Comments on Discussion Paper: The Future of Micro-Insurance Regulation in South Africa

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Entity submitting: Submission by the South African Insurance Association (SAIA) on behalf of the short-term insurance industry

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Type of stakeholder: Industry representative body

SAIA Submission

The SAIA has considered the proposals included in the National Treasury Discussion Paper on the Future of Micro-insurance in South Africa and welcomes the opportunity to submit the comments of our industry for consideration by National Treasury.

The SAIA submission comprises two parts: Part 1: The short-term insurance industry and micro-insurance: A briefing overview and Part 2: Specific comments on the “National Treasury Discussion Paper: The Future of Micro-Insurance in South Africa” (the Discussion Paper).

PART 1:

THE SHORT-TERM INSURANCE INDUSTRY: A BRIEFING OVERVIEW

Micro-insurance as an international topic has been gaining ground for some time. The objective of promoting financial inclusion for low income people is to be applauded.

From a short-term insurance industry point of view, however, most initiatives in South Africa have not centered around short-term insurance products but rather around life insurance products, including funeral insurance, as well as similar types of “informal” products such as those offered by burial societies and the like. Some types of consumer credit insurance and legal insurance products have also been recognised as micro-insurance products.

The recently released Discussion Paper also seems to have its origins in the life insurance industry, specifically mostly from a need to formalise informal assistance business. It does not appear as if a short-term insurance perspective has been considered in any depth in the Discussion Paper.

The short-term insurance industry has been struggling to enter the low income market in South Africa, although it is required to do so in order to fulfill the Access requirements of the Financial Sector Charter (FSC). The short-term insurance industry therefore wholeheartedly agrees that an enabling environment is needed for micro-insurance. It is acknowledged that, since micro-insurance is much wider in concept than the Access requirements in terms of the FSC, an enabling environment created for micro-insurance would assist short-term insurers to reach their specific FSC Access targets (according to the FSC generic access standards).

The SAIA believes for the reasons mentioned briefly above that a thorough overview of the short-term insurance industry and its relation to micro-insurance should be included in our comments on the Discussion Paper.

What follows below is an attempt to provide such an overview, with our recommendations appearing in italics at the end of each section.

Typical short-term insurance and the low income market

(Please note, for the sake of clarity, 'short-term insurance' in this section of this paper, unless otherwise indicated, means 'asset and property insurance'.)

Traditionally, short-term insurance has been bought by LSMs 7 – 10, i.e. the higher income market. Typically, short-term insurance is linked to assets and/or property. Even in the high income market, short-term insurance is often 'sold' not 'bought', seen as a 'grudge' purchase, and often just bought when linked to the acquisition and/or financing of an asset, such as a motor vehicle, home, or household contents and especially when such an asset was bought on credit.

FinScope, the market survey conducted by FinMark Trust, has consistently shown that only a negligible number of short-term insurance products are bought by the low income market. In fact, the latest FinScope survey (2007) found that less than 2% of respondents from the LSM 1 – 5 grouping had any form of short-term insurance.

Demand

Although it is acknowledged that a definite need exists in the low income market for insurance that could protect assets, although these assets might be few in number and low in value, the question should be asked whether the need would translate into demand. In fact, the SAIA believes that this is a crucial issue that is central to the ability of the short-term insurance industry to provide micro-insurance products relating to asset and property insurance in the micro-insurance market.

A study commissioned by FinMark Trust and researched by Corporate Research Consultancy (crc), “Exploring the need for an awareness of asset insurance as risk management tool amongst the poor: A Summary of focus group findings”, produced some interesting findings in this regard:

- It has been found in this, and other studies, that South African people in the low income market, having access to a very small income only, have a set of priorities that mostly in the last instance include asset and property insurance only. The list of priorities typically include food, shelter, clothes, medicine, provision for funerals, provision for education, provision for saving, and only later on provision for asset protection.
- In the study by crc, it was found that the greatest risk perceived to warrant insurance included loss of a job, an income or an income provider, and the next most important risks were disease followed by violence. Provision for education for children was also seen as important. However, the least important risk concerned things that could be replaced, including assets.
- The disposable income of South Africans in the low income market is such that it is highly unlikely that asset and property insurance could be afforded in view of the above mentioned list of priorities.
- People in this market own few, mostly low-value assets.
- People in the low income market have little or no experience with asset and property insurance, although the crc study found that good awareness exists about insurance, including short-term insurance. Short-term insurance is understood and perceived as something that could make life easier.

The case studies done by crc in this piece of research also showed that people in the low income market would be very interested in asset and property insurance, should appropriate and affordable products be available. In fact, the reasons why the people participating in the case studies did not use short-term insurance included the fact that it was perceived to be unaffordable, they did not have job security so were not in a position to honour regular payments, they believed their possessions were not of significant value, and there was a lack of push, cultural or otherwise, to buy such products.

It was clear from this study that a desperate need exists for education with regard to short-term insurance.

It is recommended that a study be commissioned to determine the real demand (as opposed to need) in the micro-insurance market for short-term insurance products.

Supply

Traditionally, short-term insurers have not targeted the low income market. The reasons for this are probably linked to the factors mentioned in the above paragraph.

However, the desire to enter this market successfully has recently become apparent amongst some short-term insurers for various reasons. Such reasons include the Access requirements of the FSC, a recognition by the industry that this market is potentially profitable, as well as a social responsibility motive linked to providing appropriate products to the low income market on a profitable and sustainable basis.

