regulatory planning may be undermined.

Lessons from an international perspective. The road that South Africa has followed and the changes in course along the way provide valuable lessons for a global audience increasingly interested in MI regulation. MI frameworks are developed within a dynamic political economy and broader financial sector regulatory landscape. Such changes will impact the implementation of MI regulation. The South African experience stresses the need for a pragmatic regulatory approach, willing and able to adapt to new circumstances. Furthermore, it emphasises the need for regulators to stay on top of market developments and realities and to recognise the importance of regulatory certainty. Should delays arise, early and clear communication with the market is needed, as well practical planning of interim approaches.

Lastly, the impact of a regional demonstration effect should also be noted. A number of countries in the Southern Africa region are moving towards regulation taking their cue from the 2011 South African Policy Document[51] – even before South Africa has started to implement the framework.

[51] For an overview, see Cenfri, 2013. Regulating for Inclusive Insurance Markets in SADC. Study commissioned by FinMark Trust as input to the SADC Committee of Insurance, Securities and Non-Banking Financial Authorities (CISNA) Microinsurance Forum. Available at:
http://cenfri.org/documents/microinsurance/2013/Regulating%20for%20Inclusive%20Insurance%20Markets%20in%20SADC.pdf

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Appendix A. List of stakeholders consulted

The table below summarises the stakeholders consulted in the compilation of this document, indicating those who attended the kick-off forum in Cape Town in September, with whom we met as part of the research process, as well as those who attended the March 2014 workshop in Johannesburg.

Organisation	Name	Kick-off forum	Meetings	Workshop
Absa Life	Cobus Fourie	x	x	
African Bank	Marius Botha		x	
Association for Savings & Investments SA (ASISA)	Brad Frank	x	x	
Assupol	Bridget Mokwena Halala		x	
ASSUPOL	Rudi Schmidt		x	
AVBOB	Colin van Son		x	
AVBOB	Deno Pillay	x	x	
AVBOB	Lucia Momberg			x
AVBOB	Tracy Cooper	x		
BUSOSA	Boitshepo Lesetedi			x
BUSOSA	Thapelo Makwena			x
Cillion Consulting Group	Cristina Sapsezian-Flett			x
Cillion Consulting Group	Morne Wiggins			x
Clientele	Gary Simpson			x
Clientele	Johan van Rensburg		x	
Constantia Insurance Group	MJ Prinsloo		x	
Constantia Insurance Group	Robert Shaw		x	
Cover Magazine	Tony van Niekerk	x	x	
Cover Magazine	Taryn Kerr			x
Doves	Minki Ngcobo		x	x
Doves	Nigel Cloete			x
FAB	John Adonis	x		
FIA	Peter Atkinson		x	
Forum for Assistance Business	John Solomon			x
Forum for Assistance Business	Colin Daries	x		
FSB	Caroline da Silva			x
FSB	Jacky Huma		x	
FSB	Jonathan Dixon		x	
FSB	Leanne Jackson			x
FSB	Lyndwill Clark		x	
FSB	Charene Nortier		x	x
FSB	Marthinus Hamman			x
Great North Burial Society	Daniel Masemola		x	
IEMAS	Gary Foster		x	
K M Dastur & Company	Michael Raal			x
KGA Life limited	Johan Ferreira		x	

