The [Past and] Future of Microinsurance Regulation in South Africa

NATIONAL TREASURY PRESENTATION TO MIJWG
20 SEPTEMBER 2010
STRUCTURE OF PRESENTATION

• Background
• Policy Making 101 – high level conceptual issues
• Drilling down – the technical detail
• South Africa – what is microinsurance & why do we need it?
• Proposed regulatory environment
• Market Impact
• Policy process – past, present, future
BACKGROUND
## BACKGROUND

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
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<tbody>
<tr>
<td>2003</td>
<td>PCOF hearings on abuses in the funeral benefits industry</td>
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<td>2005</td>
<td>FinMark Trust investigative study into funeral assistance business, entitled “The regulation of assistance business in South Africa”</td>
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<td>Joint NT / FSB task team set up to direct the assistance business reform process (PCOF updated to these developments)</td>
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<td>2006</td>
<td>Project extended beyond funeral assistance business to consider all microinsurance</td>
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<td>2007</td>
<td>Inter-department forum to ensure alignment across government</td>
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<td>2008</td>
<td>Joint NT / FSB discussion paper released for public comment, entitled “The Future of Microinsurance Regulation for South Africa” + National roadshow</td>
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<td>2010</td>
<td>Final [targeted] engagement, policy statement due October</td>
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POLICY MAKING 101 – HIGH LEVEL CONCEPTUAL ISSUES
HIGH LEVEL CONCEPTUAL ISSUES

Ask yourself:

- What is MI?
- What are your motivating policy objectives?
- Who will take responsibility for the project – political will?
- What is happening internationally – lessons learnt?
- What vulnerabilities are specific to YOUR market? (these could be abuses or simply an absence of provision)
- What does your market currently look like and what would you like it to look like?
- Who are/should-be your MI providers?
- Interface of MI with traditional insurance?
- Interface of prudential vs market conduct regulation?
- Who will supervise market participants: institutional vs functional regulation (also issue here of form vs function)
- Role of enforcement vs consumer awareness – who takes responsibility for bad conduct and bad decisions?

=> DEVELOP A STRATEGIC VIEW!!!
DRILLING DOWN –
THE TECHNICAL DETAIL
DRILLING DOWN

Now ask yourself:

- Regulatory architecture: does MI require stand-alone legislation?
- How should MI be defined - what are appropriate MI products from demand, supply and risk management perspectives?
- A role for product regulation?
- What are the appropriate prudential requirements?
- What are the appropriate intermediation requirements?
- Market impact (and on the supervisor)?
- Transition arrangements?
- How to support regulatory compliance?
- Tax?????

=> Be willing to compromise - pragmatism must trump idealism, but don’t sacrifice core principles
SOUTH AFRICA – WHAT IS MICROINSURANCE & WHY DO WE NEED IT?
MICROINSURANCE – WHAT IS IT & WHY DO WE NEED IT?

• **Microinsurance**: Insurance for low-income households

• **Purpose**:  
  • Help manage key risks (life, loss of income, etc.)  
  • Support the delivery of other important services (e.g. funeral services, health services, etc)

• **Challenge** of achieving take-up:  
  • Clients: Limited knowledge and awareness, distrust, spending priorities, etc  
  • Insurers: Low premiums require innovative products and distribution models

• **Need to create an appropriate space for models that can achieve take-up**
SA MARKET CONTEXT

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

Source: Eighty20 calculations based on FinScope 2007 (using weightings derived from the Census 2001)

* The definition of LSM used is according to the 2005 algorithm
** Does not imply that respondents in this segment do not have funeral insurance, but that they have a formal life policy
MICROINSURANCE – WHAT IS IT & WHY DO WE NEED IT?

Key issues to address

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

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

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

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

• Create the space for models to grow and **extend beyond funeral insurance**
MICROINSURANCE – WHAT IS IT & WHY DO WE NEED IT?

National Treasury / FSB objectives

- **Inclusion**: Facilitate the development of the MI market. Particularly to maintain and develop voluntary business.

- **Abuse**: Concerns about abuse increasing enforcement pressure but with risk of damage to existing MI market.

- **Alignment of regulatory changes**: Large number of regulatory changes potentially impacting on market. Need for coherent framework to manage diverse set of policy and regulatory (including non-insurance) objectives.

- **Facilitate competition**: Various new initiatives to extend market (providers and products) some of which operate at risk in grey areas of regulation.

- **Remove barriers**: Particular market segments facing constraints under current regulation (e.g. friendly societies’s use of cell captives). Remove unnecessary barriers to entry and operation to facilitate broader participation.

- **Efficiency**: Align regulation with risk to be managed.
PROPOSED REGULATORY ENVIRONMENT
Discussion paper themes

- *Better* rather than *more* regulation
- Recognise multiple policy objectives
- Level playing fields but tiering based on risk
- In favour of market development to serve the needs of the poor and illustrates willingness by government to create an environment in which this can happen
- Recognition that regulation increases costs and attempts to streamline regulation where this can be justified by “contained” risk
- Balancing consumer protection and inclusion: reducing the per transaction cost of market conduct regulation
- Encourage value to consumers: cheap products does not necessarily present value
- Specific focus on enforcement and recourse with support to entities to formalise
- Extend beyond Charter
- MI does not exist in isolation and is integrated into overall insurance framework
So what do we propose?

1. Product-based approach to reduce risk of microinsurance i.e. limit risk through a restricted product definition

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

3. **Improved enforcement and recourse**, building consumer awareness
PROPOSED REGULATORY ENVIRONMENT III

1. Proposed **micro-insurance definition** to limit risk:

   - Benefits capped – multiple product categories?
   - Term of less than 12 months
   - Covering both life and non-life but limited to risk-only
   - Simplified terms and conditions: product standards?
2. Underwriting

- Limited to MI products as defined
- Upfront capital of R3m
- Reserving based on simplified standard model
- Reduced organisational capabilities
- Minimum set of corporate governance requirements
- Public/private companies and cooperatives (migration of Friendly Societies?)
- Restricted investments
- Graduation based on ability to carry risk
- Exemptions (and support...) for informal providers?
PROPOSED REGULATORY ENVIRONMENT

Regulatory requirements (degree to which allowed to carry risk) underwritten entity

Cell owner

Specifically defined risk can be carried by re-insurer

Re-insurance possible as for friendlies

Potential micro-insurer

Full insurer

Graduation based on ability to carry risk

Same level of requirements as for formal insurer met by all versions

Ltd requirements based on more ltd risk associated with prod. def.

Potential micro-insurer

Full insurer
3. Market Conduct – Proposed Requirements

- Intermediation requirements linked to MI as product category
- Simplified product
- Simplified & clear language disclosure
- Promote the giving of advice
- No advice required but encouraged
- Uncapped commissions (voluntary products), subject to reporting and monitoring
4. Enforcement and Retribution

- Improved coordination and collaboration with other government departments (?
- Utilising apex bodies to extend capacity
- Compliance support – regulatory, operational, financial
- Empower the supervisor!
- Empower the consumer!

=> Transparency and accountability critical
MARKET IMPACT
MARKET IMPACT

- Burial societies, friendly societies and cooperatives
- Funeral parlours
- Administrators
- Long-term and short-term insurers
- Intermediaries
POLICY PROCESS - PAST, PRESENT, FUTURE
PAST, PRESENT, FUTURE

2003-7  Initial policy deliberations

2008  Policy discussion document

2008-10  Extensive public engagement

2010  Policy statement

2011  Draft legislation tabled to parliament

2012  Implementation
QUESTIONS?