Consequently, several efforts have been made by South African short-term insurers to enter this market in the past two years. To date, very little success has been achieved.

It is the view of the SAIA and its members, that such products should be provided on a profitable basis to ensure sustainability (both for the industry and policyholders), and not on a social responsibility basis only, which would end when the funding for such initiatives terminates or is exhausted, or when relevant books of business run at a complete loss. In view of this, we believe that a careful look should be taken into the reasons why short-term insurance companies have not been successful in their efforts to enter this market.

Although some information is available, it is suggested that a proper study is commissioned to look at the role and/or potential role of short-term insurance in the micro-insurance market.

An informal survey was recently done via the SAIA by Genesis while doing a study on disaster risk insurance in South Africa commissioned by FinMark Trust. This study was done in relation to short-term insurance, and specifically in the fields of asset, property-related and agricultural risks. *(Please note, this is a disaster risk study and any findings in the informal survey related to the disaster risk field.)*

However, in the absence of any other information, and because the survey was of short-term insurers and linked to short-term insurance and especially to home and homeowners insurance, the results of this survey should be relevant. The results also tally with informal conversations with SAIA members.

Possible reasons for difficulties on the supply side

- Lack of data and claims history

- Cost drivers, e.g. verification of insured items, underinsurance (especially related to indemnity cover), ensuring legality of house ownership, ensuring sound construction methods were used in the building of the houses
- Legal issues such as providing insurance in illegal settlements
- Product design still unsuitable for this market
- Collecting premiums, and dealing with skipped premiums
- Payment of claims at conveniently accessible points without costing the provider too much
- Verifying claims and controlling fraud (post-loss control)
- Distribution of products, and its related cost.

Problems are especially experienced in the distribution of products to the low income market.

In this area, the process of intermediation has become quite expensive with the advent of FAIS. In addition, the South African market has almost split into two different intermediation models, one for the high income market and one for the low income market.

Some useful insights in intermediation in South Africa, and especially in the micro-insurance market, can be found in the study, “Brokering change in the low income market – The threats and opportunities to the intermediation of micro-insurance in SA”, prepared for FinMark Trust and the Ford Foundation by Genesis in conjunction with Enteplan.

It was stated in this study that, because of the cost of intermediation associated with advice, the advice model is perceived viable only in the high income market. Conversely, a passive, non-advice or “tick-the-box” intermediation model is perceived as the only cost-effective way to reach the low income market.

However, because short-term insurance products are not top of mind or high on the priority list for low income earners, an intermediation model that includes a certain level of information-giving and/or consumer education is crucial to expand access to short-term insurance products.

Potential solutions to these problems on the supply side

- Forms of direct distribution of products such as pre-pay and retail options
- Distribution through groups such as affinity groups, unions or other community groupings
- Distribution through bundling with other products like microfinance or funeral insurance
- Relaxing of FAIS and other regulatory requirements in the micro-insurance space

- Making use of potential aggregators in the public arena to assist in the distribution of products, as well as with premium collection and claims disbursement. Such aggregators could include municipalities, and new types of public-private partnerships that relate specifically to disaster and other big risk areas in which government has a definite role to play.
- Consumer education.

These potential solutions were also mentioned in the replies in the informal survey done by Genesis in the disaster risk insurance study mentioned above.

Potential micro-insurance products (short-term insurance products in addition to asset and property insurance products)

As stated before, the term "short-term insurance" in this section of the paper thus far mainly refers to asset and property insurance. However, many other short-term insurance products exist that could very easily fit into the low income market space. The SAIA believes that it is quite possible that a bigger demand exists for many of these other types of short-term insurance products, than for asset and property insurance.

Products that might fit higher on the priority lists of low income people include certain types of consumer credit insurance products, income protection-type policies, accident and health related insurance, commercial products in the SMME space, legal expenses insurance and others.

The SAIA believes that a demand already exists for the products mentioned above, especially products that provide cover for small businesses such as spaza shops and the like, as well as for health related insurance products such as hospital plans. Consumer credit insurance and legal expenses cover already have penetrated this market to a certain extent.

Short-term insurance industry and micro-insurance: Our needs

In view of the above, the short-term insurance industry needs at least the following elements to create an enabling environment in which to reach the low income market:

- Access to non-traditional options for the distribution of products, the collection of premiums and the payment of claims.
- Adjusted regulatory requirements that would assist in doing business with the low income market, and specifically on the distribution side. Relaxation of FAIS qualifications/requirements for short-term insurance micro-insurance intermediaries is specifically needed urgently. ***This aspect could be addressed within the FAIS regulatory space and we***

do not need to wait for a new micro-insurance licence for amendments to current legislation to create such a space. We believe that this could make an immediate difference.

- A type of intermediation allowed by FAIS that includes a level of information-giving, without the onerous (and costly) activities linked to high level advice giving. Evidence has shown that short-term insurance products distributed on a purely non-advice level into this market have not been successful. It seems as if information and education need to go hand in hand with the distribution and or marketing of products to the low income market, at a level needed by and understood by consumers in this market. ***This aspect could be addressed within the FAIS regulatory space and we do not need to wait for a new micro-insurance licence for amendments to current legislation to create such a space. We believe that this could make an immediate difference***.
- The potential to bundle different products, i.e. the possibility to write business across life and short-term licences.
- Ensuring that room exists for products that could be of higher priority for people in the low income market than traditional property and asset short-term insurance products, such as accident and health related products.
- An environment where consumer financial literacy is at a high level will assist tremendously. Any enabling environment should include ways in which consumer education in this market is recognised and encouraged as a crucial element to improving access.