Organisation	Name	Kick-off forum	Meetings	Workshop
KGA Life limited	Sara-Lize Barnes	x	x	
KPMG	David Kirk		x	
KPMG	Kerisha Bhoola			x
KPMG	Nabeelah Kolia		x	
KPMG	Stefan Strydom			x
Liberty Life	Joe Mwase	x	x	x
Lion of Africa	Adam Samie		x	
LIPCO	Willie van der Merwe	x		
McKinsey Consulting	Jayshree Naicker			x
Mutual and Federal	Herman Moloi		x	
National Treasury	Ingrid Goodspeed		x	
National Treasury	Jeannine Bednar-Giyose			x
National Treasury	Ngoni Mangoyi	x		x
National Treasury	Reshma Sheoraj		x	x
National Treasury	Roelef Goosen			x
Old Mutual	Annemi Slabbert	x	x	x
Old Mutual	An-Ria Schreuder		x	x
Old Mutual	Jaco Vlok	x		
Old Mutual	Michael Goemans		x	
Ombudsman for Long Term Insurance	Ganine Bezuidenhoudt	x		
Ombudsman for Long Term Insurance	Jennifer Preiss	x		
Ombudsman for Short Term Insurance	Nosipho Mfeka			x
Private	Sonja Visser	x		
PV Labs	Dino Lazaridis			x
SAIA	Suzette Strydom			x
SAIA	Viviene Pearson		x	
Sanlam Sky	Hayley Kuhn		x	
Santam	Willoe Myburgh		x	
Smart MI	Mari van Rooyen	x	x	
The Best Funeral Society	John Turnbull	x	x	x
UCT DPRU	Aalia Cassim			x
Vodacom	Andrew Culbert		x	

Appendix B. Key tenets of recent and proposed regulation

In this section we expand on the main tenets of recent and proposed regulation as discussed in Section 3.4 in the document (some of which are summarised in Table 1 in Section 3.4).

Financial Sector Regulation Bill[52]*.* The Financial Sector Regulation Bill is the first in a series of bills that seeks to give effect to Cabinet's decision to implement a Twin Peaks model. The Bill follows two policy papers released by the National Treasury following the financial crisis, namely: *Safer Financial Sector to Serve South Africa Better* (released in 2011) and *A Roadmap for Implementing Twin Peaks Reforms* (released in 2013). The Bill establishes two new regulators, one with a prudential focus, the other responsible for market conduct. The Bill also introduces the concept of mono- and dual-regulated institutions. Mono-regulated institutions are those that are subject to market conduct regulation only, while dual-regulated institutions are subject to both market conduct and prudential regulation. The objectives of the Bill include enhancing coordination and cooperation between regulators, establishing a crisis management and resolution framework and strengthening enforcement. The draft Bill was released in December 2013 and was open for comment until March 2014.

Financial Services Laws General Amendment Act, 45 of 2013 (FSLGA)[53]. Enacted in January 2014, this Act addresses outstanding amendments to financial sector regulation of particular interest to insurance, including:

- Removal of the requirement that the Registrar must obtain prior approval of Minister for various actions;
- Authorising the Registrar to prescribe what constitutes an inducement;
- The Registrar is to approve compromise, arrangement, amalgamation, demutualisation or transfer instead of Courts;
- Section 53 (Long term insurance only): The sum of money paid as a benefit must be equal to the value of the services provided for under the policy. For example, if a policy provides for a funeral service to the value of R5,000, and the beneficiary opts to take the cash value, that person must receive R5,000;
- And revised, broadened definition of the business of a medical scheme, paving the way for the issuing of revised draft demarcation regulations.

Insurance Laws Amendment Bill (ILAB)[54]*.* The ILAB Bill amends current Insurance Acts to allow for enhanced governance and group supervision. The Bill was tabled before Parliament in June 2013 and provisions are not expected to come into effect until mid-2014. The National Treasury also released the ILAB for public consultation from June to July 2013. A review of the Bill indicates there are no obvious implications for the provision of MI.

Forthcoming Insurance Bill[55]*.* The Insurance Bill will introduce a new solvency regime (SAM) and will update the regulatory framework to reflect the revised IAIS Insurance Core Principles. Under Twin Peaks, the Bill will have a prudential focus (insurance conduct of

[52] Ferreira, J. and Dixon, J. 2013. Insurance Regulatory Framework Update. Financial Services Board, Insurance Regulatory Seminar, 31 October 2013.

[53] Makhubela, O. and Bednar-Giyose, J., 2013. Financial Services Laws General Amendment Bill Presentation to the Select Committee on Finance NCOP. (Online). Available. http://db3sqepoi5n3s.cloudfront.net/files/131105treasury.pdf (Accessed February 2014).

