national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

THE SOUTH AFRICAN MICROINSURANCE REGULATORY FRAMEWORK

National Treasury Policy Document

Republic of South Africa

July 2011

THE SOUTH AFRICAN MICROINSURANCE REGULATORY FRAMEWORK POLICY DOCUMENT is the final outcome of the consultative process initiated after the publication of a discussion paper "*The Future of Microinsurance in South Africa*" in April 2008 (available on www.treasury.gov.za). It takes into account the submissions received, as well as recommendations made via the extensive public consultation process during 2009.

The policy document summarises the proposed regulatory framework for microinsurance in South Africa that is envisaged to be incorporated into a forthcoming Microinsurance Act and subordinate legislation.

No further comments are required on this policy document, as the National Treasury and the Financial Services Board will now shift their focus to implementation of the proposals, and on forthcoming legislation. Public engagements will take place on implementing the proposals, with a view to informing the drafting of legislation and regulations. As is the normal practice, the public will be invited to formally comment on all draft legislation and subordinate regulation in the coming months, and also be able to participate in the parliamentary process after the tabling of such legislation.

Any queries on this document or the process may be submitted to:

microinsurance@treasury.gov.za

Fax No: 012 315 5206

Or to:

Ingrid Goodspeed (Chief Director: Financial Inclusion and Market Conduct)

(012 315-5706/ ingrid.goodspeed@treasury.gov.za)

Contents

EXECUTIVE SUMMARY

"To promote sustained economic growth and development, South Africa needs a stable financial services sector that is accessible to all."

A Safer Financial Sector to Serve South Africa Better, published by the National Treasury on 23 February 2011

In a developing country like South Africa, financial exclusion is a challenge in the financial sector as too many South Africans remain excluded from formal financial services. For this reason the National Treasury has prioritised access to financial services as an important objective in the sector's reform. Indeed this was a key objective in the 2004 Financial Sector Charter, resulting in the Mzansi banking accounts initiative, which provided access to many previously unbanked people.[1]

The challenge of inclusion is proving to be more difficult in the insurance sector. While informal insurance or risk pooling remains one of the largest single financial services in South Africa, insurance cover obtained by a registered insurer reflects a penetration rate of only 25.6%.[2] The take up of insurance since 2008 (when it stood at an even lower rate of 19.6%), and a seeming improvement in the mind-set of South Africans towards insurance, masks a concerning feature within the South African market: that the importance of insurance for personal risk reduction is understood, but not necessarily translated into behaviour. This is evidenced by the low number of South Africans covered by insurance, as well as the mismatch between what is perceived as the biggest risk to families – a loss of income through death or job loss of the primary breadwinner – and the dominant insurance product held being funeral cover.

Three features of the insurance market therefore stand out as needing urgent policy address. There is a need to promote better access for South Africans to affordable insurance products that meet the risks that they face; consumers need to better match the products that they buy

[1] The total number of Mzansi accounts opened with the big four banks since its launch is over 4.6 million, 3 million of which are active.
[2] These statistics are sourced from the survey FinScope South Africa 2010.

with their insurance needs; and consumer protection must be strengthened as more policies are sold through funeral parlours that may not be licensed for this business (thereby leaving consumers vulnerable to abuse).[3]

In its recent articulation of policy reform for the financial services sector, the National Treasury's policy agenda rests on five pillars - financial stability, consumer protection, better access to financial services, improved regulatory coordination, and comprehensiveness (meaning that all businesses in the financial sector should be on the regulatory radar).[4] These goals are mutually reinforcing.

As government, a well regulated financial services sector is not the end goal. The sector is instrumental in assisting South Africans to live safe and fulfilling lives by growing their wealth and providing protection against unforeseeable daily risks. Moreover, the financial services sector must support South Africa's overarching macroeconomic objectives of economic growth, job creation and poverty alleviation.

The National Treasury's "*A Safer Financial Sector to Serve South Africa Better*" explains the financial inclusion initiatives intended to support these objectives. These relate to developing the roles of Co-operative and Development Banks in the South African economy and strengthening the Postbank, as well as introducing a microinsurance framework. Where the banking initiatives focus on credit, savings and transactional products, microinsurance looks to risk-management products designed to meet the needs of lower income households (which can otherwise be seen as the emerging mass insurance market).

In 2008 the National Treasury released for public comment a discussion paper on the "*Future of Microinsurance in South Africa*". The document explained the background to the policy review, landscaped the existing market, and proposed a comprehensive policy framework to encompass microinsurance underwriting and intermediation, consumer education and regulatory enforcement.

---

[3] Indeed, the origins of the debate underlying the microinsurance policy originally centred on consumer abuses in the funeral insurance market where consumers were exposed to exploitation.

[4] *A Safer Financial Sector to Serve South Africa Better*, page 2.

The policy document that follows is the result of consultation on the 2008 discussion paper, and sets forth the policy position that underpins the proposed Microinsurance Act.

THE MICROINSURANCE POLICY FRAMEWORK

Microinsurance refers to insurance that is accessed by the low-income population (also known as the mass market), provided by a variety of different providers and managed in accordance with generally accepted insurance practice. It forms part of the broader insurance market, distinguished by its particular focus on the low-income market, which translates into distinct means of product design and distribution.

The National Treasury's policy framework is intended to achieve the following objectives:

- Extend access to a variety of good-value formal insurance products appropriate to the needs of low-income households, thereby supporting financial inclusion.

- Facilitate formalised insurance provision by currently informal providers, and in the process promote the formation of regulated and well-capitalised insurance providers and small business development.

- Lower barriers to entry, which should encourage broader participation in the market and promote competition amongst providers, further supporting poverty alleviation through economic growth and job creation.

- Enhance consumer protection within this market segment through appropriate prudential and business conduct regulation, improved enforcement of regulatory transgressions, and consumer education interventions targeted at understanding insurance and its associated risks and benefits.

- Facilitate effective supervision and enforcement, supporting the integrity of the insurance market as a whole.

In working towards these objectives, the policy framework is underpinned by National Treasury's principles to reform the financial regulatory system.[5] In particular, financial service providers should be appropriately licensed and regulated, regulations should be of universal applicability and be comprehensive in scope to reduce regulatory arbitrage, and market conduct must be sufficiently strong to complement prudential regulation.

The microinsurance policy document therefore proposes the following:

A microinsurance licence provided for under current or separate legislation (for example a new Microinsurance Act). A stand-alone act may be preferable, given the significant differences between the regulation proposed for microinsurers and the existing regulation applied to long-term and short-term insurers. These differences relate to institutional arrangements to be accommodated, as well as prudential and intermediary requirements (a microinsurer will therefore in each of these instances have a regulatory treatment distinct from long- or short-term insurers). For the sake of simplicity the proposals summarised below therefore presume a stand-alone act; in any event the substance of these proposals will be retained irrespective of legislative approach (be it new or existing legislation).

Leveling the playing field for providers. The licence should be accessible to public and private companies (which will accommodate existing insurers and potentially funeral parlours) and co-operatives (to accommodate the existing Friendly Societies and other insurance co-operatives).

Product standards and benefit limits. Products must be designed in an appropriately simplified way, to support improved understanding of insurance products by consumers in the market. Benefits are restricted to risk products only (therefore excluding contractual savings), although providers can offer both long- and short-term products; in this environment long- and short-term products are similarly structured and the risk is similarly managed, and

[5] As stated in "*A Safer Financial Sector to Serve South Africa Better*," pages 25 to 27.

therefore the demarcation applied across the Long-term and Short-term Insurance Acts is unnecessary and would only impede competition.

The size of the benefits that a microinsurer can offer will be capped (current caps for life, in-life and asset products are proposed at R50 000, R50 000 and R100 000, respectively). These restrictions are introduced to contain potential risk exposure by the microinsurer, and allow in turn for reduced prudential requirements. The size of the caps will also be informed by consumer need, for example the cost to insure an RDP house has informed the proposed higher benefit allowance of R100 000 for asset insurance, relative to the life and in-life categories.

Lower prudential requirements. Commensurate with the simplified product offering, microinsurers will require R3 million upfront capital (compared to the current R5 million and R10 million required for short- and long-term insurers), and will enjoy simpler capital reserving, reporting and corporate governance requirements. This is envisaged to support the provision of more appropriate products by the existing formal insurers. It should also enable improved regulatory compliance by currently illegal or informal operators.

Appropriate intermediary requirements. Sellers of microinsurance products will enjoy appropriately streamlined Financial Advisory and Intermediary Services (FAIS) requirements. This does not mean that consumers are less protected but that the nature of the protection afforded is proportionately applied to meet the needs of the market.[6] To encourage “human” intermediation in this market, in contrast to the current practice of selling products off a retailer shelf, commission is proposed to be uncapped. This is the current treatment for assistance business policies written under the Long-term Insurance Act. Exploitive commission charges have not been observed in this market, and the Financial Services Board (FSB) will vigilantly monitor commission structures to ensure that there is no abuse.[7]

[6] For example, requiring a microinsurance intermediary to have a standard 8 or 10 will keep potential intermediaries out of the market, while at the same time may not necessarily affording greater assurance that the individual understands insurance or will sell the right product to the right person. In this instance one could consider alternative benchmarks like experience or a relevant qualification.

[7] This treatment will not apply to the credit insurance market, which is a captured market and subject to poor disclosure and over-charging of commissions. There is a separate policy process underway to address these abuses.

Growing consumer awareness and responsibility. Curbing the potential for mis-selling in this market requires that consumers understand what daily risks they or their families are exposed to, and are able to match an appropriate insurance product to that need. The National Treasury, through the FSB's Consumer Education Department, has designed a targeted education strategy that will be piloted this year. Response to this pilot will inform a broader roll-out of the strategy in 2012.[8]

More effective supervision and enforcement. The existing prudential and intermediation requirements are overly complex relative to the type of products sold and discourages regulatory compliance. For instance many funeral parlours and administrators are doing insurance business although not registered with the FSB to do so, while lack of disclosure and exorbitant costs characterise the credit insurance market. While recognising the role of these players in the market to facilitate access of low-income households to microinsurance products, such provision should be done in a manner consistent with best risk and intermediation practices. These considerations have informed the design of a regulatory framework accessible to all insurance providers and intermediaries. Non-compliance cannot as a result be blamed on "inaccessible" regulatory requirements, and will therefore be dealt with resolutely.

TRANSITION ARRANGEMENTS AND MARKET IMPACT

The microinsurance regulatory framework will be implemented against the backdrop of a large informal market where consumer abuse is rife. As already indicated, formalisation is therefore a core objective of the framework. Transitional arrangements will include the following:

[8] The consumer education strategy is intended to help families better identify the life and asset risks that they face, learn about insurance and better recognise when the various products are appropriate. Consumers should also be informed about what questions to ask before purchasing a product, in particular to know who the insurer is, whether that insurer is licensed with the FSB, whether the policy is subject to exclusions, how to claim and how to lodge a complaint. The project is currently not tailored specifically to the microinsurance regulatory framework (as this framework is proposed in the policy statement), but will increasingly be aligned to that framework as it is implemented.

***Phasing in of the microinsurance regime*.** Market participants will be given a three year transition period to comply with the Act. Provided that a suitable business plan accompanies a licence application, the prospective microinsurer will be allowed to build up its capital over the three year transition period. Consolidation in the market is expected as entities such as funeral parlours, that do not have the upfront capital or the capacity to become microinsurers, may aggregate into larger corporate or co-operative entities to better facilitate compliance. Consolidation should support the FSB's supervision and enforcement function, in line with a risk-based approach to supervision. Other support mechanisms may also be provided to existing providers seeking to be licensed, the exact mechanism to be determined after consultations with the industry.

Burial societies and small insurance co-operatives. These informal groups that do not guarantee benefits will be able to continue to operate informally, although must act in accordance with the regulatory framework for co-operatives as supervised by the Department of Trade and Industry (dti). However when reaching a membership threshold (proposed at 2 500 members), the society/co-operative will need to register with the FSB for a microinsurance licence. This threshold is introduced to balance the break-down of governance benefits associated with mutuality and the number of members required for a sustainable risk pool.

***Friendly society transition into co-operatives*.** It is envisaged that Friendly Societies will be required to convert their institutional form into a co-operative structure. Where benefits are guaranteed or the society/co-operative is greater than the proposed *de minimis* membership threshold of 2500 members, it will need to be underwritten by a licensed insurer or obtain a microinsurance license. These societies are currently registered with the FSB in terms of the Friendly Societies Act, 25 of 1956, but are subject to minimal prudential and governance requirements. Their migration into the co-operative and microinsurance space is seen as critical to improve protection for their members. Potential tax implications of the conversion should be minimised.

