South African Case Study: Consumer Protection in Microinsurance

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How do we protect consumers?

- Prudential vs. market conduct regulation – blurring lines?
  - Sound risk management, transparency, fair treatment of consumers, effective recourse, plus role of competition?
- Understanding your market, understanding South Africa
  - Focus on access, black economic empowerment charter
  - Unregulated informal sector, opportunistic formal sector
  - Parliament notes abuses in 2003, policy debate asks
    - How to formalise illegal operators?
    - How to build the market?
  - 1/4 population unemployed, near 50% penetration rate BUT weighted by funeral cover (45%)
  - Recent expansion comes from formal not informal sector (up 20% to 39.6%)
    - Substitution formal for informal funeral products
    - Overall growth for short-term products (5% penetration)
    - Growth in demand for medical insurance

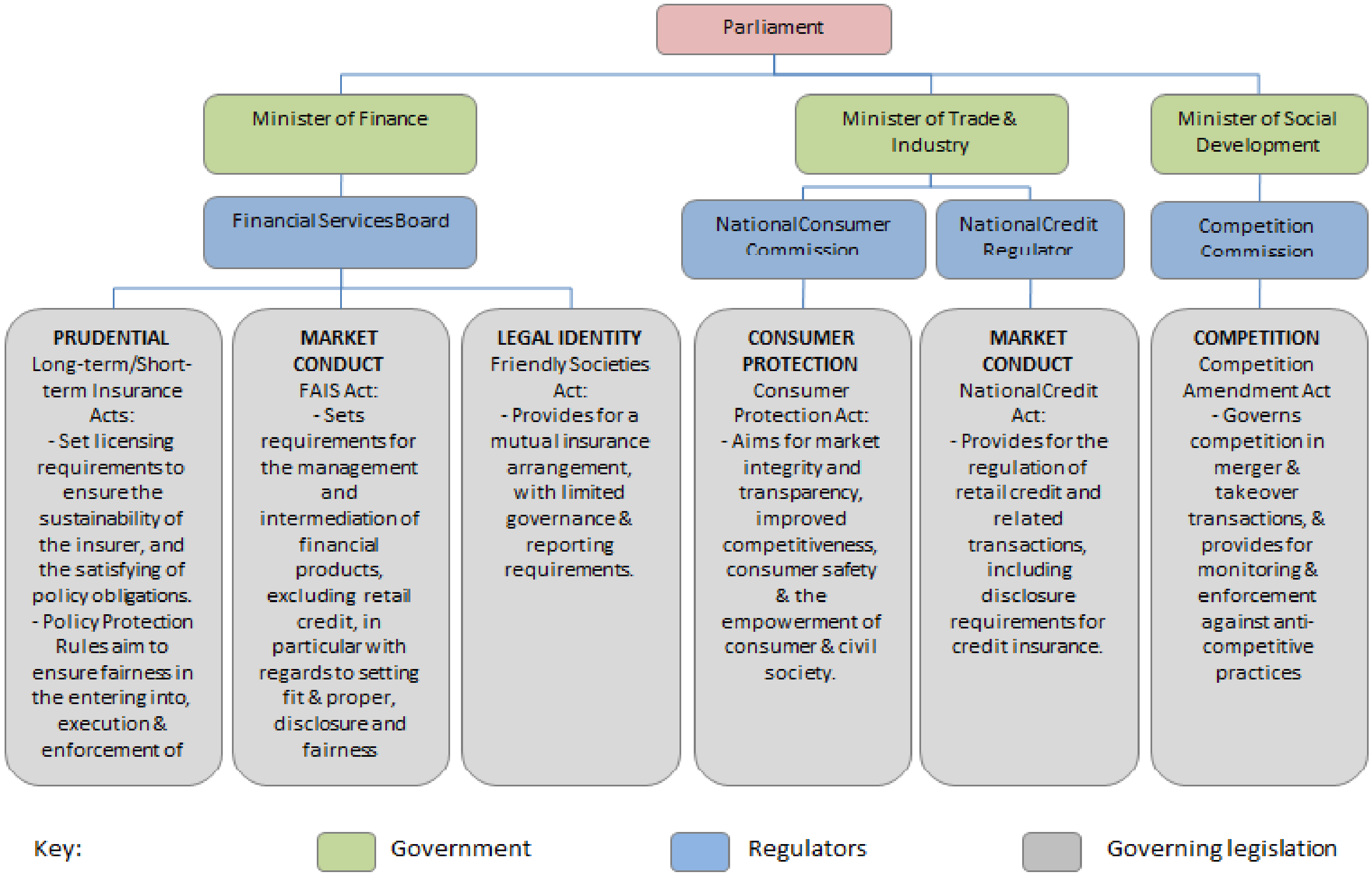
The South African microinsurance market

	No. of entities	No. of members / policyholders	Annual premium income	Policies issued (ave. size of benefit)	Regulatory requirements
Burial societies	Est. 150,000	Est. 6 million	Est. R6 billion	Funeral related (R5,000-R10,000)	None. May be registered as friendly society
Friendly societies (2008)	198 (107 exempt from submitting regulatory returns as <R100,000 contributions pa)	104,000 (this figure includes only those societies that have submitted returns)	R58 million (incl. only return submitting societies)	Mostly funeral, some education and savings (R7,500, the regulated maximum limit)	Friendly Societies Act
Funeral parlours	Est. 3,000-5,000 (approx. 1,500 registered with relevant health authorities)	Not available	Est. R5 billion (may be underwriter and/or intermediary)	Funeral (R18,000, the regulated maximum limit)	Long-term insurance Act, FAIS Act (as applicable)