[54] Ferreira, J. and Dixon, J. 2013. Insurance Regulatory Framework Update. Financial Services Board, Insurance Regulatory Seminar, 31 October 2013.

[55] Ferreira, J. and Dixon, J. 2013. Insurance Regulatory Framework Update. Financial Services Board, Insurance Regulatory Seminar, 31 October 2013.

business provisions will be dealt with in a separate piece of legislation). The Bill envisages both life and non-life insurance being regulated through one piece of legislation. The draft Bill will be released for public comment in the last quarter of 2014 and is planned to be tabled in parliament in mid-2015, with commencement expected in 2016.

Forthcoming health insurance demarcation regulations[56]. In 2012, the National Department of Health, the Financial Services Board and the Council for Medical Schemes released a discussion document that proposed a revised demarcation of medical schemes and other health insurance products. The discussion document outlined the required amendments to the Long Term and Short Term Insurance Acts in line with the proposed revised demarcation. Key revisions to the demarcation included:

- Capping of daily hospital cash plan benefits to 70% of the daily income of the policyholder.
- Updated marketing and distribution requirements requiring insurers to explicitly communicate cover provided and the fact that these products are not designed to meet the total cost of health care.

Based on more than 300 submissions on the proposed demarcation, the positions have been revised. In October 2013, the National Treasury released a press statement to indicate that, amongst others, the proposed capping of hospital cash plan benefits will fall away. The sale of hospital cash plan and gap cover will be allowed within defined regulatory parameters to avoid compromising medical schemes.

The revised draft demarcation regulations are expected in the first quarter of 2014 and will draw on the FSLGA Act revision of the definition of the business of a medical scheme.

Treating Customers Fairy (TCF). Treating Customers Fairly (TCF) is a regulatory approach that seeks to ensure fair treatment of customers by financial service providers, as per a predefined set of outcomes. TCF will serve as the overarching regulatory framework guiding the FSB in regulating market conduct across the financial services sector. It will regulate the manner in which financial service providers interact with customers. Financial service providers are required to consider the fair treatment of customers across the product cycle from product design to advice, point of sale and after-sales. In 2010, the Financial Services Board released a discussion paper, which proposed the introduction of the TCF programme in South Africa. In March 2011, the Financial Services Board released a TCF roadmap, which commits the FSB to the development of a self-assessment tool that assists industry in assessing preparedness. A pilot version of the tool was tested on a sample group of financial service providers from July to November 2011. TCF will be implemented on an incremental basis in tandem with the introduction of Twin Peaks. FSB has already begun implementation through:

- Embedding TCF in existing subordinate measures; and
- monitoring TCF readiness and delivery.

[56] a) South African National Treasury. Online. (Available). *Process for the release of the envisaged revised draft regulations on the demarcation between health insurance policies and medical schemes*. (Online). Available. http://www.treasury.gov.za/comm_media/press/2013/2013101501%20-%20Demarcation%20media%20statement.pdf (Accessed March 2014).
b) Lighthouse Actuarial Consulting, 2013. *Review of the History and Legislative Landscape of the South African Market for Hospital Cash Plan Insurance.* (Online). Available. http://www.finmark.org.za/wp-content/uploads/pubs/Note_HCPInsurance_Regulatory-History_1120131.pdf (Accessed March 2014).

Table 2 below shows how TCF will be embedded into the insurance regulatory framework through current and forthcoming regulatory projects.

TCF Outcome	Current projects	Forthcoming projects
1. Culture and governance	SAM Pillar II governance requirements to include conduct risk governance	
	Conduct of Business reporting to Registrar and public	
2. Products and services	Consumer credit insurance review	Legal expense insurance
		Complex linked products
		Extended motor warranty business
		Review of inducements and warranty schemes
		Unfair contract terms – through new Policyholder Protection Rules
3. Disclosure	Key Information Documents (KID's)	Customer specific disclosure standards
	Standardised terminology	Review of product aggregation and comparison services
	Guideline on advertising and marketing	
4. Suitable advice	Retail distribution review	
5. Delivery on expectations	Causal event charges	On-going disclosure (linked to Outcome 3 next steps)
		Unilateral cancelation of policies
		Life insurance premium escalations
6. Claims, complaints and changes	Complaints handling guidelines and reporting	Claims handling guidelines
		Combating insurance fraud