***FSB enforcement capacity and coordination with government departments*.** Microinsurance is likely to lead to a number of new entrants to be registered and supervised.

This will require additional supervisory capacity from the FSB. It is envisaged that the FSB will develop an implementation and outreach strategy that will cut across the microinsurance and FAIS frameworks. Part of this strategy will be a broad enforcement campaign aimed at facilitating formalisation and protecting consumers. It will also include ongoing supervision of registered microinsurers. A process of intergovernmental coordination has been initiated between the National Treasury and dti (relating to the regulation of co-operatives and support for small businesses). The National Treasury is considering mechanisms to support the tax and regulatory regularisation of entities that are currently neither taxed or FSB registered (keeping in mind that only those offering financial services to its customers should be registered with the FSB), to facilitate a coordinated drive towards improved regulatory and tax compliance.

WAY FORWARD

This policy document summarises the proposed regulatory framework for microinsurance in South Africa that is to be incorporated into the regulatory architecture through either amendment to the existing Long- and Short-term Insurance legislation or a stand-alone Microinsurance Act (although for reasons stated, at this stage the National Treasury believes the latter more appropriate). While aware of the imperative for more available and appropriate savings products for lower income families, exploring options for an alternative regulatory framework for these products will be deferred to a later stage – the focus now remains a framework for risk-only products.

The National Treasury and the FSB will engage on this document to build awareness of the proposed regulatory framework. As this document already considered the submissions received on the 2008 discussion paper, no new comment period is considered necessary. The public will be given the opportunity to comment on the final framework once the legislation has been drafted, before it is formally tabled in parliament. Draft legislation is intended for 2012, for tabling to parliament in 2013. Implementation is likely to follow in 2013/14.

1. INTRODUCTION[9]

A large proportion of the South African population remains excluded from formal financial services. An improvement in the attitude of South Africans and take up of insurance through a registered insurer – from 19.5% in 2008 to 25.6% in 2010 – may mask a concerning feature within the South Africa market: that the importance of insurance for personal risk reduction is understood, but not necessarily translated into behaviour. Although 74% of South Africans recognise the need for insurance, 34% have not made plans to address perceived threats to their livelihoods. And while most South Africans fear the loss of a primary breadwinner's income, only 11% appear to hold products that will help in managing this risk. In looking at the composition of insurance cover held, growth can be seen in the areas of health, physical asset and life insurance, but funeral cover obtained through a combination of formal and informal channels remains the most popular, with approximately 45% of adults covered (about 15 million people).

This snapshot of the mass insurance market highlights three features needing policy address. First, there is a need to promote better access for South Africans to affordable insurance products that meet their observed needs. Second, consumers need to better match the products that they buy with what they understand their insurance needs to be. And third, keeping in mind that the microinsurance policy debate originally centred on consumer abuses in the funeral insurance market, a challenge of inadequate consumer protection may result from changes to intermediation patterns, as funeral policies are increasingly underwritten and sold through funeral parlours which may not be licensed for this business (exposing consumers to exploitation).[10] [11]

In its recent articulation of policy reform for the broader financial services sector, the National Treasury's broad policy agenda rests on five pillars - financial stability,

[9] The statistics cited in this section are sourced from the survey FinScope South Africa 2010.
[10] FinScope South Africa 2010.
[11] Approximately 1 500 funeral parlours are registered with the relevant health authorities in South Africa. The full market is estimated at between 3 000 and 5 000 parlours, earning collectively an estimated R5 billion per annum.

consumer protection, better access to financial services, improved regulatory coordination, and comprehensiveness (meaning that all businesses in the financial sector should be on the regulatory radar).[12] These goals are mutually reinforcing. A stable financial sector in which participants behave with integrity improves consumer protection. Improved regulatory coordination and a complete regulatory scope likewise support better protection of consumers and mitigates systemic risk. Improved financial inclusion follows from well designed and affordable products sold by trusted product providers, which in turn follow from a more efficient and accountable financial industry. At the heart of holding the industry accountable is not just supervision and enforcement by the regulator, but also ensuring that the industry answers first to the consumers themselves. In this context a well functioning complaints and ombuds mechanism becomes critical, supported by improved consumer awareness through education.

As government, a well regulated financial services sector is not a goal in of itself. The aim is to ensure that the sector is instrumental in assisting South Africans to live safe and fulfilling lives by growing their wealth and providing protection against unforeseeable daily risks. Moreover, the financial services sector must ultimately support South Africa's overarching macroeconomic objectives of economic growth, job creation and poverty alleviation.

The National Treasury's "*A Safer Financial Sector to Serve South Africa Better*" explains the financial inclusion initiatives intended to support these objectives, including developing the role of Co-operative and Development Banks in the economy and strengthening the Postbank, as well as introducing a microinsurance framework. Where the banking initiatives focus on credit, savings and transactional products, microinsurance looks to risk-managing insurance products designed to meet the needs of lower income households (which can otherwise be seen as the emerging mass market).

[12] *A Safer Financial Sector to Serve South Africa Better*, page 2.

In 2008 the National Treasury released its discussion paper on the "*Future of Microinsurance in South Africa*" for public comment.[13] The document explained the background to the policy review, landscaped the existing market and proposed a comprehensive policy framework to encompass microinsurance underwriting and intermediation, consumer education and regulatory enforcement.

The policy document that follows here is the result of consultation on the 2008 discussion paper[14] and sets forth the policy framework for the development, regulation and supervision of the microinsurance market.

1.1 Policy objectives

Microinsurance refers to insurance that is accessed by the low-income population, provided by a variety of different providers and is managed in accordance with generally accepted insurance practice. It forms part of the broader insurance market, distinguished by its particular focus on the low-income market, which translates into distinct means of product design and distribution.

With the microinsurance policy framework the government proposes to achieve the following policy objectives:

- Extend access to a variety of good-value formal insurance products appropriate to the needs of low-income households, thereby supporting financial inclusion.

- Facilitate formalised insurance provision by currently informal providers and in the process promote the formation of regulated and well capitalised insurance

---

[13] The original discussion paper is available at:
http://www.treasury.gov.za/public%20comments/The%20Future%20of%20Micro-insurance%20Regulation%20in%20South%20Africa.pdf

[14] Formal engagement included: 10 written submissions on the 2008 discussion paper, input from approximately 200 stakeholders at five public workshop events held across the country, eight formal follow-up stakeholder meetings to submissions on the 2008 proposals, feedback received from two public seminars at FSB coordinated events, and feedback received from the International Association of Insurance Supervisors. A list of the submissions received and of the attendees at the public events will be made available for public consideration.

providers, thereby supporting the development of small businesses. This balances government's dual objectives of extending the scope of regulation to all financial service providers, and supporting job creation through economic growth by encouraging small business participation in the insurance market.

- Lower barriers to entry, which should encourage broader participation in the market and promote competition amongst providers, also supporting poverty alleviation through economic growth and job creation.

- Ensure protection of the consumers of microinsurance through appropriate prudential and business conduct regulation, improved enforcement of regulatory transgressions, and consumer education interventions targeted at understanding insurance and its associated risks and benefits.

- Facilitate effective supervision and enforcement, supporting the integrity of the insurance market.

To achieve these policy objectives, it is proposed that a new Microinsurance Act be introduced, permitting the licensing of a new category of insurers that can provide only microinsurance products.[15] Microinsurance products will be characterised by systematically lower risk, enabling reduced prudential and market conduct requirements to facilitate lower cost underwriting and distribution. The intention is to make it possible for informal insurance providers who find current registration requirements under the Long-term Insurance Act and the Short-term Insurance Act (also referred to as the Long-term and Short-term Insurance Acts) too onerous, to be able to register as insurers with reduced but appropriate requirements, that still enable

[15] Stand-alone legislation may not be necessary (or even appropriate) should there be significant enough overlap between the microinsurance provisions and those of the existing long-term and short-term insurance legislative framework, that warrant amendment to this legislation to accommodate the microinsurance regime instead. For the sake of simplicity however, the remainder of the document will refer to the proposed Microinsurance Act, and related sections, for example with respect to licensing in Section 2.3.1, presume a stand-alone act to be the case. This should be read as meaning that stand-alone legislation is not *fait accompli,* and will be tested for reasonableness during policy implementation through the legislative drafting process. Whether enabled through stand-alone legislation or amendment to the existing legislation, the substance of the proposals explained in this policy document remains constant.

them to meet a minimum acceptable bar from a risk management and consumer protection point of view. At the same time it is proposed to repeal the Friendly Societies Act, 25 of 1956 (the Friendly Societies Act). This act is weak on prudential and governance requirements and so affords minimal protection to members of registered Societies. In addition the restricted scope for underwriting insurance products for members has proven too limiting for emerging microinsurance providers. Friendly societies currently registered under the Friendly Societies Act will be migrated to the Co-operatives Act, 14 of 2005 (the Co-operatives Act). Those that offer insurance products and/or have more than 2500 members will be required to be underwritten by a registered insurer or regulated under the new Microinsurance Act.

Insurers registered under the Long-term and Short-term Insurance Acts will also be allowed to provide microinsurance products under the new Act, provided they obtain a microinsurance licence and conduct their microinsurance activities in a separate legal entity or convert an existing entity to a microinsurer (although can share management, supporting back-office infrastructure and other resources – see Section 2.3.1). It is expected that current insurers will find the reduced market conduct requirements of the new regime attractive.

1.2 Process

The impetus for a dedicated microinsurance regulatory framework dates back to concerns about the risk of consumer abuse in the informal funeral insurance market raised at a Parliamentary Portfolio Committee on Finance meeting in August 2003. Subsequently, National Treasury recognised the opportunities for financial sector development and inclusion through building the microinsurance market beyond just funeral and credit insurance. As a first step regulatory reform has concentrated on risk-products – a next step will explore the potential for expanding this framework to savings products.[16]

[16] While recognising the need and demand for savings products, tailoring prudential regulatory requirements to these types of products is more challenging, and so is left to a future work stream.

A discussion paper was released for public comment in 2008, supported by a written comments period, a national National Treasury/FSB road show to disseminate the proposals and gauge feedback from informal and less formalised market participants, and a final round of public engagement in 2010.[17]

This policy document incorporates the comments received on the discussion paper and sets forth the policy positions that will be captured in the Microinsurance Bill (or integrated through amendment to the existing legislation, as the case may be).

2. MICROINSURANCE POLICY FRAMEWORK[18]

2.1 Defining microinsurance products

At the simplest level, microinsurance refers to insurance products that are accessible to and/or used by low-income households. To turn this conceptual definition into a practical one wide enough to facilitate the development of a dynamic microinsurance market in South Africa, the definition of microinsurance should simultaneously achieve two goals:

- It should reflect the features of products demanded by the low-income market; and
- It should generate sufficiently low prudential risk so that microinsurance products can safely be provided by a wide range of microinsurers and be straightforward to distribute, these factors combining to merit simplified regulatory requirements.

[17] The National Treasury also presented its proposals to stakeholders participating in FSB regulatory training events (on Insurance and FAIS) and industry association led forums (like the Forum for Assistance Business). As a final step proposals were submitted to the Long- and Short-term Insurance Advisory Committees for review and feedback (these committees are established by the Minister of Finance in terms of the governing insurance legislation, comprise the FSB, National Treasury and industry experts, and are established to advise the Registrar on policy and regulatory matters).

[18] To the extent reasonable and possible, the regulatory requirements detailed below should be contained in subordinate regulation under the Microinsurance Act – the Act itself should specify the enabling policy principle, to be effected through regulation.

To achieve this, it is proposed that microinsurance should be defined generically, rather than as a list of specific product types. Licensed microinsurers should be able to write policies for all types of risk currently being written under the Long-term Insurance Act, 52 of 1998 (the Long-term Insurance Act), and the Short-term Insurance Act, 53 of 1998 (the Short-term Insurance Act), but will not be able to conduct the business of a medical scheme as defined in the Medical Schemes Act, 131 of 1998.