In closing

We welcome the opportunity to participate in the micro-insurance regulatory debate, and welcome National Treasury's inclusive approach.

However, we are aware of the fact that there will still be a fairly lengthy process before new micro-insurance legislation is in place.

We are of the firm belief that many changes could be made with almost immediate effect, and that could already start creating an enabling environment in the low income market space. We strongly recommend that such changes are effected a soon as possible while the debate around new micro-insurance legislation follows its course. Such immediate (or at least quick) changes, from a short-term insurance industry point of view, should include:

- Changes in FAIS regulations regarding intermediary qualifications in the low income market space
- Changes in FAIS regulations regarding a new level of information-giving in the low income market space
- Certainty with regard to the types of products that could be provided in the health arena

- An urgent revisiting of cell captive legislation. The cell captive structure is seen as the ideal structure for smaller new entrants into the micro-insurance market, however, current legislation is inadequate to protect customers and to prevent less than scrupulous operators (especially in the third party cell environment where the cell is unrelated to the products sold) from tarnishing the image and reputation of the cell captive model, to the detriment of existing cell captive role players that adhere to their strict licensing requirements. It is desirable for a standard regulatory and prudential framework to exist with regard to cell captive requirements that is monitored and policed in an efficient manner by the Financial Services Board (FSB).

PART 2:

COMMENTS ON THE "NATIONAL TREASURY DISCUSSION PAPER: THE FUTURE OF MICRO-INSURANCE REGULATION IN SOUTH AFRICA"

1. Introduction and background : Pages 12 – 15

As stated in the Introduction and Background, as well as in the Executive Summary of this Discussion Paper, the paper seeks to propose that a regulatory space for the provision of micro-insurance products be carved out within the broader regulation of insurance provision in South Africa.

Micro-insurance, as per the definition accepted by the International Association of Insurance Supervisors (IAIS), is insurance that is accessed by or accessible to the low-income population, provided by a variety of different providers and managed in accordance with generally accepted insurance practices.

Because of the inherent complexity of insurance products, as well as the vulnerability of this market, it is essential that a balance is found between the protection of the consumers of this product type and the need to develop the market.

Micro-insurance is an internationally identified focus area, and South Africa with its clear objectives in terms of poverty alleviation, Black Economic Empowerment (including the need to promote access and encourage SME development), as well as consumer protection should certainly be at the forefront here.

Comments and/or proposals

1(a)
Micro-insurance is identified internationally and locally as an important focus area. It is clear that a need exists for affordable and appropriate insurance products to the low income market. In order to facilitate the provision and distribution of such products, an enabling environment is needed. In principle, a regulatory framework that could facilitate this objective is welcomed.
Supports: Financial inclusion

1 (b)
A micro-insurance regulatory framework is also important in view of the fact that micro-insurance should be seen as a wider and more holistic area than just the FSC related access space that currently exists in South Africa. From a consumer point of view (demand side), the need to alleviate risks will always remain. From the supply side, while it is true that the FSC Access pillar has encouraged South African insurance companies to enter the micro-insurance space, this might not be enough to address the needs of the low income market. In fact, if one considers CK Prahalad's view that there is a fortune at the bottom of the pyramid, the insurance industry is in favour of creating an enabling environment.
Supports financial inclusion

1 (c)
It is, however, suggested that an attempt to more specifically define 'low income market' – especially in the South African context - is made. This will clarify the issue. As the FSC sets targets for LSMs 1 – 5, some existing players might confuse the requirements of the FSC with the new enabling micro-insurance legislation.
Supports financial sector development

1 (d)
A link does exist between this proposed enabling micro-insurance legislation and the Access requirements of the FSC. The short-term insurance industry is in favour of an environment that would make it easier successfully to serve the low income market, and assist them in meeting their FSC requirements. Short-term insurers experience a particularly difficult environment in terms of the cost of bringing appropriate products to a market that has limited or no experience of short-term products. One of the big issues is the cost of distribution – see our comments on distribution later in this document.
Supports financial inclusion, financial sector development

2. Objectives and principles for micro-insurance regulation Pages 16 – 21

(Section 2.1)

The Discussion Paper states the following as objectives of the proposed framework:

- Financial inclusion
- Competition and market efficiency
- Financial sector development
- Stability
- Consumer protection
- Empowerment
- SME development

Comment and/or proposals

2 (a)
These objectives are to be supported, however, it is questioned whether the proposed prudential changes in this Discussion Paper will achieve these objectives. It seems that even though proposals in this regard are meant to create a more enabling environment, they may not achieve this to the extent that they should. Although it is acknowledged that existing insurers in the life insurance industry will benefit from the proposal with regard to lower capital requirements, existing insurers operating under the current Short-term Insurance Act of 1998 will not benefit from the proposal as the proposed capital requirement is the same as the current de jure requirement. (However, it is acknowledged that as the de facto situation in terms of the FSB's Guidance for Registration of Long-term and Short-term Insurers specifies a minimum capital of R5 million, the proposed requirement might be beneficial for short-term insurers as well.)