Retailers (2008)	Approx. 2,700 dealers	11.7 million credit accounts, 3 million people have credit insurance. Only 1.15 million people in LSM 1-6 claim to have a credit contract, while only 710,000 claim to have a related insurance policy	Consumer credit insurance: R3 billion, funeral: unknown (may be underwriter and/or intermediary)	Est. consumer credit insurance - micro-loans (R5,000), vehicle financing (<R85,000), mortgages (<200,000), credit cards/loans (R10,000) Funeral (R18,000, the regulated maximum limit)	National Credit Act, Long-term Insurance Act, Short-term Insurance Act, FAIS Act (as applicable)
Insurers, LSM 1-6 only (2009/10)	Long-term assistance policies: 31, long-term other: not available, short-term: not available	Long-term: 9.6 million, short-term: <1 million	Long-term assistance policies: R4,2 billion, long-term other: not available, short-term: not available	Long-term assistance policies: R18,000, long-term other: not available, short-term: est. R10,000-R180,000 (determined by value of assets, mostly cell phone, legal & household structure/contents)	Long-term Insurance Act / Short-term Insurance Act, FAIS Act (as applicable)

Source: Data compiled from FSB 2010 Annual Report, FinScope 2010, National Credit Regulator 2010 Annual Report, and a 2008 report on Consumer Credit Insurance in South Africa

Regulatory landscape

FINMARK TRUST



Consumer protection concerns 1

Objective: *Appropriate affordable products, proportionately meet savings/risk needs – impact on mass market?*

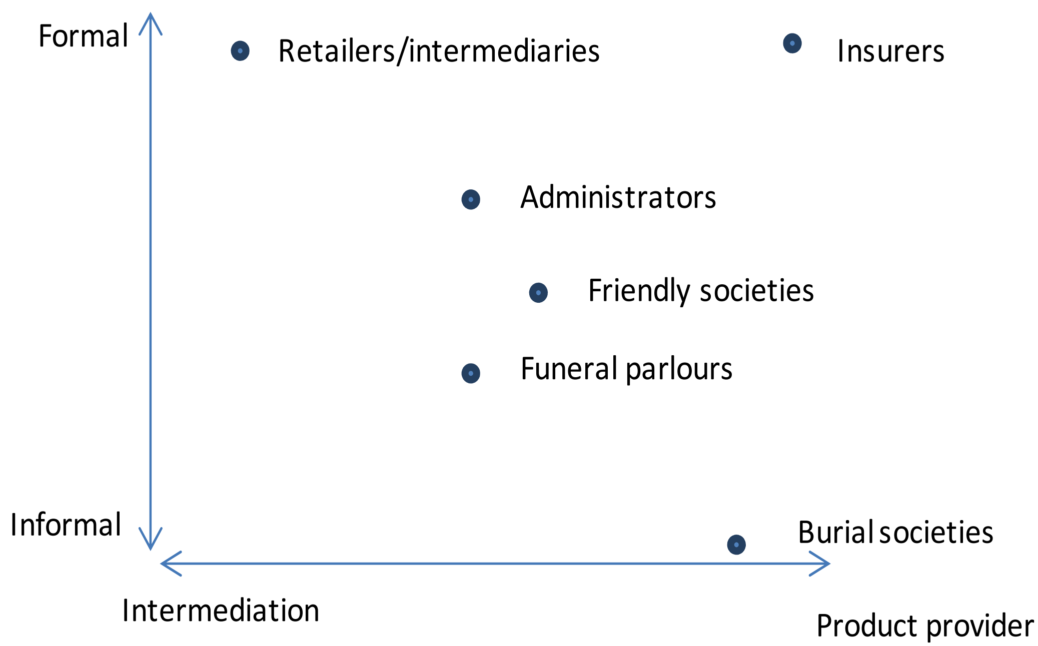
- Burial/friendly societies
  - Mutuality limits fraud but may be poor financial management
  - Stringent benefit limits erode competitiveness
  - Benefits to mutuality may break down in large societies
- Funeral Parlours
  - Insurance coverage a secondary purchase
  - Weak competition, consumer "ignores" price/value (no monetary benefit, pricing behaviour tends to exploitation, set funeral package)
- Administrators
  - Low transparency gives undue power to administrator
  - Prevalent "splitting of the book"
  - *Consider ombudsman case relating to Ms Kekana*