2.1.1 Product features and standards

To qualify as microinsurance, products will have to comply with the following product features and standards:

a) **Risk-only**. It is proposed that only risk benefits with no surrender value be included in the microinsurance product category. Risk benefits provide cover against a certain risk event or a combination of risk events, as defined in the policy contract, with the occurrence of the risk event serving as trigger for a claim. No savings component is included. Microinsurers will therefore not be able to write sinking fund policies and endowment policies, or policies with a cash-back component.[19]

b) **Benefits provided on a sum assured basis**. All microinsurance policy benefits should be defined on a first loss or sum assured basis. First loss insurance refers to insurance that provides a defined benefit upon a defined event as opposed to indemnity insurance that indemnifies losses, i.e. pays benefits according to the actual value of the loss suffered. This restriction is considered necessary since the loss adjustment process required for indemnity insurance is generally too costly for microinsurance. However, should the market develop cost-effective ways to provide indemnity insurance to low-income households, the need for this provision will be reviewed. A consequence of this restriction is that asset microinsurance policies,

[19] Savings and broader medical products can be contemplated at a later stage, and to the extent possible legislation will strive to be "enabling", and thereby crafted in a way to reflect this intended flexibility.

liability policies and accident and health policies must disclose how many claims (and the monetary limit thereof) may be made within the contract period.

c) **Defined benefit caps.** Benefits provided under microinsurance policies will be subject to defined financial limits depending on the nature of the policy. Though the size of benefits is not a main driver of prudential risk, benefit caps are nevertheless important from a consumer protection point of view and in order to justify special treatment in intermediation regulation. The caps will be individual, i.e. they will apply to one person insured under a policy with one insurer. Where more than one person is insured under a single policy, the caps will apply severally to each insured and not collectively to the policy as a whole. Thus, if three people are insured under a policy with a R50 000 cap, the total permissible cover that an insurer can provide under that policy will be R150 000, i.e. R50 000 for each person insured. To facilitate the provision of more than one form of cover by an insurer to the same policyholder, it is proposed to apply the caps to three different categories of policies as follows:

i. *A maximum benefit of R50 000 per insured life, per insurer for any insurance related to a death event:* with a death event being the event of the life of a person or an unborn child having ended.

ii. *A maximum benefit of R100 000 per person, per insurer, per contract period for all insurance on assets only*. This cap will apply to a person and not to an asset. A single person will therefore be allowed to take out more than one policy on more than one asset with the same insurer, provided that the aggregate sum assured does not exceed the cap of R100 000.

iii. *A maximum benefit of R50 000 per insured life, per insurer for all other risk events*. This cap relates to policies covering all risks not defined as either a death event or an event relating to an asset. This can for example include a legal policy, a health policy (but only if it falls outside the scope of the Medical Schemes Act), a disability policy, a retrenchment policy, a premium waiver policy, etc.

The following general provisions will apply to the capping regime:

- A microinsurer may provide any or all of the products in category (a), (b) and (c) above and will be licensed for these categories based on competence demonstrated in its business model.

- No minimum limit is set for a policy benefit. A single microinsurance policy may provide any benefit totalling up to the cap in each category, but may not exceed it.

- One insurer may sell more than one microinsurance policy to a policyholder, as long as the total benefits per category of risk events (as defined in (a), (b) and (c), respectively, above) do not exceed the maximum limit for that category. Thus, the limits apply per insurer, to all policies bought from that particular insurer, rather than to the total value of cover for any single person across insurers.

- A claim may be paid out in a single lump sum or in instalments, as stipulated in the policy contract, subject to the present value of all payments being within the applicable cap.

- Benefit limits will be reviewed at least once every two years, taking account of inflation and industry developments. Should the maximum permissible benefit levels increase, the minimum capital requirement will have to be increased correspondingly.

d) **Maximum contract term**. It is proposed that microinsurance policies should have a contract term of up to but not exceeding 12 months. To facilitate uninterrupted cover, microinsurance policies should be automatically renewable at the end of the contract term, without the need for a new policy document or a new waiting period. The only proviso is that the policyholder continues to pay the premium. Subject to there being no selective non-renewal within group policies insurers may, however, decline to renew policies after the contract term expires, or adjust pricing upon contract renewal.

Should there be actuarial grounds to change the terms of or cancel the contract, the limited contract term implies that the insurer is not locked into a contract or price beyond the 12 months prescribed maximum. As contract term is one of the primary drivers of the level of prudential risk, this limitation is central to allowing a lighter regulatory regime for dedicated microinsurers. This is not to say that longer-term products do not hold value to lower-income households, but the increased complexity of these longer-term products requires the more onerous regulatory regime currently applied to insurers. Microinsurers should however be encouraged to use a longer-term view for pricing even though they are allowed to adjust prices more frequently.

The short contract term could however be open to abuse. Unscrupulous players may abuse the opportunity to selectively cancel policies, or to underprice to get a new book of business and thereafter steeply escalate prices. The provisions set out in 5, 6 and 8 below are intended as counter-measures for such practices.

e) **No selective non-renewal within group policies**. Where policies are underwritten on a group basis (see provision 7 below), it is proposed that insurers should not be able to selectively cancel (that is, to refuse to renew) individual policies within the group. Should the insurer no longer find the level of risk acceptable, it must decline to renew the policies for the whole group or increase the premiums for the whole group, with three months notice provided to the policyholders in either case.

f) **Actuarial certification of premiums**. Initial pricing and subsequent price changes on microinsurance policies have to be signed off by an actuarial technician, based on verifiable risk considerations. As indicated above, microinsurers will be required to give policyholders three months notice of proposed price changes.

Where group underwriting is applied, no price discrimination will be allowed between individuals within a group other than on the basis of age at entry or level of cover. Where the age profile of the group changes, the microinsurer may reprice for the group as a whole, but not for individual aging members.

Where products are bundled, i.e. one policy combines more than one type of cover, the premiums associated with each discrete element of cover must be separately disclosed to the policyholder.

g) **Basis of underwriting to be discretionary.** Insurers providing microinsurance products should be able to underwrite policies in the manner they consider most appropriate, be that on an individual or group basis. Based on current market practices most microinsurance policies are likely to be priced and underwritten on a group basis. Group underwriting takes place where the risk is not evaluated or underwritten on an individual basis, but is based on the general characteristics of a group. Individuals can buy such policies without the need to submit their individual risk characteristics. Group versus individual underwriting defines the way in which the insurer designs and prices the product, rather than who exactly is covered by the product or how it is distributed.

The Insurance Laws Amendment Act of 2008 introduced the concept of binder agreements into the Long-term Insurance Act and enhanced the requirements in the Short-term Insurance Act. Binder agreements are intended to deal with situations where a person performs certain underwriting functions on behalf of a registered insurer and thus has the power to bind the insurer to a policy or set the conditions of a policy. The person who performs such underwriting functions on behalf of an insurer is not to be confused with an administrator or intermediary who simply performs administrative or intermediation functions on behalf of an insurer (see Section 2.5.7 below which deals with group intermediation). It is proposed that the principles applicable to binder agreements under the Long-term and Short-term Insurance Acts should apply consistently across the entire insurance sector, including microinsurance. Therefore the full set of binder agreement provisions as set out in Section 49A of the

Long-term Insurance Act and Section 48A of the Short-term Insurance Act shall apply to the underwriting of microinsurance policies.

h) **Waiting periods.** Waiting periods are introduced to reduce the risk of adverse selection in situations where no individual underwriting occurs. It is proposed to restrict waiting periods in microinsurance policies to a maximum of six months for death or disability due to natural causes for policyholders younger than 65 upon entry.[20] The risk of adverse selection falls away in the case of accidental death or disability, therefore no waiting period will be allowed for policies covering these risks.

The imposition of a waiting period could however adversely affect policyholders, should they move between insurers. In this instance, the risk of adverse selection has been substantially dealt with, and the rationale for imposing a waiting period falls away. Therefore, should a policyholder cancel a policy with one insurer in favour of a policy providing similar cover with another insurer, and provided that there is uninterrupted cover, the new insurers must request the previous insurer to issue a certificate to it, upon which the new insurer may not impose a waiting period. This will apply to individual policyholders as well as group schemes.

i) **Exclusions**. No exclusions will be allowed for pre-existing conditions. This provision is included to ensure consistency and fair treatment of consumers across the microinsurance framework. To avoid adverse selection, standard exclusions for suicide will be allowed.

j) **Simplification**. Microinsurance policies must be simple and easy to understand and policy documentation must be provided in plain language, avoid uncertainty or confusion and should not be misleading (refer to Section 2.5.6 for further standards in this regard).

[20] While the National Treasury sees this limitation as an important policyholder-protecting feature, more actuarial work may be required over time to monitor its impact on product supply and costs.

The Registrar may issue norms and standards for common terminology used across microinsurance policies (based on, for example, a microinsurance glossary), or endorse industry standards for standardisation of terminology.

k) **Right to a monetary benefit.** Where microinsurance benefits are offered in-kind, the policyholder must be given the option, when claiming, of receiving a monetary benefit equal to the stated value of the in-kind benefit had it been provided.

The amounts of the monetary benefit option and the in-kind benefit must be clearly disclosed when the policy is entered into, although the policyholder may exercise the right to make the choice at the claims stage.

The right to a monetary benefit has been a long-standing provision in the assistance business sphere, and will now be extended to all microinsurance. Initially, Section 53 of the Long-term Insurance Act of 1998 stated that the monetary option should be equal to the *cost that would have been incurred by the long-term insurer*, had the in-kind benefit been provided. This led to substantial uncertainty in the market. Consequently, the Insurance Laws Amendment Act of 2008 amended Section 53 to provide that the policy must "provide that the policyholder is entitled to demand that the policy benefit be provided as a sum of money in lieu of the benefit and … state the amount of the policy benefit that is to be provided as a sum of money". However, the requirement that the monetary benefit must be equal to the cost of the in-kind benefit was dropped. This omission has, in some instances, given rise to market practices where there is a large discrepancy between the value of in-kind benefits and the monetary option.

In order to ensure fair treatment of customers, it is proposed to revert to the pre-June 2009 position, but with the additional requirement that the insurer discloses the value of the monetary benefit upfront and that the face value of the in-kind benefit and the monetary option provided must be the same (rather than the cost to the insurer). In addition, the insurer must revise the value of the monetary benefit over time to ensure that it keeps track with changes in the value of the benefit-in-kind.

l) **Claims payments**. All valid microinsurance claims should be paid within a period of 48 hours after the insurer received all the requisite documentation, with the qualification that claims may be paid in instalments if this was provided for in the contract.

m) **Grace period**. Many microinsurance policyholders, especially those in the informal sector and seasonal workers, are likely to have irregular income streams which may make it difficult to maintain regular premium payments. To ensure that such policy holders are not unduly disadvantaged by their irregular cash flow, it is proposed that microinsurance policies be subject to a grace period if a premium(s) is not paid when due. The following grace periods are contemplated:[21]

- As a minimum, cover will continue for one month after the due date of the premium. The outstanding premium may be paid any time during that month without compromising the cover. If the premium is not paid within the month of grace, the cover will cease after that month.

- For policies that have been in force (including all renewal periods) for one year or more, the grace period will be extended by one month for each completed twelve month period that the policy has been in force with no reduction in cover. However, the maximum grace period for a policy (where renewals are considered to be part of the same policy) will be six months. For the purpose of calculating the beginning and end of a grace period, payments during a grace period will cover the oldest premium due. For example, if a policyholder is entitled to a four-month grace period, a payment of one month's premium after month three will simply mean that the total grace period is extended by one month.

[21] Note that this draws on the Zimele product standards, although may be subject to change as the policy debate around inclusion orientated product standards evolves. To engender certainty in the market, it is important to work towards harmonisation across regulatory requirements and other inclusion initiatives like the financial sector charter.

- Should a policyholder submit a claim during the grace period, the value of the claim may be reduced by the sum of the unpaid premium/s including interest.

Illustrative example: if a person pays premiums continuously for five years and then is unable to maintain premium payments, he/she will enjoy a grace period of up to six months although a claim during this period may be reduced by unpaid premiums.

n) **Target market.** There are no prescriptions in terms of the specific customers that may be microinsurance policyholders (e.g. LSM1-5). The intention of the microinsurance definition is not to define the microinsurance product category in terms of the specific customers that will use it. Rather, it seeks to create a space for microinsurance providers that provide products that will be attractive to the low-income market, without explicit provisions to filter out richer clients.

o) **Further product standards**. Further product standards, such as the need for minimum and maximum excess payments in the case of asset microinsurance, may be developed in subordinate legislation.

