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Regulatory landscape and challenges facing the microinsurance industry

The insurance industry plays a pivotal role in protecting us against unforeseen events, and those that need it most are the lower income earning individuals. While these individuals represent the large majority of the South African population, affordability of relevant insurance products is a high barrier to entry for said individuals. At the turn of the century, most insurance cover, barring funeral cover, was held by policyholders representing the middle to upper class. It was clear that changes were needed to the highly regulated insurance sector, to better incorporate relevant and affordable products, that would protect the majority of South Africans while still proving to be commercially viable to insurers.

As a result, in 2008 National Treasury released a discussion paper titled "The Future of Micro-insurance Regulation in South Africa" which sought to develop a regulatory framework that would encourage and facilitate the provision of microinsurance. Following on from this, instead of introducing a separate legislative framework to regulate microinsurers, the Prudential Authority incorporated microinsurance regulations under the Twin Peaks regulatory framework with the Insurance Act. This outlined the prudential and product standards set out in rule 2A of the policyholder protection rules (PPR) and created a microinsurance category which reduced the barriers to entry to the insurance industry, while still providing protection to consumers.

The International Association of Insurance Supervisors defines microinsurance as a "protection of low-income people against specific perils in exchange for regular premium payments proportionate to the livelihood and cost of the risk involved". Microinsurance protects those that are most vulnerable in our society, namely the lower income market who, unlike their wealthier counterparts, tend to have a smaller safety net when disaster strikes.

The Prudential Standards set out both the framework for financial soundness of microinsurers (FSM) and the governance and operational standards for microinsurers (GOM). These standards aim to scale back the regulatory requirements when compared to the requirements for traditional insurers, to attract both the existing large industry players and new businesses. The cumulative effect is the ability to offer low-cost, yet effective cover across both life and non-life insurance product classes.

A high-level overview of these frameworks seeks to simplify the requirements of microinsurers and sets out the following:

1. The minimal capital requirements, which are designed to be a simple measure, have two elements:
   a. Fifteen percent of the greater of the amount of net written in respect of policies entered into -
      i. Twelve months preceding the current reporting date; or
      ii. Twelve months preceding the previous reporting date.
   b. An absolute minimum of R4 million.

2. A microinsurer is not required to have a risk and remuneration committee but must have an effective actuarial function capable of assisting the board of directors and responsible for expressing an opinion on the reliability and adequacy of the calculations of the microinsurer's technical provisions, and minimum and solvency capital requirements.

3. A microinsurer may not engage in fronting arrangements and is not allowed to reinsure or retrocede directly or indirectly more than 75% of premiums in respect of its life or non-life insurance business to one reinsurer.

4. The maximum amount for life and non-life insurance which may be underwritten by a microinsurer is R100 000 per life insured and R300 000 per policy, escalating annually by the Consumer Price Index (CPI) annual inflation rate.

5. Microinsurers can only issue a life or non-life insurance policy that provides for a loyalty benefit, no claim bonus or rebate in premiums with the approval of the Prudential Authority.

6. A microinsurer must annually, and when the risk profile of the microinsurer changes materially, or when so directed by the Prudential Authority, undertake an Own Risk and Solvency Assessment (ORSA).

Further to the above, the PPR sets out the following requirements:

1. All policies issued by a microinsurer may not have a contract term longer than twelve months and no variations are allowed within the first twelve months of the policy unless the insurer can demonstrate actuarial grounds for the change, or it is to the benefit of the policyholder.

2. A policy must at the end of the expiry date be automatically renewed.

3. Waiting periods are generally limited to three months or six months under certain circumstances and no waiting period is allowed following an accidental death, disability, or health event.

4. Claims must be paid, repudiated, or disputed within two business days after all required documentation has been received from the policyholder.

5. A microinsurance policy may only provide one standard excess per risk event covered under a particular class of non-life insurance business which may not exceed the lower of –
   a. Ten percent of the value of the policy benefits; or
   b. R1 000.

6. Commission is uncapped except for credit life at 7.5% and for motor policies with a sum insured between R120,000 to R300,000, at a rate of 12.5%.

To date, only nine microinsurance licences and one composite cell captive microinsurance license have been issued, which is below the envisaged target. While this can be used as a proxy for the growth in the microinsurance market, it can be misleading as many larger insurers already offer microinsurance products through their fully-fledged life or non-life insurance licensed operations.

Africa has historically had large gaps in its insurance coverage, where relatively few had insurance cover, were either underinsured or their insurance policy was misaligned to the actual insurance they needed. Even today access to and uptake of insurance cover across South Africa remains relatively low by global standards. Insurance penetration in South Africa has increased steadily over the last two decades with uptake increasing by approximately 7% for the period 2003 to 2021, mostly driven by funeral insurance cover. That being said, there has been a decrease in non-funeral insurance cover (life insurance and medical cover) with asset insurance remaining relatively flat over the past twenty years. Largely due to COVID-19, for the period between 2019 to 2021 there was a noticeable decrease in non-funeral insurance cover from 21% to 19% and funeral insurance cover from 53% to 42%.

Whilst insurance penetration is on the right trajectory, it is not yet accessible to the majority of the population in South Africa. However, I would like to remain optimistic that microinsurance will challenge this status quo in the coming years. The real challenges driving the lack of demand for microinsurance are a lack of awareness and financial literacy of what insurance is and the benefits it can provide, coupled with a general lack of trust in the industry and understanding the complexity of these products. This is evidenced by the large unclaimed reserves held by insurance companies and the relatively low claims/loss ratios observed across microinsurance products. However, evidence also suggests that as perception changes over time and policyholders understand and experience the benefits of insurance; the word spreads, gross premiums increase, claims ratios increase and the overall underinsured and non-insured gap becomes smaller.

Another challenge that is facing the microinsurance industry is finding sustainable, effective and far-reaching distribution channels. Profitability and financial viability in the insurance industry require economies of scale and diversification in products, business lines and policyholders to aggregate risk and provide value for money to policyholders. To tackle the challenge, insurers have developed new and unique distribution models to reach low-income individuals who are often situated in remote areas. These are most notably due to the rapid advances and accessibility of mobile technology to low-income individuals. The rapid increase in smartphone users has allowed insurers to reach remote populations with little to no acquisition costs or upfront expenditure. Other developments include the emergence of insurtech and mobile intermediaries who often understand the target markets better than traditional insurers and can offer useful services, from product development to administration. There are still some drawbacks though; premium collection and low claims ratios still seem prevalent and difficulties incorporating IT systems across insurers, administrators and other service providers are often misaligned, making it difficult to manage centrally.

While the regulatory reforms aim to lower the barriers to entry, the regulatory requirements still appear to be too cumbersome for the informal sector. For many, insuring with a community-based risk pooling businesses remains cheaper and is perceived as more trustworthy. Having said that, there are often few consequences for those managing community-run risk pooling mechanisms, who can avoid any regulatory requirements and often leave policyholders vulnerable, and the scheme open to fraud, corruption, and abuse.

The inclusion of a microinsurance category in the insurance regulatory universe is just the start and has allowed a framework for success and the opportunity to extend insurance cover across South Africa.

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