Table 2. Embedding TCF into the insurance regulatory framework

Source: Ferreira & Dixon, 2013

Consumer credit insurance review[57]*.* In recent years, concerns have been raised around client value and consumer protection within the credit life insurance space. A joint consumer credit insurance task force led by the National Treasury and the Financial Services Board, with inputs and data from the National Credit Regulator and the Competition Commission, was set up in 2011 to review practices within the consumer credit insurance market. A discussion document will be released in 2014 that highlights key findings from the task team's review and sets out a range of policy interventions. Following input on the discussion paper, and further technical work, final policy proposals will be published.

Guidelines on advertising and marketing[58]*.* There have been cited increases in the contravention of disclosure requirements as set out in the Section 4(3) of both the Long Term and Short Term Insurance Acts. In October 2013, the Financial Services Board announced the introduction of guidelines on advertising and marketing for insurers. The

[57] National Credit Regulator (NCR), 2013. *Making Credit Markets Work: A Policy Framework for Consumer Credit.* (Online). Available. http://www.ncr.org.za/publications/Background_NCA_docs/Credit%20Law%20Review.pdf (Accessed February 2014).
[58] Ferreira, J. and Dixon, J. 2013. Insurance Regulatory Framework Update. Financial Services Board, Insurance Regulatory Seminar, 31 October 2013.

guidelines on advertising and marketing seek to stipulate principles that will be applied to white labelling, endorsements, cash back bonuses and value judgements and subjective assessments by insurers. The guidelines will be issued in an information letter, which will highlight general applicable principles to advertising and marketing. These principles will include accuracy, truthfulness, disclosure measures as well as preventative and remedial measures.

Co-administration agreements[59]*.* There has been an increase in co-administration agreements between insurers and funeral parlours in respect to assistance business and life policies. Co-administration agreements are essentially a profit-sharing agreement between insurers and funeral parlours or administrators. Funeral parlours or administrators make an insurer's policies available to their clients, conduct marketing of policies, intermediate between the client and the insurer and perform other binder functions. In addition, the funeral parlour or administrator collects premiums on behalf of the insurer, while retaining a certain percentage for themselves as commission/fees. The funeral parlour or administrator may also be involved in claims processing and management depending on the nature of the agreement. It is the view of the FSB that such agreements are not consistent with the regulatory framework and result in potential consumer abuse and an un-level playing field. Furthermore, they impede the Regulator's ability to oversee and enforce compliance. In 2013, the FSB issued an information letter providing guidelines concerning co-administration agreements. It required insurers to amend current co-administration agreements to ensure alignment with the current regulatory framework and to refrain from entering into additional co-administration agreements.

Binder agreement regulations[60]*.* In their simplest form, binder agreements are outsourcing agreements between an insurer and third party administrators, brokers or underwriters. Under a binder agreement, an insurer mandates a third party (e.g. administrator, broker or underwriter) to conduct certain functions on its behalf. These functions are largely related to the administration of the insurance policies as well as claims. Binder regulations were first introduced in 2008 within the Long Term Insurance Act. Following this, the Short Term Insurance Act was amended to include binder provisions. In 2010 the Financial Services Board released draft revised binder regulations for comment. The new binder regulations define the type of entity that can enter into a binder agreement with an insurer and the functions that it can play. Since 1 January 2012, only non-mandated intermediaries or underwriting managers can enter into binder agreements. In 2012, the FSB held roadshows in major urban centres to raise awareness and improve understanding. Following the revised draft regulations, the FSB has also issued guidance through various information letters.

- Information letter 8/2012 – Guidance to facilitate compliance and supervision;
- Information letter 3/2013 (July) – Activities constituting binder functions and alignment of binder agreements; and
- Information request 7/2013 – Request for information pertaining to binder functions.