2.1.2 Product regulation

To facilitate product innovation, the microinsurance product definition as set out above was designed to be generic. A generic, as opposed to a product by product definition, requires checks to be in place to ensure that products meet the microinsurance standards and will not undermine consumer protection. To ensure effective monitoring, it is important that the FSB be aware of all product features – at the time of registration but also on an ongoing basis, should new products be launched.

It is therefore proposed that microinsurers be required to submit all new microinsurance products to the Registrar for review at least 60 calendar days before launching the products.[22] This will entail submitting an example of the proposed policy

[22] The duration of the proposed 60 day filing period will be subject to further review over the regulatory design finalisation process, in particular considering the need to balance costs, competition and other market

document as well as a summary of policy features including the risk events covered, benefit level, risk rate, premium (with actuarial sign-off on pricing as set out in Section 2.3.6) and commission structure.

Product review will take place on a file and use basis. This means that unless the FSB instructs the microinsurer to desist from launching the product, or to alter certain product features because they do not comply with the product standards or other regulatory requirements set out in the Act, the insurer can proceed to launch the product. 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. The Registrar however reserves the right to request changes to the product at any time after it has been launched. This approach does not constitute product approval, as the review will place no liability on the Registrar and does not imply that the Registrar in any way guarantees the policies. Rather, it is a review of whether the policy conforms to prescribed product standards, and to enable the Registrar to ban products not deemed to meet the prescribed standards.

2.2 Institutional regulation

2.2.1 Permissible institutional forms

Current insurance legislation permits only public companies to register as insurers. Member-based entities, such as co-operatives, are excluded, and so are private companies.

Member-based organisations have been foundational to the development of insurance in South Africa and elsewhere. Such institutions are often loathe to sacrifice their member-based form and principles of mutuality. It is therefore proposed to allow member-based entities to obtain microinsurance licences, provided they are registered under the Co-operatives Act and satisfy the microinsurance regulatory requirements

inefficiencies brought about by too long a period, against insufficient scrutiny of the products by the regulator should the period be overly short.

imposed. Member-based entities will then be on a level playing field with the existing large insurers, which should promote competition in this space.

As the consumer protection benefits intrinsic in a public company, such as transparency and corporate governance, will be built into the microinsurance framework, there is limited motivation for preventing private companies from also registering as microinsurers. Permitting private companies to register may be attractive to many of the entities currently providing underwriting beyond the regulatory net (like funeral parlours or microlenders). It is therefore proposed that to promote competition and market formalisation, public and private companies registered under the Companies Act, 71 of 2008 should likewise be permitted to apply for a microinsurance licence.

This space is intentionally not extended to friendly societies, primarily for two reasons. Firstly, the prudential requirements imposed on friendly societies by the Friendly Societies Act are inadequate to support the provision of microinsurance products as envisaged in this policy document. Secondly, the 2008 Co-operatives Act provides a more modern and sophisticated regulatory framework for member-based and member-governed institutions. Its provisions are more enabling than those of the Friendly Societies Act. At the same time the proposed provisions of the Microinsurance Act will allow entities far more flexibility to offer insurance than the restrictive provisions of the Friendly Societies Act. It is therefore proposed to phase out the Friendly Societies Act. Existing friendly societies will be required to register under the Co-operatives Act (which will provide their institutional identity) and those that wish to continue their insurance operations will be required to either obtain a microinsurance licence or obtain underwriting by a licensed insurer.

Note though that a burial society or co-operative that does not guarantee member benefits will not be considered as an insurance provider under the microinsurance regime. It will as a result not be required to obtain a microinsurance licence to continue its activities. However, it is submitted that the assumption of unguaranteed benefits breaks down in practice once an organisation reaches a certain size and there is distance between individual members and the management of the organisation. At this point new members will have an expectation of guaranteed benefits, even if the organisation does not technically guarantee benefits. Such organisations have grown large enough to create a level of prudential risk that should be managed through compliance with microinsurance legislation. A *de minimis* threshold will therefore be introduced beyond which all entities, even if they nominally provide unguaranteed benefits, will be required to register under the microinsurance regime or else to obtain underwriting. This threshold will be determined in subordinate legislation. It is proposed that the *de minimis* threshold initially be set at a level of 2 500 members. The Registrar should have the discretion to require a burial society or co-operative to register as a microinsurer even if it has fewer than the default 2 500 members, and similarly can exempt a society or co-operative from registering if it has more than 2 500 members.

A transition period (see Section 3.2) of three years from the enactment of the Microinsurance Act will apply during which burial societies and other risk pooling institutions that provide guaranteed benefits or with membership above the *de minimis* threshold must register and comply with the new Microinsurance Act.

The implications of this regime are the following:

a) The R7 500 exemption for friendly societies under the Short-term Insurance Act and the Long-term Insurance Act will fall away and it is intended that the Friendly Societies Act will be repealed; friendly societies will instead be required to register either as financial service co-operatives or co-operative burial societies under the Co-operatives Act (under the institutional jurisdiction of the Department of Trade and Industry - dti). A transitional period of three years will be allowed (see Section 3.2) and suitable transitional arrangements implemented.

b) The Co-operatives Act will be amended to allow for co-operatives who wish to provide insurance to have the option to register as microinsurers under the proposed Microinsurance Act. The Microinsurance Act may amend, vary or exclude certain provisions of the Co-operatives Act that apply only to the microinsurance regime, or impose additional requirements on such co-operatives at registration.

c) Friendly societies currently providing insurance (with guaranteed benefits) must obtain a microinsurance licence to continue doing so. Alternatively, if the organisation is not able to obtain a microinsurance licence (either by itself or through a secondary or apex co-operative), it must transfer its insurance business to a licensed microinsurer, or opt to no longer guarantee benefits and operate only under the co-operatives framework (provided the entity has fewer than 2 500 members, being the membership threshold above which a microinsurance licence becomes mandatory).

d) Section 94 of the Co-operatives Act, which exempts co-operatives that do not guarantee the benefits that they provide from the provisions of the Long-term Insurance Act, needs to be amended to also exempt such co-operatives from the provisions of the Microinsurance Act, subject to the *de minimis* threshold. Therefore the estimated thousands of small, informal burial societies will be able to continue their operations under this exemption, should they be deemed as co-operative burial societies.

e) The Microinsurance Act should provide for the principle of a *de minimis* threshold, the level of which to be prescribed by the Registrar.

2.2.2 Corporate governance

Corporate governance requirements are essential to ensure adequate oversight, including risk management and compliance. As microinsurance will cut across different institutional forms, it is important that common corporate governance principles be set to which all microinsurers, regardless of legal form, should adhere. All microinsurers will be required to adhere to at least the following corporate governance requirements:

a) **Transparency**: all microinsurers must undergo an annual audit and submit audited annual and unaudited quarterly statutory returns to the Registrar based on the template to be developed by the FSB (refer to Section 2.4).

b) **Skilled supervision of management**:

- All corporate microinsurers must have a board of directors of at least four members, of which at least two should be non-executive. Of the non-executive members, at least one should be independent.

- In the case of co-operative microinsurers, the board will be elected in accordance with the constitution of the co-operative and in compliance with the rules and stipulations as contained in the Co-operatives Act.

- All microinsurers must appoint a public officer to ensure compliance with the microinsurance regulatory framework.

- All directors, executive managers and public officers should be fit and proper and should fill in a standard personal questionnaire that will be the same as that for long-term and short-term insurers.

Adherence to corporate governance requirements under the microinsurance regulatory framework will not in any way exempt microinsurers from any additional corporate governance requirements applicable under their institutional regulation, namely the Companies Act or the Co-operatives Act.

2.3 Prudential regulation

The prudential regime for microinsurance is proportionate to the lower prudential risk associated with the microinsurance product category as defined.

2.3.1 Registration requirements

No person will be able to offer microinsurance products without being licensed as a microinsurer. All microinsurers will have to use the word ‘microinsurance‘ or any derivative thereof in its registered name. Note that, to the extent that a licensed long-term insurer or a licensed short-term insurer targets low-income customers with products that fall within the definitions of long-term insurance business and short-term insurance business respectively (i.e. the products do not straddle the long-term/short-term demarcation) such registered long-term and short-term insurers can continue to provide these ‘microinsurance’ products under their existing licences. However, should they wish to offer composite microinsurance products or qualify for any of the regulatory concessions applicable to microinsurers, they have to apply for a microinsurance licence.

The proposed registration requirements for microinsurers are designed to ensure that the licensee has the requisite skills to manage risk and conduct the business of a microinsurer in a sound way. At the same time the requirements should encourage institutions that are currently providing insurance beyond the law to formalise their operations.

Existing insurers wishing to apply for a microinsurance licence must set up a separate public company for this purpose. Furthermore, existing insurers that provide only products that will qualify as microinsurance products may want to convert to microinsurers. Where an existing insurer sets up a separate public company for microinsurance purposes, the management and governance structure of the parent company may be used for the subsidiary. Transitional provisions and further exemptions may be provided to facilitate existing insurers to seamlessly obtain a microinsurance license or convert into a microinsurer. Keeping microinsurance separate, in a dedicated legal entity, is simpler from a supervisory point of view and should not be a big obstacle for insurers who can continue to operate their business units internally as before.

Institutions wishing to register as a microinsurer without a prior registration under existing insurance laws will be permitted to do so as either a public or a private company, or a financial services co-operative registered under the Co-operatives Act.

Licensing requirements: Microinsurance licence applications will be subject to similar registration requirements as currently required for long- and short-term insurers, but with the capital and reserving regime and operational requirements as set out in the sections to follow. The various registration requirements will be adapted to a microinsurance licence that crosses the long-term and short-term divide. The requirements will also be streamlined to meet the capacity realities of a small microinsurer.

To obtain a microinsurance licence, applicants will be required to submit the following:

- A standard application form;

- A memorandum and articles of association in the case of a company or a constitution in the case of a co-operative as well as the official registration documents in each case;

- A business plan and five year financial projections;

- A personal questionnaire to be completed by board members and management to ensure that they are fit and proper; and

- An application for approval of the auditor(s).

Streamlining applications: The application forms, guidelines and templates for each of these will be streamlined to tailor it to a dedicated microinsurance licence. The business plan templates will be reviewed by the FSB to develop a standard template for microinsurance applicants.

Cell captives: It is proposed that microinsurance cell captive insurers be restricted to registered public companies with a microinsurance licence that are fully owned by a registered long-term or short-term insurer. This is because being a cell captive insurer requires specialised skills and experience that may not be suited to a new entrant microinsurer. Note though that an entity that is not a public company, like a co-operative, while not being permitted to operate a microinsurance cell captive, can nonetheless buy or rent a cell in a cell captive. Over time this limitation relating to which entities can be microinsurance cell captives may be reconsidered.

Because microinsurance is a composite class of policies, an existing long-term or short-term cell captive that does not have a microinsurance licence will also not be allowed to rent/sell cells to entities for the purpose of microinsurance provision.

Cells will be subject to lower capital requirements commensurate with the size of that cell relative to the total cell captive insurance business (see option 4 of Section 5.2).

2.3.2 Separation of business

For the sake of sound prudential management and to minimise the level of actuarial scrutiny required of microinsurance, registered microinsurers may only conduct insurance business. Other business operations, such as the provision of funeral services or credit, will not be permitted within the same legal entity (although management and governance structures may be shared).

2.3.3 Capital and reserving requirements

The proposed definition of microinsurance will limit the prudential and market conduct risks of underwriting and selling these products. This facilitates the creation of a prudential and market conduct regulatory framework tailored to the lower risk products. This includes tailoring capital requirements to the risk characteristics of this product category. Moreover, the current minimum long-term (R10 million[23]) and short-term (R5 million[24]) capital requirements present a barrier to entry that is unnecessarily high for insurers that will only provide low-benefit, short contract term microinsurance products.

The rationale for the fact that the short-term formula-based reserving will be applied to microinsurance is the fact that all microinsurance products will be written on a short contract term (maximum 12 months) basis.

Capital and reserving requirements: A microinsurer will at all times be required to provide for its (policyholder) liabilities and capital adequacy requirement:

- The **(policyholder) liabilities** for a microinsurer shall consist of the following reserves:

    - the Unearned Premium Reserve (UPR);
    - the Outstanding Claims Reserve (OCR);
    - the Incurred But Not Reported Reserve (IBNR); and
    - the Unexpired Risk Provision (URP)

    where:

    - The UPR shall be calculated according to the following prescribed formula:

        - UPR = (A – B) × (1 – C/D), where

[23] As contained in the *Prescribed requirements for the calculation of the value of the assets, liabilities and capital adequacy requirement of long-term insurers*. Published under BN 72 in GG 27846 of 5 August 2005 by the Registrar of Long-term Insurance.
[24] As contained in BN 27 of 2010.