On the other hand, it is questionable whether the requirements will entice currently unregulated or even new entrants into this market. Should the latter be the main focus, even lower capital requirements may need to be set which then could have unintended consequences with regard to risk and potential failures. (See comments on 5.2.1 and 5.2.2.3 in this paper for more details in this regard.)
Supports financial sector development

2 (b)
However, the proposed changes with regard to distribution will be advantageous – see our comments re 3.2 and 6.2 for specifics on this topic.
Supports financial inclusion, financial sector development

3 Current reality: South African market Pages 25 - 27

(Refer to Section 3.2 in the Discussion Paper)

The Discussion Paper refers to the fact that the current reality with respect to the insurance market in South Africa includes the fact that South Africa has a relatively well developed insurance sector, with a substantial (in comparison to other countries) formal micro-insurance sector.

However, this micro-insurance sector has several unique characteristics, including the fact that it (formal) mainly consists of funeral insurance, consumer credit insurance and to a much lesser extent legal expenses cover. However, activity is increasingly taking place in the micro-insurance market as all companies operating in the financial sector are compelled by the FSC to become involved in the low income market.

(3.2.1, 3.2.2)

Comments and/or proposals

3 (a)
With reference to the above, it is noted that the lack of an enabling environment impedes the progress set in motion by the Charter.

3 (b)
One of the biggest stumbling blocks in this regard is the current regulation regarding the distribution of products. Although the FAIS Act allows for a set of lower requirements for Category A intermediaries (assistance business, which forms part of the micro-insurance market) other classes of business in this market should be allowed to benefit from such lower intermediation requirements in order to reduce the cost of distribution.

3 (c)
On the other hand, it is noted that training costs are fairly fixed. Although lower requirements could assist insurers with the distribution of micro-insurance products, it might not assist to the extent envisaged as the training costs per person might remain the same, whatever the level of training. Of course, one of the biggest stumbling blocks with regard to micro-insurance is the cost of getting these products to market.

3 (d)
It is agreed that such lowering of requirements should encourage appropriate people to enter the market as micro-insurance intermediaries and assist in the distribution of products.
Supports financial inclusion, competition, SME development

3 (e)
It is not in the interests of the micro-insurance market that micro-insurance products could be sold to this market using a non-advice model where there is no effective disclosure of or access to information. The non-advice model is currently mainly used to distribute micro-insurance products in order to keep costs down, with the ultimate aim of keeping the products affordable – although it has only been successful for funeral insurance. However, experience in the market is that some form of advice or information giving is needed in order to distribute these products more successfully, especially in the short-term insurance environment. An environment that would encourage a level of advice or rather information appropriate to a lower risk product would assist with both increasing access and achieving consumer protection.
Supports consumer protection, financial inclusion

3 (f)
In the current SA environment, it is quite clear that a level playing field does not exist. Several unregulated and informal entities are operating in the micro-insurance market, and especially in the funeral market. This is not prudentially sound and is not conducive to consumer protection.
Supports competition, financial sector development

3(g)
With traditional insurers having to comply with stringent prudential and other regulations, and the cost of compliance quite high, it would be advantageous if the better managed providers operating outside of the current law could be brought within the regulatory net which would allow the regulator to clamp down on the abusive ‘fly by nights’. It is questioned whether such operators will enter the regulated space unless forced to do so.
Supports consumer protection, competition and market efficiency

3(h)
However, this would only be equitable if there were a level playing field for all suppliers to this market. One would not like to exchange one uneven playing field for another. We therefore welcome the proposals in the paper that appear to have a similar intention.
Supports competition and market efficiency, financial sector development

3(i)
Should amnesty arrangements be considered for previously illegal operators, this should be done with governance top of mind. Perhaps legitimate, effective industry associations with codes of good practice, coupled with an intensive consumer awareness campaign, could be encouraged as a way to achieve an acceptable level of good governance for these operators that would assist in providing consumer protection. Existing industry associations in this space, as well as any future such bodies that could assist in providing a more consumer friendly environment, should be encouraged to play a positive role.

Supports consumer protection

3(j)
On page 28, under “new distribution models”, cash premium models are mentioned. The SAIA would encourage the use of such models, however wishes to draw attention to the safety and security aspects that should be part and parcel of such models, especially given the current crime situation in South Africa. Any cash collection model should consider the physical and financial welfare of the collecting agent or intermediary.
Supports financial inclusion

3(k)
The SAIA would also like to suggest that consideration be given to the role community groups could potentially play in premium collection and even disbursement of claims payments. In this case, the safety and security issues will also come into play.
Supports financial inclusion

4. Take-up

(3.2.4)

It is clear that take-up of micro-insurance products in South Africa mainly relates to funeral business and, to a significant extent, informal funeral-type products.

Comments and/or proposals

4 (a)
An enabling environment is needed for other micro-insurance products, including asset related short-term insurance products.

5. Deriving a micro-insurance definition suitable to the South African context Pages 33 - 38

The Discussion Paper seeks to limit the “riskiness” of the products whilst still allowing for the key needs of the micro-insurance market by developing an operational definition of micro-insurance.

Benefit levels (4.2) Page 37

The paper recommends a maximum benefit level of R50 000 per individual risk per year.

Comments and/or proposals

5(a)
Although the idea of low benefit amounts is supported in principle, the R50 000 cap might need to be reconsidered.