[59] Financial Services Board, 2013. *Conducting of insurance business in respect of assistance and life policies through co-administration agreements (Information letter [-]/2013).* (Online). Available. ftp://ftp.fsb.co.za/public/insurance/info%20letters/Draft_Info_letter_of_2013_(LT)_Conduct_ins_through_coadm_agreements .pdf (Accessed March 2014).

[60] Dixon, J. *Binder regulations.* (Online). Available. https://www.fsb.co.za/Departments/insurance/archives/Documents/Binders_5_Oct_2010.pdf (Accessed February 2014).

Retail Distribution review[61]. The objectives of the review are a) to ensure the appropriate definition of intermediary services and related remuneration structures in the insurance sector, as well as b) to promote appropriate and fair advice, while supporting a sustainable business model for financial advice. While FAIS raised the level of professionalism there are still a number of issues that remain. Clients may be receiving financial advice but they may not be aware of or understand the financial advice they are receiving. In addition, they may not be fully aware of the charges pertaining to the information they are receiving. Among the proposals are a revised fee structure for advice for various financial products and services. However, for risk only/insurance products, the FSB does not propose introducing a fee-based approach.

Outsourcing directive. In order to facilitate cost-effective delivery of insurance products, insurers may outsource key functions within the value chain to other entities. In 2012, the FSB issued a directive within information letter 159 A.i. requiring insurers to adopt a risk-based approach to outsourcing agreements in line with the adoption of SAM. The directive was issued under Section 4 (4) of the Long term and Short Term Insurance Acts and requires insurers to have outsourcing policies, internal review and application processes, written contracts and management and regular review of outsourcing agreements. In addition, the directive prescribes that insurers' top management remain responsible for all activities, regardless of the nature of the outsourcing agreement. The directive was effective 12 April 2012 and insurers were given until 1 January 2013 to amend existing outsourcing agreements[62].

Revised assistance business caps. In November 2013, the FSB issued an information letter (9/2013), which served as a directive increasing the assistance business benefit caps from R18,000 to R30,000.

3rd party cell captive review[63]. In 2013, the FSB released a discussion paper which summarised a review of the current landscape of cell captive arrangements and introduced regulatory policy proposals. The main regulatory policy proposals introduced in the discussion paper include:

a. Cell captive insurance to be conducted under a dedicated insurance licence.
b. Existing arrangements will no longer be permitted and must be converted to a dedicated insurance licence with a minimum share capital of R1 million (US$ 100,000).
c. Third-party cell captive insurance arrangements may only be entered into with a binder holder.
d. Ongoing monitoring of cell agreements by the registrar in compliance with all regulatory requirements.

Policyholder protection scheme[64]. In 2013, the FSB issued a call for contributions to industry associations soliciting comments concerning the introduction of a Policyholder Protection Scheme ("PPS") in South Africa. The FSB encouraged contributions on the draft Issues Paper

[61] Ferreira, J. and Dixon, J. 2013. Insurance Regulatory Framework Update. Financial Services Board, Insurance Regulatory Seminar, 31 October 2013.
[62] Martin (2013)
[63] Financial Services Board, 2013. Review of third-party cell captive insurance and similar arrangements. (Online). Available. ftp://ftp.fsb.co.za/public/insurance/Discussion_paper_3rd_Party_Cell_and_similar_arrangements.pdf (Accessed March 2014).
[64] Insurance Gateway, 2013. SAIA Legislation and Regulation Update July 2013. (Online). Available. http://www.insurancegateway.co.za/ShorttermProfessionals/PressRoom/ViewPress/Irn=6949&URL=SAIA+Legislation++Regulation+Update+July+2013+1#.UyHAuz-SySo (Accessed March 2014).

on Policy Holder Protection Schemes, issued by the International Association of Insurance Supervisors (IAIS) by late August 2013. Following this, it is envisaged that the FSB will draft regulations with a cost-benefit analysis also being undertaken. No specific timelines concerning implementation have been communicated.