- A is the gross premium for the full term of the policy, irrespective of the frequency of premium payment

- B is the sum of policy refunds due to cancellation or variation of the policy, approved reinsurance premiums for the respective policies and the amount of consideration payable by the insurer reduced by the amount of consideration payable by the reinsurer

- C is the number of days in the period from the date of the commencement of the incidence of risk under the policy until the day on which the calculation is made in accordance with this paragraph

- D represents the total number of days during the whole period for which the risk is covered under the policy

- The IBNR shall be equal to 7% (or such other percentage or method as the Registrar may approve or require) of the total amount of all the premiums payable to the Microinsurer under policies entered into by it in the 12 months preceding the date on which the amount is calculated, reduced by the total amount payable by the microinsurer as premiums under approved reinsurance policies in respect of the policies concerned.

- The OCR is the amount which the microinsurer estimates will become payable in respect of claims incurred under policies which are reported but not yet fully paid, reduced by the amount which it estimates will be paid in respect of those claims under approved reinsurance policies.

- The URP shall be held if the microinsurer incurs an underwriting loss in the conduct of its microinsurance business as reflected in any prescribed return in terms of the (Act) ,and the Registrar or micro-insurer (in consultation with its auditor), considers it necessary to defray the possible cost of claims together with the costs to carry on the said business.

- The **minimum capital adequacy requirement** for dedicated microinsurers will be set at R3 million.

- The **capital adequacy requirement** shall be an amount equal to the greater of the following amounts :

- The minimum capital adequacy requirement; or

- 15% of the greater of the amount of net written premium in respect of policies entered into

  - in the 12 months preceding the current financial year end; or

  - in the 12 months preceding the previous financial year end, where the written premium refers to the total amount of all the premiums payable to the microinsurer under policies entered into by it in the respective 12 month period.

The amount provided for in the policyholder liabilities is calculated to cover the amount payable due to expected future claims, to cover the amount payable for claims that have happened but that the insurer is not informed of at the reporting date, as well as claims that the insurer does know about but that have not been paid as yet.

The capital adequacy requirement is to provide for the risk that the liabilities may be higher than expected, i.e. to allow for experience worse than assumed in the calculation of the policyholder liabilities.

The minimum level of capital is the absolute minimum amount required upon registration. Once the insurer's book grows beyond a certain point, the actual capital may exceed the minimum capital requirement at which point the insurer will be required to hold the higher amount in capital.

Where co-operatives are registered as microinsurers, the minimum capital and reserving requirement for microinsurers will override the provision for reserving contained in the Co-operatives Act (Section 3(1) requires that at least 5% of the annual surplus should be set aside in a reserve fund that will be indivisible among members).

2.3.4 Building up of capital

The minimum capital adequacy requirement of R3 million was deliberately set at a conservative level. This however means that for some potential entrants upfront capital will remain a barrier to entry. To accommodate legitimate new entrants who cannot immediately put up the required minimum capital, it is proposed to permit them to build up the requisite capital over a period. It is important from a formalisation and enforcement point of view that a graduation path is provided towards full compliance, rather than entities continuing to operate informally. Furthermore, entities who wish to consolidate their operations into a larger entity should be provided a period over which to combine their business into a new microinsurer that meets the requisite capital requirements.

In light of the above, all microinsurers will be allowed to reach the minimum capital requirement over a period of three years from the enactment of the new microinsurance legislation (for more details of the transitional arrangements, see Section 3.2). Upon registration, all microinsurers must hold at least R1.5 million in unencumbered capital, to be phased up to R3 million at the end of the third year of operation. The business plan submitted by the microinsurer upon registration must clearly state how capital will be built up to the required minimum level of R3 million.

This concession for new licensees to build up capital during the first three years of operation after the enactment of the new Microinsurance Act will not entail a lowering of the absolute minimum capital requirement of R3 million. There will also be no relaxation of the capital requirement that requires capital to increase in accordance with the size of the book, set at 15% of the previous year's net premium. Those licensees that fail to build up the capital as stipulated will not be allowed to conduct new business and will be placed into run-off.

2.3.5 Investment restrictions

Since microinsurance contract terms will be limited to a maximum of one year, it is proposed to apply an investment regime suited to short-term, liquid investments:

- Only cash (or liquid, cash-like) investments will be allowed for assets backing policyholder liabilities, as well as for shareholder assets.

- If a microinsurer's assets exceed its reserving requirement and its capital requirement, it may apply to the Registrar to invest such free assets or a portion thereof in other asset classes.

If investment in more risky asset types were allowed, the capital regime would need to test the adequacy of both the capital and the assets backing the policyholder liabilities, as the insurer will need to absorb the market risk. This would require a full actuarial valuation – something that will not be required under the microinsurance regulatory framework (see below).

2.3.6 Role of actuarial assessment

Certification by an actuary of the financial position of an insurer, especially a life insurer, is normally required to ensure that sufficient assets are held to cover the capital requirement and policy liabilities, allowing for different stresses. This, in turn, relates to pricing and the level of reinsurance. Where reserving is done on a simple formula basis, as will be applied to microinsurers, the most important aspect requiring actuarial input is pricing, as this will determine reserving. It is therefore proposed that microinsurers must secure actuarial sign-off on the total premium (and not only the risk premium) for all new products, as well as any changes in pricing. Actuarial sign-off on the total premium allows for scrutiny regarding the proper allocation of expenses, as well as for allowance for profit and investment income. While statutory actuarial sign-off on capital will not be required by law, the FSB will reserve the right to request such should it be seen as necessary.

A microinsurer will not be required to appoint either a full-time actuary or a statutory actuary, and no annual statutory actuarial valuation will be required. The Actuarial Society will be requested to develop criteria for actuarial skills needed to sign off on microinsurance premiums, and to issue corresponding certificates to qualifying individuals to authorise them to do so.

2.3.7 Implications of the Solvency Assessment and Management (SAM) regime

Microinsurance will be excluded from the Solvency Assessment and Management (SAM) framework currently being developed in South Africa, given that:

- The microinsurance capital and reserving requirements will serve to create a separate prudential regulatory model suited to the risk profile of microinsurers. This will allow microinsurers to be exempted from SAM Pillar I. The specific product parameters applying to microinsurance facilitates the creation of a single set of rules to apply to the category as a whole, without each individual microinsurer having to assess its own solvency to which capital requirements will then be tailored.

- The microinsurance regulatory framework will also incorporate relevant elements regarding transparency and governance to ensure that the framework is in line with the principles of SAM Pillars II and III, but appropriate to the nature of the business of microinsurers.

2.3.8 Reinsurance

Reinsurance allows insurers to pass on some of their risk. It can potentially fulfil a valuable function in the microinsurance market, especially where microinsurers may be exposed to covariate or catastrophic risks. In addition to risk-sharing, reinsurers have also supported smaller insurers in developing and pricing products in return for buying reinsurance on their portfolio. The following provisions shall apply with regard to the reinsurance of microinsurance:

- Reinsurance will not be compulsory for microinsurers. There is no actuarial reason for compulsory reinsurance. As long as pricing is signed off actuarially, reserving should be adequate and risk accounted for. In line with the risk appetite of the insurer and the resources available to it, each microinsurer may decide whether or not to obtain reinsurance and what proportion of its book to reinsure. The Registrar however reserves the right to compel a microinsurer to obtain reinsurance on part of its risk as a licensing or ongoing condition, should the need for this become apparent.

- Composite, professional reinsurers that only provide reinsurance under the Long-term and Short-term Insurance Acts may provide reinsurance to microinsurers.

- Registered insurers may underwrite part of the risk of microinsurers, but will be required to register a microinsurance licence in a separate legal entity for the purpose of doing so. If an insurer is only registered as a long-term or short-term insurer, it cannot reinsure part of the risk of a composite microinsurer. Isolating microinsurance reinsurance into the microinsurance licence also allows microinsurance reinsurance to be managed and reported on separately.

- Registered microinsurers will be allowed to underwrite part of the risk of other microinsurers, but subject to such licensing conditions with regard to the provision of reinsurance as may be imposed. This provision is primarily intended to allow full insurers with a microinsurance licence to act as reinsurance partners to smaller microinsurers and is not intended to allow small entities into the reinsurance space who are not deemed competent to provide reinsurance.

- In line with international developments, the introduction of a policyholder protection fund could be considered in South Africa in future that will also be of relevance to microinsurance. The role of such a fund has been emphasised by the International Association of Insurance Supervisors (IAIS).

2.3.9 Distribution of profits

The provision of microinsurance by private enterprises must be done on a profitable basis to be sustainable. Moreover, it is anticipated that the formalisation of currently informal insurance providers can add significantly to the growth of well capitalised financial institutions owned by the previously disadvantaged in South Africa. However, profit-taking and the distribution thereof to the owners of microinsurers should not be at the expense of the financial soundness of those microinsurers. It is therefore proposed that, in recognition of the fact that statutory actuarial sign-off on profit distribution (as currently required under Section 29(4) of the Long-term Insurance Act) may add significant costs, the board of a microinsurer should sign off on the distribution of dividends. The decision of the board will be subject to the requirement that dividend payments may not undermine the solvency of the microinsurer.

Distribution of dividends will still be reported to the Registrar as part of the audited financial statements (see Section 2.4).

This requirement will apply regardless of institutional form. For a company, the provision will apply to the distribution of dividends to shareholders, and for a co-operative, to the distribution of surplus among members.

2.3.10 Tax dispensation

Taxation is relevant to the microinsurance regulatory proposals in at least five ways:

a) **Taxation of friendly societies and co-operatives**

Friendly societies are currently tax exempt while co-operatives are not. For consideration then is the tax impact of migrating Friendly Societies into the Co-operatives space. There are two related issues here. Firstly, the winding down of a friendly society and the transfer of its assets into a newly formed co-operative would in the normal course of business trigger a tax event. Transition arrangements may be required to ensure that the change in institutional form bears no tax consequence, thereby protecting the members' asset base.

A distinction should be made between a co-operative that provides services to its members only and a co-operative that provides services at least in part to non-members. In both instances one should consider how distributions are taxed and how this may impact members and/or non-members. For member-only co-operatives, distributions to members should be negligible as premium surplus will primarily be directed towards the building-up and maintaining of capital reserves. As these entities do not have a profit-making motive, any surplus generated above reserve requirements should, rather than being distributed to members, be used to offset the insurance premium required of the next year. This in turn means that tax treatment of distributions is less relevant in this context. In contrast, co-operatives established to provide insurance to non-members are profit driven, and will therefore as part of its operations regularly distribute profit to members. To ensure a level playing field with other institutional forms, it is considered appropriate that these distributions are subject to the tax treatment described.

Any investment income earned by the co-operative on its investments will be subject to the same tax treatment as microinsurance companies.

b) **Accumulating reserves to meet regulatory requirements**

The impact of income and capital gains taxes on microinsurers is important insofar as surplus earned by the microinsurer through premiums, that is transferred to reserves in order to meet the prudential regulatory requirements, should not be taxed as surplus during the transition phase; taxing transfers of surplus to reserves could significantly weaken a new microinsurer's ability to build up its reserves over time, undermining prudential regulatory compliance and member protection. The National Treasury is committed to ensuring that tax treatment of a microinsurer does not undermine its ability to meet its reserving requirements. Surplus transferred to regulatory reserves should not be subject to income tax over the three year transition period or until the minimum capital and regulatory reserve requirements are met, whichever is sooner.

As entities may "over" reserve to enhance net profitability or push through non-microinsurance products to get this tax dispensation, safeguards may be entrenched from a tax perspective to ensure that tax deductability applies only to the minimum regulatory reserve requirement, and that microinsurers are offering appropriately "traditional" insurance products.

c) **VAT**

Long-term insurance products are VAT exempt while short-term products are not. The tax exemption granted to long-term products is intended to promote savings. To ensure a level playing field between life and in-life policies written by a long-term insurer and those written by a microinsurer, it is expected that this same tax treatment will apply for these products written under a microinsurance licence. Asset insurance on the other hand (written under the R100 000 cap) should remain subject to VAT.

d) **Transition arrangements for currently unregistered business**

With this in mind, the National Treasury recognises that existing entities offering insurance products without being registered as insurers may be reluctant to formalise into the proposed microinsurance regulatory regime, i.e. register as microinsurers, for fear of triggering significant tax penalties (assuming that these entities are likewise not registered taxpayers).