The current highest amount covered under the Mzansi short-term insurance access standards is R180 000, and although it is not suggested that this should be the limit, the maximum benefit level should be reconsidered, based on actuarial evidence, and in relation to the level of risk.

It is proposed that an actuarial exercise should be conducted before final benefit levels are set.
Supports financial inclusion

5(b)
In addition, it is suggested that a maximum benefit level is set per risk event and class of business. It is not accepted that the same maximum benefit level could be set for all the different classes of business as each of these relates to different levels and values/sizes of risk.
Supports financial inclusion

5(c)
Examples of why the current proposed cap might be problematic include the fact that a client could take out funeral cover for himself, his spouse, his three children and an extended family member which would quickly add up to a larger amount. In addition, it is a fact that the South African Government has been giving the title deeds to people who have been occupying council houses for a period. The replacement value of these houses in terms of homeowners policies if a total loss is experienced, for example, could far exceed R50 000, although the occupants may typically be in the micro-insurance target market.

Commission (4.2) Page 37

The Discussion Paper suggests that commission on micro-insurance be uncapped, similar to the current situation with assistance business. It is also proposed that commission should be paid on an as-and-when basis.

Comments and/or proposals

5(d)
It would be a good idea to allow for higher commissions, provided enough competition exists to keep commissions in check and there is effective disclosure. Consumer education is a vital factor to ensure that consumers are protected.

Uncapped commission is especially supported in view of the fact that some level of advice/information-giving, linked to the lower risk of the product, would be advantageous to a consumer who might not be financially literate or sophisticated or have experience of these types of products. The SAIA therefore supports this proposal, with the exception of consumer credit insurance products where one may wish to consider capping the interest rate as long as the cost of credit is capped. Once the cap falls away on the cost of credit, the cap on consumer credit insurance should also fall away.

5(e)
It is proposed that commission should be paid on an 'as-and-when basis'. The SAIA supports this. However, it is proposed that a potential hybrid model, i.e. a combination of up-front and as-and-when commission should be considered in order to make it more likely and/or easier for intermediaries to be able to enter this market and make a living in the micro-insurance sector. As it is more likely that entry level intermediaries will enter this entry level market, it might be difficult and/or unattractive for appropriate persons to enter this market as intermediaries if only as-and-when commission is payable.

Risk products, unlike products that include a savings element, are less likely to be abused and could therefore be considered for a potential hybrid model.

Should the commission model include an element of up-front commission, however, this up-front commission could only relate to a 12-month period, as there is no guarantee that a contract would be renewed after the 12-month period has passed. The proposed offering has a term of only 12 months. Should the contract be renewed, an up-front portion could relate to the next 12 months of the contract. Up-front commission will also bring into play potential claw-back provisions which would complicate a model that needs to be simple.
Supports financial inclusion, empowerment, SME development

6. New act vs changing existing laws? (Section 5) Pages 39 – 61

It is proposed that a new act is needed to create a new enabling regulatory space.

Comments and/or proposals

6(a)
In general, the SAIA is neutral as to whether a new act is needed or changes to existing legislation would be preferable. The industry's view is that the focus should rather be on the elements of the legislation than on the debate between whether or not a new act is needed. The elements would need to include product features that would apply to the needs of the market while facilitating relaxation of both prudential and distribution requirements to create an enabling

environment. Below follows some points to be considered for and against a separate act.

6(b)
It is suggested that legislation and regulation currently under consideration should carefully be considered before a final model is decided on. Examples of relevant legislation and/or regulation include the proposed new cell captive legislation, ART, the Insurance Laws Amendment Bill, the Consumer Protection Bill, the Privacy Bill, and others.

6 (c)
Pro new act:
In view of the fact that changes to many different existing pieces of legislation would be needed to create this environment, it might be a good idea to write and enact a dedicated act. Amending several existing acts (including the Short-term Insurance Act, the Long-term Insurance Act, the Friendly Societies Act, the Co-operatives Act, as well as the FAIS Act) might be less clear and more time-consuming than to create a separate act. It might also be impossible to align the amendment of all these acts in such a way that a new, completely appropriate regulatory environment is created.

In addition, a new act will enable micro-insurers to link different products in their offerings to this market that would make it easier to market and/or distribute traditionally un- or under-utilised product types such as short-term household contents or homeowners insurance. Such products could be linked to funeral products, for example. Currently insurers can only sell either short-term or long-term insurance products unless they have both short-term and long-term insurance licences.
Supports financial inclusion, financial sector development

6(d)
Pro amending existing legislation:
It is possible that amendments to the existing relevant acts, i.e. the Long- and Short-term Insurance Acts, as well as the FAIS Act, should be sufficient to create an enabling micro-insurance space. It might be easier and quicker, as some of this could be dealt with in terms of changing regulations rather than legislation itself.

In addition, holders of a ‘full licence’ might not need a different act, as an additional class of business could suffice and the requirements of the FSC in terms of Access could be deemed enough of an incentive, especially after the gazetting of the Charter (should this go ahead as intended).

6(e)
The utility of the Co-operatives Act and the Friendly Societies Act should be investigated further with a view to amending them to assist in creating an

enabling micro-insurance environment for smaller and new entities, as it is not envisaged that as many such entities would apply for micro-insurance licences under the current proposed capital requirements as would have been deemed desirable.

(Please see section under 5.2 for more comments on the specifics with regard to a proposed new act.)