The National Treasury is therefore exploring ways to support improved tax compliance for currently unregistered market participants, to specifically include microinsurance co-operatives (including burial societies) and funeral parlours, in a way that will minimise tax penalties possibly triggered for previous non-compliance. Transition arrangements for regulatory compliance should be harmonised to any transitional tax treatment granted. This means that entities that formalise from both a regulatory and tax perspective will be considered more favorably, while those that fail to do so will face a coordinated SARS-FSB probe with no leniency granted for non-compliance on either the regulatory or tax fronts.

The National Treasury and SARS endeavour to engage the industry on appropriate transitional tax arrangements that will promote improved tax compliance.

e) **Treatment of intestate policies**

For assistance business policies, should a policy holder pass away intestate the policy can be paid out immediately without having to be considered as part of the estate. Consideration will be given to carrying this dispensation through to microinsurance, with aligned tax treatment.

2.4 Ongoing operational requirements

Operational requirements are important to ensure that microinsurers maintain, on an ongoing basis, the skills needed to manage the risk implied by the provision of microinsurance. All microinsurers need to adhere to the following ongoing requirements:

- **Levies:** Each microinsurer will pay an annual levy comprising a fixed component and a variable component, expressed as a percentage of gross premiums. The level of both components will be determined by the Registrar.

- **Statutory returns**: Ongoing reporting is important to enable the regulator to monitor trends in the microinsurance industry. A standard, simplified template will be developed for audited annual and unaudited quarterly statutory returns, taking into account the current returns for long-term and short-term insurers. As part of the standard reporting requirements, the returns will indicate the number of policyholders, gross premiums, net premiums, claims, commissions, management expenses, policy lapses, mortality and morbidity experience.

  Co-operative microinsurers and private company microinsurers will be required to report to the Registrar on the same aspects and basis as public companies.

- **Statutory auditing**: A microinsurer must appoint, and at all times have, one or more qualified external auditors to sign off on financial statements intended for submission to the Registrar.

- **Actuarial skills:** As set out in Section 2.3.6, each microinsurer must have access to actuarial skills, although no statutory actuary will be required.

2.5 Intermediation and market conduct regulation

This policy document confirms the need for adequate consumer protection, especially where low-income consumers are concerned. Therefore the principles of the Financial Advisory and Intermediary Services (FAIS) framework, as well as the policyholder protection measures included under the Long-term and Short-term Insurance Acts should not be compromised. Rather, the intention is to accommodate microinsurance in a way that will increase financial inclusion while still protecting consumers. This it will do by tailoring the FAIS requirements to the simplified and standardised product profile of microinsurance as defined. Specifically, this framework seeks to create the regulatory space to bring back verbal disclosure and/or advice into the low-income market.

The FAIS Act, 37 of 2002 (the FAIS Act) and the subordinate legislation issued in terms of it, shall apply to the provision of microinsurance whenever intermediary services or advice is provided. However, as set out in the subsections below, a special dispensation will be created for microinsurance within the FAIS framework with regards to:

- the Fit and Proper Determination for financial services providers (FSPs), key individuals and representatives;

- the FAIS Code of Conduct applicable to microinsurance providers; and

- the financial soundness of the intermediaries dealing with microinsurance.

Within the microinsurance regulatory framework itself it is proposed to incorporate provisions regarding:

- direct marketing, informed by the current legislative framework;
- the commission regime applicable to microinsurance; and
- group schemes.

2.5.1 Fit and proper determination

Fit and proper salespeople are essential to ensure consumer protection. Previously, many salespersons of low-income insurance (such as funeral insurance and credit life insurance sold through retail outlets) found it difficult to meet the fit and proper requirements under the FAIS framework. Consequently the sales processes have been structured to avoid advice-based sales as it regulated under FAIS. This implies that the potential benefit of gradually improving the qualifications and skills of these salespersons may be lost, and in turn the underlying goal of consumer protection undermined. In recognition of this fact and in an attempt to incorporate more insurance salespersons into the regulatory fold, the new FAIS Fit and Proper Determination adopted in Board Notice 106 of 2008 (as amended by Board Notices 151 of 2008 and 95 of 2009) significantly reduced the requirements for representatives where the sales of assistance business and friendly society benefits are concerned. However, no provision is yet made for other low-income market targeted products such as consumer credit insurance, other long-term risk insurance benefits and short-term personal lines.

In light of the above, a separate Fit and Proper category will be created under the FAIS Fit and Proper Determination[25] to cover all microinsurance financial service providers (FSPs), key individuals and representatives. This category will replace Long-

[25] As contained in Board Notice 106 of 2008, to be read in conjunction with Board Notices 103, 104 and 105 of 2008 and the amendments introduced by Board Notices 151 of 2008, 64 of 2009 and 95 of 2009.

term Category A: Assistance business and will apply to all microinsurance products as defined in the proposed Microinsurance Act.

In doing so, it will incorporate some FSP sole proprietors, key individuals and representatives that would previously have reported under: 1.1 Long-term Category A; 1.2 Short-term insurance Personal Lines; 1.3 Long-term insurance Category B1; and 1.19 Friendly Society Benefits. Such sole proprietors, key individuals and representatives will be incorporated under the microinsurance category if they sell microinsurance products and meet the requirements specified for microinsurance products. Should they provide microinsurance products as well as other products, they will have to meet the higher requirements applicable under the respective categories, but can then still sell microinsurance. Therefore, if an FSP intermediates multiple classes of policies, it does not need to ring fence its microinsurance business. But in order to reap the intermediation benefits applicable to microinsurance, key individuals or representatives that want to comply only with the microinsurance requirements would need to provide microinsurance only.

The substance of the existing Category IV: Assistance Business FSPs, as relating to administrators, will be retained but amended to reference microinsurer FSPs (rather than those of assistance business).

The Registrar of Financial Services Providers will develop, where applicable, the qualifying criteria (the tasks, knowledge and skills criteria set), experience requirements, qualifications requirements, requirements for regulatory examinations and requirements for continuous professional development for the microinsurance category. In doing so, the realities facing the low-income market and the challenges of selling so-called “access products” will be taken into account.

As entry level criteria, a microinsurance representative will be required to be able to read and write (in English) and calculate. Within two years, during which time he or she should operate under the supervision of a key individual, the representative will need to meet a basic regulatory exam. It is contemplated that this may be provided in-house subject to meeting minimum standards as set by the Registrar of Financial Service Providers. This qualification will be product focused to ensure that the intermediary knows the different types of products and the role each plays, as well as the various disclosures that need to be made to the client

Dedicated entry and ongoing requirements will also be set for microinsurance key individuals (including sole proprietors). While set at a higher level than that of representatives, requirements will be tailored to the lower-risk nature of the microinsurance product category.

2.5.2 Code of Conduct

The importance of verbal disclosure and advice, especially to the low-income market, cannot be overemphasised. It is therefore proposed to facilitate the provision of disclosure and advice appropriate to clients with limited experience of formal insurance. Such a regime must find an appropriate balance between the cost of providing advice on the one hand, and the need to keep premiums as low as possible on the other.

To encourage more advice-based sales in the low-income market, a situation is desirable where the advice provided is tailored to the needs and realities of the low-income market and where the cost of providing advice and keeping records thereof is as low as possible.

For this reason, a dedicated FAIS Code of Conduct will be developed for microinsurance FSPs, key individuals and representatives that will cover all aspects in the General Code of Conduct, but will be tailored to the specific characteristics of microinsurance where Part VII, Furnishing of Advice, is concerned. This will be referred to as a basic advice regime, and will seek to facilitate the provision of low cost advice to potential microinsurance client.

The basic advice regime will entail streamlined requirements regarding the suitability analysis to be conducted and the record of advice to be kept in order to reduce the transaction cost of advice. For example, a simple, short list of scripted questions to be asked to the client that do not entail a full financial needs analysis based on the person's budget could be developed, as well as a simple, short template for a microinsurance record of advice. The details of the basic advice regime will be developed upon implementation of the microinsurance regulatory framework.

2.5.3 Financial soundness of the intermediary

Where an intermediary collects premiums on behalf of an insurer, no equivalent provision to Section 45 of the Short-term Insurance Act (Insurance Guarantee Facility) will apply under the microinsurance regulatory framework. Insurers will accept responsibility for all premiums collected on their behalf. However, even if the premiums collected are guaranteed by the insurer, in some instances the insurer may not have all the insured clients' details. It is therefore important that additional measures be implemented to ensure that an intermediary is financially sound, and that the client receives confirmation from an insurer that he/she is covered by the insurer after taking out the policy.

To this end the following will be required of microinsurance intermediaries under the FAIS framework:

- The intermediary must hold a separate bank account for all insurance monies. For example, if the intermediary is a funeral parlour, funeral and insurance business monies should not be mixed.

- The intermediary must issue the policyholder with some kind of storable receipt, be it in printed or electronic format, as soon as a premium payment has been made.

- A microinsurance intermediary with an annual turnover of premium values in excess of R1 million or such higher amount determined by the Registrar, will be required to submit audited annual financial statements to the Registrar.

- New policyholders must receive confirmation from the insurer that he/she is a policyholder within thirty days of paying the first premium or signing up for the insurance policy. This may be confirmed by SMS. Likewise, if a premium lapse occurs, the fact that the premium is in arrears should be communicated to the client (whether by SMS or otherwise). This is to manage the situation that an intermediary did not pay over the funds to the insurer. Recourse options should be clearly communicated to the client in the event that he/she receives a communication that a premium is in arrears despite his/her having paid it.

2.5.4 Levies

The Registrar of Financial Services Providers will consider the possibility of reduced FAIS levies for microinsurance FSPs, key individuals and representatives.

2.5.5 Commission regime

Level. Microinsurance products generally have low premiums. The commission required to viably sell such products, though low in absolute terms, therefore tends to be high relative to the value of the premium. It is therefore proposed to, with certain exceptions, uncap commissions in the microinsurance market. Current industry practices in assistance business (where commission is uncapped) signal that competition will serve to keep commission levels in check and that uncapping commissions will not undermine consumer protection. Although commission levels will be uncapped, they will be required to be reasonable and market practices will be reviewed on an ongoing basis to assess this. Providers will also be required to disclose proposed commission rates as part of the file and use process (see section 2.1.2).

The one exception to this general rule will be consumer credit insurance or any "embedded" insurance policy (for example a combination of credit insurance and funeral insurance in one policy) where access to credit is made subject to the purchase of an insurance policy sold through the credit provider. In this market segment significant abuses have been observed, deriving primarily from the fact that the insurance product is a secondary [and relatively marginal] purchase to the product being insured. Such conditions foster an environment of exploitive fees and sales practices. For this reason, commissions on such policies will remain capped at the existing rates as contained in the Regulations passed under Section 72 of the Long-term Insurance Act, 52 of 1998 and as amended in Government Notice R952 in Government Gazette 31395 of 2008.[26]

Structure. The position on the structuring of commissions seeks to balance, on the one hand, the need to disincentivise churn and encourage the ongoing servicing of policies by intermediaries, and on the other hand, the need to ensure that microinsurance distribution is viable for intermediaries. It is therefore proposed that microinsurance commissions should be structured to include both an upfront component (or "policy initiation fee") and an "as and when" component, as follows:

- Commissions will be payable as a fixed percentage of each premium paid.
- However, a once-off policy initiation fee may be paid, with the proposed amount being up to a maximum of R200.

In addition, the following provisions shall apply:

- The Registrar reserves the right to formulate claw-back requirements in subordinate legislation.

[26] Note also that abuses relating to credit insurance pricing are currently being scrutinised by the National Treasury and FSB as part of a separate process. More stringent regulation of these products relating to pricing and market conduct are being considered.

- There will be ongoing monitoring of commission practices, including of commission levels and structuring as well as of lapse rates. Additional requirements may be imposed should market practices be considered to undermine fair treatment and protection of consumers.

2.5.6 Requirements for simplified disclosure

Key information necessary to facilitate an informed decision must be appropriately disclosed by the insurer and intermediary. Microinsurance policy documents should therefore be in plain language, avoid uncertainty or confusion and not be misleading. The disclosure requirements in this regard as contained in Part VI of the FAIS Code of Conduct for all authorised FSPs other than direct marketers, and in Part III of respectively the Short-term and Long-term Policyholder Protection Rules for direct marketers, will be incorporated into the microinsurance regulatory framework.

Each microinsurance policy document must have a policy summary, in English, of no more than one page. This should form the first page of the policy document and be in a clear and readable print size, spacing and format. It must clearly state the name of the microinsurer and that it is registered with the FSB as a microinsurance provider. In addition, it should state the following six questions and the answers to each:

a. What am I covered for?

b. What are the exclusions? (if any)

c. How much are my premiums and where do I pay them?

d. What will happen if I do not pay my premium?

e. When, where and how can I claim and what documents will be required?

f. When and where can I complain? This should state both the microinsurer's and the Ombudsman's contact details.

In addition, the following provisions shall apply:

- The duty of disclosure on the policyholder will be limited to questions pertinently asked by the insurer. The insurer or intermediary must keep a record of the questions asked.

- Microinsurance will be subject to the Treating Customers Fairly regime once implemented, with due consideration provided under the Treating Customers Fairly framework to the unique features of microinsurance.

2.5.7 Group schemes

Most insurance in the low-income market is sold on a group basis. Underwriting takes place on a group basis (see Section 2.1 above) and policies are marketed to groups rather than individuals. When policies are marketed to groups, the insurer would usually issue a master policy to the group or the person administering the group. Individual members of the group obtain cover by signifying their acceptance of the terms of the master policy and commencing payment of premiums and receiving benefits in terms of the master policy. Whereas the advantage of group schemes has been to reduce underwriting and distribution costs, their weaknesses are reflected mostly in the absence of a direct relationship between the individual insured and the insurer.

Intermediation of microinsurance through group schemes will be subject to additional controls to safeguard against the worst excesses that have occurred in this market. It is proposed to define group schemes for microinsurance products as all policies providing benefits to groups (being two or more persons who each pay premiums) where (1) pricing and reserving is done at a group (rather than individual) level, and

(2) the individual person, who has the insurable interest, directly or indirectly pays the premium.

Where a group scheme is administered by a person other than the insurer (who we refer to as the administrator) it is proposed to protect the interests of the policyholders through requirements similar to those currently contained in the long-term PPR. In particular:

- The individual persons paying premiums under the policy will be deemed by law to be the policyholders, rather than the administrator or any other entity on behalf of the individual policyholders. This implies that the individual policyholders should receive confirmation from the insurer of the fact that they are a policyholder and of the policy requirements and benefits;

- The individual policyholders will have the right to cancel their cover at any time;

- The administrator must enter into a written agreement with the insurer setting out the terms of the agreement (minimum terms to be specified by the Registrar); and

- The administrator must be licensed as a FSP in terms of the FAIS Act or must be a representative of the insurer within the terms of that Act.

2.6 Consumer education and recourse

To complement the consumer protection mechanisms built into the product definition, the requirement for product approval, as well as the institutional, prudential and market conduct regulatory requirements, it is proposed that provision be made for adequate consumer recourse, both to the provider itself and to an independent statutory body. In addition, a comprehensive consumer education strategy will be implemented.

2.6.1 Consumer education

Educated consumers who know their rights are more easily protected against abuse (or are empowered to seek redress) and are in a position to make effective product choices to cover the material risks that they face.

The implementation of a microinsurance regulatory framework will go hand in hand with a consumer awareness and education campaign to be implemented by the FSB. This campaign will focus on creating awareness of insurance and its value proposition among consumers, as well as their rights and responsibilities, should they become insurance clients. It will also alert them to potential abuses.

2.6.2 Consumer recourse

Every microinsurer shall maintain a client care system through which clients can lodge complaints and receive redress. All microinsurance policy documents will clearly state the contact details or client care number of the microinsurer for the purpose of lodging a complaint and shall also set out the procedure for lodging a complaint. In addition, it will state the contact details of a dedicated ombudsman's office and the procedures for making a complaint, should the insurer be unable to resolve the matter.

A single ombud scheme, whether it be the statutory ombud or one of the existing voluntary ombuds, will be empowered to receive all complaints regarding microinsurance and may appoint an expert in this regard. More engagement will be done in making this decision; microinsurance policyholders should have certainty withy respect to which complaints channel to use, and what is crucial is that expertise are developed within the empowered ombud's office going forward to deal with cases related to both short-term and long-term microinsurance products.

As under the current ombud schemes, complaints may be made in writing or verbally via a call centre (to be transcribed by the ombud's office).

3 IMPLEMENTATION AND TRANSITIONAL PROVISIONS

3.1 Implementation strategy

A regulatory framework can only be effective if it is properly enforced. The FSB will develop and implement a holistic implementation strategy for the microinsurance regime that will cut across the microinsurance and FAIS regulatory frameworks. Consumer protection will be a critical aspect of the strategy. The implementation strategy will include a broad ranging enforcement campaign aimed at facilitating formalisation and protecting consumers. It will also include the ongoing supervision of registered microinsurers.[27]

Supervision: The supervision of registered microinsurers will include appropriate off-site monitoring through statutory reporting, backed up by risk-based on-site visits. This will be enhanced by thematic enforcement campaigns or assessments and reactive strategies such as responding to complaints or whistle blowing. All of these components will be considered in the development of the microinsurance implementation strategy.

Formalisation: It is anticipated that formalisation of currently informal providers of microinsurance products will require a proactive enforcement campaign involving multiple government agencies, not only the FSB. The National Treasury will facilitate the involvement of different government stakeholders in this enforcement drive. It is proposed to follow a “carrot and stick” approach to formalisation. The counterpoint to the enforcement campaign will be proactive support to prospective microinsurers to assist them with building the necessary capacity to formalise and to undertake the registration process itself.

[27] Consideration should be given to the overarching regulatory architecture, in particular where responsibility for supervision of this market will rest within the envisaged twin-peaks structure. The significant interplay between prudential and market conduct regulation in the mass market space means that the answer is not straightforward. For ease of reading, this document presumes that the FSB, as current regulator of insurance and market conduct, will remain the microinsurance regulator going forward.

Business and operational support functions will fall outside the ambit of the FSB. The extent of support and who should provide it is under review. At this stage it is proposed that the mandate of the Co-operative Banks Development Agency, as provided for in the Co-operative Banks Act of 2007, be extended to allow for it to provide operational support to microinsurers in addition to Co-operative Banks.

3.2 Transitional arrangements

To ensure a sound and orderly transition from the current regulatory framework to the new microinsurance framework and to facilitate formalisation of all those entities currently providing microinsurance without a licence, it is proposed that the mooted Microinsurance Act and regulations allow for a transitional period of three years from the date of the enactment of the new Act. During this period:

a. All entities that currently provide insurance without a licence must register as a microinsurer (either individually or as a consolidated entity in cooperation with other similar entities), obtain underwriting, enter into a cell captive arrangement, or terminate their insurance activities. Entities wishing to register under the proposed Microinsurance Act will be provided with support.

b. Friendly societies currently registered with the FSB must transform into either co-operatives or companies, or must dissolve. Those who wish to continue providing insurance to their members must either obtain an insurance licence (most likely a microinsurance licence) or secure underwriting from a registered insurer (which could include a microinsurer – see the provisions regarding reinsurance in Section 2.3.8). The same will hold for friendly societies and burial societies who do not provide guaranteed benefits, but fall above the *de minimis* threshold as stipulated in Section 2.2.1

c. Companies currently registered under either the Long-term or Short-term Acts may register a separate company and apply for a microinsurance licence. Some insurers (for example those doing only assistance business) may choose to convert the existing insurance license into a microinsurance license. The transfer of policies that constitute microinsurance policies from the insurer to the microinsurer will be provided for.

d. A coordinated consumer education and awareness-building campaign will be launched to introduce the new microinsurance dispensation and to stimulate demand for products compliant with the new regime.

e. The state will launch a coordinated enforcement campaign targeted at those entities continuing to offer insurance in violation of the new microinsurance regime.

The transitional period will proceed in two phases:

Phase 1: During the first twelve months following the enactment of the Act all entities currently underwriting their own books without registration as insurers, whether they intend to obtain a microinsurance licence or not, will be required to register nominally with the FSB. No compliance requirements will be attached to such registration. It will entail submitting a simple registration form providing details of name, business conducted and contact details. Entities that complete this nominal registration within the twelve month cut off period, will be entitled to amnesty from regulatory prosecution for the rest of the three-year period that will cover all the aspects of their informality. Concessionary tax treatment is likewise being explored for entities that should be tax registered but are not, subject to registering with SARS over this period. This amnesty period is intended to provide sufficient time to allow entities to obtain a microinsurance licence (either individually or consolidated with other entities or through a new entity in which they are all shareholders or through a secondary co-operative) or to obtain underwriting from another registered insurer, including a microinsurer. Those entities that do not complete the nominal registration will be subject to immediate prosecution under the proposed coordinated enforcement campaign. As soon as an entity completes the registration, it will become entitled to receive the public support referred to in Section 3.1. Nominal registration will not in any way amount to authorisation to operate as a microinsurer under the Microinsurance Act. It is simply the first step in a possible registration process.

Phase 2: During the balance of the three years the actions set out in 1 to 3 above will be permitted with the additional concession that all entities registering as microinsurers during this period (which commences with the coming into operation of the Act) will be permitted to register with a minimum capital of R1.5 million. Microinsurers who register with a minimum capital of R1.5 million will be granted a provisional rather than a full microinsurance licence. The provisional licence will entitle them to offer microinsurance products similar to a full licence, but may be subject to additional conditions specified by the Registrar. Holders of a provisional licence will be given 3 years from the date of enactment of the Microinsurance Act to comply with the minimum capital requirement of R3 million after which the provisional licence will lapse if they fail to comply. At the end of the transition period the option of obtaining a provisional licence will lapse.

All entities that can meet the full compliance requirements, including the full minimum upfront capital requirement, may register as a microinsurer and start operating as such at any time within the three year period. These entities will be entitled to make use of the full concessionary microinsurance regime as soon as they are registered.

In all of the above cases, insofar as financial advisory and intermediary services are provided as defined in the FAIS Act, the entity will also be required to obtain authorisation as an FSP under the FAIS Act and become fully compliant with microinsurance requirements (refer to Section 2.5) within the three year period.

3.3 Consumer education

Consumer education will be an important element of the transitional phase, but will also continue over a longer horizon beyond the transitional phase. Time will be needed to build consumer awareness and educate consumers regarding the microinsurance regime, their rights under it, and the need to deal only with authorised microinsurance providers. The benefits of consumer education are likely to only become apparent over the longer-term.

4. CONSEQUENTIAL AMENDMENTS AND INTERGOVERNMENTAL COORDINATION

The microinsurance regulatory framework will require consequential amendments to the following legislation:

- The Friendly Societies Act should be repealed, with the implications as set out in Section 2.2.1. Transitional arrangements in this regard will be determined by the National Treasury and FSB, in conjunction with the dti, and communicated to all registered friendly societies.

- The Long-term and Short-term Insurance Acts need to be amended where applicable to allow for microinsurance provision and to remove references to the Friendly Societies Act. As already explained, the outcome of the drafting process will determine the extent of amendments required to the Short- and Long-term Insurance Acts. Significantly greater amendments will be needed in the instance where microinsurance principles are fully captured in the existing legislation rather than a stand-alone act.

- References to assistance business will be removed from the Long-term Insurance Act and all long-term or assistance business insurers wishing to write assistance business and reap special benefits under it (such as uncapped commissions) would henceforth have to do so under a microinsurance licence. The R18 000 benefit cap specifically for assistance business will fall away in favour of the R50 000 microinsurance cap for life products. The current requirement that assistance business benefits be paid within 48 hrs will be carried over to the microinsurance regime as a product standard. Existing assistance policies on the book of a long-term or assistance business insurer should either be placed in run-off or be transferred to a microinsurer, provided the policies in the book meet the requirements of the microinsurance product regulations. Insurers may also carry on doing such business under a long-term licence, but under the normal regime that applies to the relevant long-term class of policy.

- Consequential amendments need to be brought about to the Policyholder Protection Rules, the regulations pertaining to commissions and all other relevant instances where the regulatory framework needs to refer to provision under the proposed Microinsurance Act.

- The FAIS framework will be amended to accommodate microinsurance. Specifically, the Fit and Proper determination will be amended to create a category for microinsurance and a new General Code of Conduct will be drawn up for microinsurance.