7. Fraud
(5.1.1) Page 39

It is suggested that there is no evidence (based on the burial society experience) that fraud is pervasive.

Comments and/or proposals

7(a)
The risk of fraud in the micro-insurance market, specifically with regard to non-funeral type products, is underestimated in this proposal. Fraud is a huge issue in the insurance environment (especially short-term, funeral and hospital cash business), and it is expected that the same will be true in this market. The experience of burial societies might not be relevant as one of the reasons for the success of burial societies is a cultural one with burial society membership having social and community roots and links which will not be true of other types of micro-insurance products. Funeral parlour experience, on the other hand, is negative, with very high loss ratios.

8 Burial societies exempt
(5.1.1) Page 40

It is proposed that burial societies should remain exempt from insurance regulation, except when they grow beyond a certain size in membership and annual income.

Comments and/or proposals

8(a)
This might not be practical. In reality, bigger burial societies that should be included under the regulation could escape the regulation by ensuring that they somehow remain just under the radar screen in terms of regulation.

8(b)
It is also suggested that the potential role of mutual cell captives could be considered in this regard. Rather than exempting smaller burial societies, and

especially smaller operators with different small branches, they could be encouraged to enter into a mutual cell captive arrangement instead.

Please note that the SAIA believes that clear legislation regarding cell captives is urgently needed, and especially with regard to setting a legislative standard that all cell captives have to comply with instead of with an ad hoc licensing arrangement between specific entities and the FSB – see comments below.

9. Cell captives
(5.1.2) Page 41

Comments and/or proposals

9(a)
It is suggested that the cell captive model for potential micro-insurance players should be explored more fully. This is seen as the ideal model for smaller and/or new entrants into the micro-insurance space.

9(b)
It is recognised, however, that currently no appropriate cell captive legislation exists in South Africa, and therefore this area of legislation should be addressed and included into these proposals.

In fact, the SAIA strongly believes that the proposed revisiting of the cell captive legislation should be addressed urgently in order to create a standard regulatory and prudential framework to facilitate this structure being used successfully and without any unintended consequences in the micro-insurance environment. The current situation of unique relationships existing between the FSB and cell captives, governed mainly by licensing arrangements, could present difficulties with regard to consumer protection should the legislation not be changed first and the cell captive structure be used by entities in the micro-insurance space who have no track record in a weaker regulatory environment.

10 Potential restricting requirements in the current insurance regulation

(5.2.1) Page 46

The Discussion Paper considers the potential restricting requirements in the current insurance regulation.

Comments and/or proposals

10(a)
Operational capabilities: We welcome the view that the regulations of the Short-term Insurance Act are more applicable to micro-insurance than the Long-term Insurance Act. However, the regulation should not encourage companies to take on risks at inadequately priced levels knowing that the business can be cancelled after one year. This could compromise sustainability and lead to the tarnishing of the reputation of the industry.

10(b)
Institutional form: The current regulation does present barriers to entry and a change in the regulation will allow other entities the opportunity to compete on an equal basis with the insurance industry. Research shows that a mutual company is often more appropriate for the provision of micro-insurance. In the South African context, affinity groups such as stokvels and friendly societies will have the opportunity to create such mutuals.

10 (c)
Capital: A less onerous capital requirement (whether based on product offering or risk event rather than insurance licence) would be welcomed. However, as stated before, the capital levels proposed should be revisited in order to provide any real benefit. The current proposal does not pose any incentive for short-term insurers specifically (as the proposed capital requirement is the same as the current de jure situation), although the proposal with regard to capital requirements will certainly benefit current life insurers who would wish to play in this market. On the other hand, the proposal might still be too high for smaller entities proposing to enter the micro-insurance market.

11 Lower prudential risk generated by micro-insurance as defined would justify lower additional capital requirements

5.2.2.3 Page 56

The Discussion Paper states that there are arguments to suggest that the lower prudential risk generated by micro-insurance as defined would justify lower additional capital requirements.

Comments and/or proposals

11(a)
Additional capital requirements: Despite our view that even lower base capital requirements could be set, it is cautioned that it might be simplistic to believe that lower prudential risk generated by micro-insurance justifies lower capital requirements. Insurance in the low income market has additional risks which

would require additional reserving requirements such as operational/administration risk, risk of catastrophe and fraud, as well as concentration of risk.

11(b)
The proposal to exempt micro-insurance from the current proposed FCR requirements is welcomed, provided that this applies to all business written in this class of business in order to prevent an unfair advantage to micro-insurers versus holders of full insurance licences. It is cautioned however that this could result in insurers transferring portfolios of business between licences in order to circumvent restrictive regulation (i.e. regulatory arbitrage).

11(c)
Investment restrictions: The proposal that micro-insurance should adopt the same investment restrictions as those which would apply to short-term insurers, is supported. It is cautioned, however, that although contracts will be no longer than 12 months, these will be renewable and a small percentage of assets held in equities might be considered.

12 Summary of proposed licence requirements

(5.2.2.4) **Page 57**

Under capital requirements, it is suggested that permission should be given to a potential micro-insurer to build up to the required level of capital over time.

Comments and/or proposals

12(a)
Again, it is questioned whether the proposed level of capital is not such that little or no incentive exists for small new players to enter the market. The fact that it is suggested that permission should be given to micro-insurers to “build up” to the proposed capital level over time probably seeks to address this. However, should this be allowed, then it should be allowed for all players across the board, also for existing licence holders in the micro-insurance market, or else it would lead to an uneven playing field.

In the note on reinsurance, it is suggested that ‘to limit risk, the FSB may decide to compel a micro-insurer to obtain reinsurance on part of its risk as a licensing condition...’

Comments and/or proposals

12(b)

In terms of short-term insurance specifically, large losses could be incurred by micro-insurers should a catastrophic event for example wipe out several houses on risk. It is felt that if reinsurance were not to be considered compulsory in certain risk areas, a case could be made for the FSB to at least insist on mentorship relationships. The FSB could compel a micro-insurer, for example, to enter into a relationship of mentorship with an existing full insurer in order to limit the possibility of failure in the event of a “cat” claim.

13. Potential gaps in this section

VAT on premiums

Comments and/or proposals

13(a)
Under the current regulatory regime, the premium on short-term products attracts VAT whilst that on long-term products does not. Commission is vattable. It is not mentioned anywhere in the Discussion Paper what the status of micro-insurance products would be in terms of VAT nor the commission earned by intermediaries for distributing them.

13(b)
It is suggested that, in the interest of simplification, VAT should not apply to micro-insurance products.
Supports financial inclusion, financial sector development, SME development

Insurance Guarantee Facility (IGF) in terms of the Short-term Insurance Act

Comments and/or proposals

13(c)
The Discussion Paper does not consider the implications of Section 45 of the Short-term Insurance Act on micro-insurers. This section states that all intermediaries collecting premiums on behalf of an insurer (micro-insurer) have to have an IGF guarantee to protect these premiums until paid over to the insurer.

13(d)
Should the new micro-insurance environment be created by changing existing legislation, exemption for micro-insurance intermediaries in terms of Section 45 needs to be considered.

13(e)
If micro-insurers are to be governed by their own act and licensed separately, there should ideally be no IGF implications for micro-insurers as this would be

impractical and will add to the cost. IGF is administratively intensive as well as costly and would be quite onerous for players in the micro-insurance market.

However, the protection of micro-insurance customers with regard to premium collection by intermediaries should be considered in both above-mentioned scenarios. Consumer protection should be paramount, and the protection of premiums in the hands of the intermediaries should be explored in order to find a simple way to address the situation.

14 Facilitating intermediation and consumer protection (Section 6) Pages 66 - 75

The risk of consumer abuse and misselling

(6.1) The risk of consumer abuse and misselling Page 66

The Discussion Paper touches on the risk of consumer abuse and misselling.

Comments and/or proposals

14(a)
Although a simplified product will be the result of the proposed new micro-insurance framework, consumer protection is crucial. Should this not be achieved, this market will not be sustainable and substantial reputational damage might be suffered.

14(b)
The first step towards consumer protection is to assist consumers in this market (as in every other market) to become informed. Consumer education, information and advice should therefore go hand in hand with the distribution of micro-insurance products.

14(c)
The FSC approach of including consumer education funding in the Access requirements of the Charter makes enormous sense and should in some way be followed by the proposed framework.

14(d)
In order for an enabling environment to exist for micro-insurance, in terms of consumer protection, the following are encouraged:

- Recognising the role the intermediary could play with regard to consumer education and/or dissemination of information at point of sale;

- Incentivising the giving of appropriate information of some sort through, for example, commission levels linked to advice/information given;
- Linking consumer education to access products (for example, all insurers may be required to hold a workshop on the product in a central location once a month which any policyholder or potential policyholder could attend);
- Creating the environment for an effective recourse system through a comprehensive consumer recourse plan.

Supports consumer protection

14(e)
To provide effective consumer redress it is important that the current proliferation of avenues of consumer redress is minimised. This is necessary for two reasons: to minimise the confusion to consumers with the existence of a number of Ombudsmen offices with potentially conflicting jurisdictions and to prevent 'forum shopping'. We do not suggest a Micro-insurance Ombudsman be established, but instead, we suggest modifying (and where necessary, fortifying) the current ambit and powers of the relevant voluntary and statutory Ombudsmen offices.

14(f)
Given the market segment at which the micro-insurance product is aimed, consumer redress must take into account the likely low levels of literacy and numeracy, and the limited access to current systems, e.g. the current requirement that complaints must be in writing should be addressed as this would be highly impractical in this market.
Supports consumer protection, financial inclusion

14(g)
It is suggested that a central call centre in the micro-insurance market is established, with appropriate facilities such as toll-free numbers, sms, 'please call me' and other more accessible communication methods.
Supports consumer protection, financial inclusion

14(h)
It is also suggested that a decentralised complaints mechanism should be put into place to provide easy access to recourse for micro-insurance clients. An example of such a decentralised system is to use current infrastructure such as (for example) the Post Office, as an avenue for the submission of complaints.
Supports consumer protection, financial inclusion

15 Current regulatory framework

(6.2) **Page 67**

It is proposed that the Category A in the FAIS Act should be extended to include micro-insurance intermediaries.

Comments and/or proposals

15(a)
This is supported (see elsewhere in this submission our comments on 3.2), however may not be enough to create an enabling environment.

15(b)
The micro-insurance business class will have to be defined in the FAIS Act in order to give the FAIS Ombud clear guidelines.

15(c)
Should the micro-insurance space itself, intermediaries operating in this market, and the requirements with regard to advice/information giving in this market not be defined and/or categorised in very clear terms within the FAIS environment, it is highly likely that a conflict situation between the FAIS Ombud interpretations and the proposed unique space for micro-insurance could follow.