- The Co-operatives Act will be amended to allow for microinsurance, notably to state that co-operatives that wish to provide insurance must register under the Microinsurance Act to do so. The co-operatives regulatory framework will also make mention of the fact that all friendly societies will henceforth be deemed to be co-operatives, and any transitional arrangements and other provisions in this regard. Furthermore, the Co-operatives Act will be amended to include the *de minimis* threshold beyond which co-operatives providing insurance cover without guaranteeing the benefits will still need to be incorporated under the microinsurance regulatory framework (refer to the discussion in Section 2.2.1).

- Should it be agreed that the Co-operative Banks Development Agency will assist fledgling microinsurers with their operational requirements, the Co-operative Banks Act will need to be amended to accommodate this broadening of the agency's mandate.

- At this stage, requirements under the Financial Intelligence Centre Act of 2001 (FICA) are not considered to be impeding development in this market, although will be monitored for unintended impact (short-term insurers are not classified as accountable institutions under the Act, and as a result do not have to comply; long-term insurers are exempt from certain parts of FICA and in addition a policy is exempt should recurring premiums on that policy fall below R25 000 per year or a single premium on that policy fall below R50 000 – microinsurance products fall well within these thresholds).

The microinsurance regulatory framework will not operate in isolation. Other existing or pending legislation or regulatory processes that may have an impact on the microinsurance regulatory regime include:

- The National Credit Act, 34 of 2005
- The Consumer Protection Act, 68 of 2008
- The Companies Act, 71 of 2008
- The Protection of Personal Information Bill
- The proposed amendment of the Co-operatives Act
- The Financial Intelligence Centre Act, 38 of 2001
- Provincial processes to consider the development of provincial-level regulation for funeral undertakers and the proposed Department of Home Affairs process to develop national standards for death registration.

- The dti's SME support programmes and other governmental business support projects that could provide possible support for funeral parlours and other entities wishing to formalise.

This underlines the need for intergovernmental coordination. In recognition of the fact that the microinsurance sphere (particularly funeral insurance) is informed by related activities that are relevant to a number of national government departments, National Treasury is pursuing a range of bilateral engagements and will continue to actively pursue direct engagement between different stakeholders.

5. MARKET IMPACT

This section outlines the implications that the microinsurance regulatory framework, as set out in this policy document, will have for different types of entities that are operating (or want to operate) in the low-income insurance market:

5.1 Existing insurers

Any existing insurer will be able to register a separate microinsurance licence or convert to a microinsurance licence. To do so, it will need to set up a separate legal entity, or convert an existing legal entity to a microinsurer. The regulatory framework will be set up to allow seamless registration. Other concessions will include the use of a single governance and management structure across legal entities.

Under the microinsurance licence, lower prudential requirements, notably a lower minimum capital requirement, will apply, as well as a separate category of microinsurance intermediaries in the FAIS Fit and Proper Determination. Importantly, benefits will also be reaped from the streamlined requirements where the provision of advice and the records to be kept in that regard are concerned. With the exception of credit-linked and other embedded products, commission levels will be uncapped for all microinsurance. A further distinct benefit will be the ability to sell products that would traditionally have been regarded as long-term and short-term under one microinsurance licence.

The enforcement and formalisation drive will seek to regulate hitherto unregulated players. While this will increase the number of direct competitors that existing insurers face, it will level the playing field for legitimate players, equalise compliance requirements and costs, and clamp down on those who wish to remain outside of the regulatory net.

Existing insurers with a microinsurance licence in the group will be able to:

- Reinsure part of the risk of a microinsurer; and

- Obtain permission, as part of its licence conditions, to act as a cell captive insurer and provide cells to groups/entities wishing to sell microinsurance products as defined.

Existing insurers who choose not to register a microinsurance licence will:

- continue to be able to underwrite groups or entities operating in the low-income market;

- continue to be able to provide products that do or do not meet the definition of microinsurance as contained in this policy document, but in doing so will not reap any of the prudential and/or intermediation benefits or concessions contained in the microinsurance regulatory framework; and will

- No longer be able to utilise the regulatory concessions applicable to assistance business under the current Long-term Insurance Act since the assistance business class of policies will be removed from the Long-term Insurance Act.

5.2 Burial societies, friendly societies and co-operatives

The thousands of small, informal burial societies that do not provide any guaranteed benefits but are just a mechanism of social support will continue to operate informally as they currently do. Nominally, their institutional home will now however be the co-operatives regulatory framework. As the proposal is that the Friendly Societies Act should be repealed, all entities that would up to now have fallen under the ambit of that Act will be deemed co-operatives. This is in line with the intention of the Co-operatives Act, which provides explicitly for co-operative burial societies and exempts all co-operatives that provide insurance-like cover to members without guaranteeing their benefits from having to comply with insurance legislation.

However, a *de minimis* requirement of 2 500 members, as set out in Section 2.2.1, will be included in the Microinsurance Act. This will entail a size threshold for co-operative burial societies or financial services co-operatives beyond which insurance provision will be assumed present, even if benefits are not contractually guaranteed. The provisions as set out under options one to four below will then become relevant.

Registered friendly societies that currently submit financial statements to the FSB will also be deemed co-operatives. It is proposed that they will have to register under the Co-operatives Act and become compliant with the co-operative regulatory framework. Notably, the rules of the friendly society will have to be transformed into a co-operative constitution. An institutional assessment indicates that this should not be onerous. Registered friendly societies will be informed by the FSB of the procedures required to register as a co-operative and, if necessary, support will be given to them in the transition process.

Registered friendly societies that currently operate under the R7 500 exemption for friendly societies in the Long-term and Short-term Insurance Acts will no longer be able to do so. They will convert to co-operatives in the same way as other registered friendly societies and the same guidance will be provided to them.

The most notable impact on friendly societies transforming into co-operatives will be the phasing out of their [the friendly societies] tax exempt status. However, as discussed in Section 2.3.10, potential tax implications of this migration will be minimised. In its new form as a microinsurance co-operative the friendly society will be able to transfer pre-tax surplus to build up its reserves, and as distributions to members are expected to be negligible (in a co-operative that provides services to its members only), tax impact at this level should likewise be negligible.[28]

Whenever a co-operative, be it an existing friendly society transforming into a co-operative or an existing co-operative, wishes to provide insurance (defined as guaranteed benefits, or any benefits provided by a co-operative with membership above the *de minimis* threshold) to its members, it has the following options for doing so:

- **Option 1: autonomously underwrite own risk**. In addition to institutional registration under the Co-operatives Act, a co-operative that wishes to act as an insurer in its own right must obtain functional licensing as a microinsurer and meet all the requirements of the microinsurance regulatory regime. This will allow it to provide all microinsurance products as defined, up to the maximum benefit levels as defined. It will therefore no longer be subject to the R7 500 limit, but will now also be required to meet the corporate governance, capital and other prudential as well as intermediation requirements set under the microinsurance regulatory framework.

- **Option 2: obtain underwriting from a licensed insurer.[29]** A financial services co-operative or co-operative burial society that obtains full underwriting of its insurance book by an insurer licensed for the product classes in question, will

[28] Friendly societies that chose to not guarantee their benefits - and fall beneath the *de minimis* level of 2 500 members - will not require a micro-insurance license. As such these entities will not require capital and reserving, and so the issue of transferring pre-tax surplus [to reserves] falls away.
[29] Note that, under **Option 1**, partial underwriting may still be obtained, but this will not exempt the financial services co-operative or co-operative burial society from the requirement to register as a microinsurer and comply with the microinsurance regulatory regime.

not be required to obtain a microinsurance licence as it will not be carrying any risk itself. It will however be subject to all the requirements of the Co-operatives Act and, where it intermediates insurance to its members, the FAIS Act.

- **Option 3: consolidate under a secondary co-operative**. A number of co-operatives may also consolidate under a secondary co-operative, as allowed for under the Co-operatives Act, to provide microinsurance. The secondary co-operative will then be the entity that obtains the microinsurance licence and it will underwrite the insurance book of the various member co-operatives, who act purely as intermediaries. The same provisions as under Option 1 will apply to the secondary co-operative and the same provisions as under Option 2 will apply to primary co-operatives who are members of the secondary co-operative.

- **Option 4: enter into a cell captive or similar arrangement**. The same provisions as under Option 2 will apply to co-operatives that enter into a cell captive, joint venture or partnering arrangement with a licensed insurer. This is subject to the imminent review of intermediaries being able to take out cells on an affinity scheme basis.

5.3 Funeral parlours

Funeral parlours that currently have full underwriting by a registered insurer may continue to intermediate insurance on the same basis. As before, these entities must be authorised as FSPs under the FAIS Act.

Funeral parlours that currently operate outside of the insurance acts (by carrying their own insurance risks on a cash flow basis without underwriting from a registered insurer and without a long-term insurance licence of their own) will be required first to nominally register, then to follow either of the following routes:

i. Obtain underwriting from an existing insurer that is licensed to provide the product classes in question (i.e. become an intermediary);

ii. Enter into a cell captive, joint venture or partnering arrangement with an existing insurer, subject to the imminent review of intermediaries being able to take out cells on an affinity scheme basis;

iii. Obtain a microinsurance licence of their own and split their insurance business from their funeral parlour business into a separate legal entity (be it a public company or a co-operative); or

iv. Consolidate with other entities to form a microinsurer – be it as a company or a for-profit co-operative.

As discussed in Section 3.2, an appropriate transition period will be provided during which to reach legitimacy through any one of the options named above. Thereafter, the enforcement drive will focus specifically on any entities that still choose to operate illegally, with the power to oblige them to comply or else shut them down.

Those that do follow the formalisation path will gain access to government assistance programmes.

All microinsurers linked to funeral parlours, as well as all funeral parlours acting as intermediaries for an underwriting insurer, will reap the intermediation benefits of the microinsurance regulatory regime as set out in Section 2.5. Microinsurers linked to funeral parlours will reap the full benefits of the prudential regime as set out in Section 2.3. Furthermore, the funeral insurance that they provide may now increase up to a maximum of R50 000 as compared to the current maximum of R18 000 for assistance business and they will also be allowed to provide other insurance products, subject to the benefit limits specified in Section 2.1. They will however be required to strictly adhere to the right to a monetary payout where benefits are provided in-kind, as set out in Section 2.1.

5.4 Any other new entrants

Any other new corporate or co-operative entities who meet the registration, prudential and operational requirements as set out in Section 2.3 will be allowed to register as microinsurers. More than one entity will also be allowed to consolidate under one microinsurance licence, with the licence holder acting as underwriter of the risk other entities, who then act as intermediaries. Any entity that performs advisory or intermediary services with regard to microinsurance will be required to obtain authorisation as a FSP under the FAIS Act, with the concomitant intermediation provisions for microinsurance as set out in Section 2.5.

6. WAY FORWARD

This policy document summarises the proposed regulatory framework for microinsurance in South Africa that is to be incorporated into the regulatory architecture through either amendment to the existing long- and short-term insurance legislation, or a stand-alone Microinsurance Act. At this stage the National Treasury believes it will be the latter, on the grounds that the microinsurance proposals:

- encompass both long- and short-term insurance products;
- provide for various institutional forms;
- cements a rules-based approach to prudential regulation (with a degree of product regulation) that differs fundamentally from the principles-based direction that insurance supervision for the traditional market is heading; and
- illuminate the need for supervision to focus on this insurance segment distinct from the traditional market given its unique characteristics and vulnerabilities.

These proposals are intended to support National Treasury's financial sector policy objectives of financial stability, consumer protection, financial inclusion, improved regulatory coordination, and regulatory comprehensiveness. With an emphasis on improving the access of poorer and economically vulnerable households to financial services, delivering upon these objectives is expected to ensure that the financial services sector better supports economic and employment growth and the alleviation of poverty. The microinsurance proposals highlighted here importantly reinforce this broader strategy. As the promotion of savings remains a priority for the South African government, expanding this framework to accommodate savings products is considered a necessary next step to developing the insurance market.

The National Treasury and the FSB will engage on this policy document to increase awareness of the proposals and support the transition into this new regulatory framework. However no new comment period is considered necessary, as this policy document considered the submissions received on the 2008 discussion paper and has extensively engaged stakeholders on the proposals contained herein. The public will be given the opportunity to comment on the final legislative framework once the legislation has been drafted. Draft legislation is intended to be released for comment as part of the parliamentary process in 2012, for tabling to parliament in 2013. Implementation is likely to follow in 2013/14.