15(d)
The FAIS Code of Conduct is currently a generic one and does not even include short-term insurance specific requirements. This is already resulting in problems for the short-term insurance industry with regard to the interpretations and rulings by the FAIS Ombud, and it is suggested that should the Code of Conduct not recognise the different business classes, including short-term insurance and micro-insurance, the current uncertainty will continue and insurers will remain wary of entering this market.

(6.5)

The SAIA and its members agree that any regulatory framework will fail should it not be effectively monitored, supervised and enforced.

The industry therefore supports 6.5 in this regard but questions whether the Regulator (and other relevant role players) has the capacity to do so. In order to create this capacity, the cost of such additional capacity could become so onerous as to contradict the goal of creating an environment in which the cost of doing business could be lower in order to facilitate the provision and distribution of appropriate and affordable micro-insurance products.

The cost of consumer education undertaken by the Regulator (and the FSB Consumer Education Foundation), and the way in which funds would be sought for this, should also be considered in more detail.

General comments and/or proposals with regard to potential gaps

The SAIA has identified some potential gaps in the Discussion Paper.

Comments and/or proposals

15(e)
The exclusion of certain indemnity health insurance products, as well as savings products, might be seen as a gap. Although it is noted that personal accident and disability products are included, it might be advantageous to include other health products such as hospital cash plans etc, as short-term insurance products related to assets (such as homeowners and household contents) are known to be very low on the lower income group's priority lists. The latter product might be more viable as a group-based product, including disaster risk cover for vulnerable communities.
Supports financial inclusion, financial sector development

15(f)
The role of cell captives has not been adequately addressed.

15(g)
The potential impact of fraud in the micro-insurance market is underestimated.

15(h)
The VAT issue needs to be addressed – see comments in section 5 under 'Potential gaps in this section'.

15(i)
The protection of micro-insurance premiums in the hands of the intermediary should be considered (see comment on Section 45 (IGF)).

15(j)
The role of Government, including potential public-private partnerships in the low income insurance arena, has not been considered, especially in terms of the provision of disaster cover. Disaster risk management will be difficult to achieve if it is only seen as a private sector responsibility. Government's role could include state-funded reinsurance, social welfare, and possibly using Sasria to include co-insurance or reinsurance for micro-insurers and/or general insurers.
Supports stability

15(k)
In fact, the role of Sasria has not been considered at all. Will Sasria cover be expected to be included in a micro-insurance (property and/or asset insurance) product? Will Sasria provide a limited and/or more affordable product, similar to the one currently on offer for access products in the FSC space, in the micro-insurance space? Or will such products not be required to offer Sasria cover at all?

The SAIA recommends that a micro-insurance-specific Sasria cover be arranged with Sasria to attach to micro-insurance products of this nature (property and asset). (Sasria has expressed its willingness to participate in this market.)

15(l)
The importance of the roles and the capability of the FSB and other role players with regard to the implementation and enforcement of the proposals, are underplayed in the Discussion Paper.

16 Current reality: International arena

(Section 9)

The Discussion Paper refers to international experience in the micro-insurance space.

Comments and/or proposals

16(a)
It would be logical to include both prudential and product category related distribution accommodation in a new micro-insurance regulatory framework that would encourage market development whilst keeping in mind consumer protection. We support this approach.

16(b)
As South Africa is actually at the forefront of developments in the micro-insurance market, it is not easy to find international examples that are relevant. However, the distribution allowances made in India and the prudential and operational allowances in place in the Philippines serve as good models, with some changes and adaptations, and if combined, could create the optimal environment for micro-insurance in South Africa.

Comments: Indian example

16(c)
Regulation allowing for a new type of intermediary, i.e. micro-insurance agent/intermediary, is seen as a desirable outcome.

16(d)
It is not agreed that such agents/intermediaries could not be commercial or individual entities, but only NGOs, micro-finance institutions and community self-help groups. Although such groups could become intermediaries in this space, it should be possible to drive intermediation of micro-insurance products on a commercial basis.

16(e)
The role of community-based groups in the micro-insurance space should be explored further.

16(f)
Micro-insurance should be encouraged as a potential profit-driven enterprise in order to create a financially viable and sustainable model.

16(g)
The quota system in India is not supported as this could lead to consumer abuse and a lack of real commitment in this market. (It is noted, however, that South Africa has a quasi-quota system in place as part of the FSC Access requirements.)

16(h)
The fact that micro-insurance agents in real terms earn higher commission is supported to encourage the optimal distribution of products together with an appropriate level of advice/information giving.

16(k)
The examples in India of successful agricultural insurance offerings should be considered as an example of what might be viable in the South African context as well.

Comment: UK

16(l)
It is agreed that a move towards product-based (or class of business-based) intermediation regulation could have its advantages in the micro-insurance space.

Comment: Philippines

16(m)
It is agreed that a prudential and operational environment where a reduced regulatory burden and lower capital requirements are applicable to entities in the

micro-insurance space, and/or micro-insurance as a product or class of business, would be beneficial provided sufficient incentive could be provided in this regard.

Comment: What can we learn from the micro-insurance experience in these two countries?

16(n)
The SAIA agrees with the lessons learnt from the limited international experience available, and agrees that "a best of both" approach should be followed.

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