Consumer protection concerns 2

- Formal insurers
  - Long-term (life) insurance
    - Challenges relate to: product features, policy/premium guarantee period, paid up value, bundled products, funeral parlour linkages
  - Short-term (asset/general) insurance
    - Inconsistent/inappropriate terminology compounded by misleading marketing & complicated contracts, results in mis-selling & undermines comparability (& competition) – *see Dr Sithole, Mr Prins ombud cases*
- Intermediaries
  - Small/medium size entities struggle with regulatory compliance
  - Structure of market cont. support strength of administrators
  - "Off-the-shelf" products promote high lapse rates
  - Prevalent over- & mis-selling - *see Mrs Guma ombud case*

Protecting the poor – what has [NOT] worked?

- Decade of reform – Move to solvency II, FAIS/FSOS/NC Acts
- BUT consumers remain vulnerable, ombud cases increasing, consumers buying policies they don’t need and/or don’t understand. WHY?
- Consider degree of formalisation of market participants



Protecting the poor – what has [NOT] worked?

- See many different providers at differing stages formalisation (legality?)
- Institutional approach to regulation implies incomplete regulatory coverage & different regulatory standards
- In practice this means:
  - Regulatory requirements in too many instances incomplete, inconsistent, ignored
  - Resources available for compliance & enforcement stretched
  - Recourse options unknown, confusing or unavailable

The long term view – a regulatory response

- Policy design process, remember purpose, informed by market failures, transparency through inclusive engagement
- Relies heavily on product & regulatory standardisation
- All providers & intermediaries brought under net onto level playing field; principle of proportionality is key
- Combine prudential & market conduct requirements to cohesively support better protection of consumers, taking account SA strengths/weaknesses. Holistic view.
  - Theme 1 – Coordinating prudential & market conduct regulation
  - Theme 2 - Connecting insurance regulatory requirements with broader regulatory & tax frameworks
  - Theme 3 – Critical role of regulatory enforcement
  - Theme 4 – Critical role of consumer education & recourse

Benchmarking against the standard

	The regulatory status quo	The planned policy
Sound risk management and governance	Good risk management & governance requirements for registered insurers, but gaps in regulatory coverage esp wrt funeral parlours & friendly societies. Coops not accommodated.	Full regulatory coverage & level playing field. Reduced upfront capital requirements, simplified reporting & corporate governance requirements to promote regulatory compliance & broader [lawful] participation in the market, supporting competition.
Transparency	FAIS Act imposes minimum disclosure standards but differ st legal form of provider. Consumers do not understand product terms and conditions. Poor compliance by intermediaries of regulatory requirements.	Standardised & simplified requirements, tailored to proportionately meet risks associated with regulated microinsurance product, to facilitate regulatory compliance & improve product understanding.
Fair treatment of consumers	FAIS Act imposes market conduct standards that differ depending on legal form of provider. Problems remain with obtuse policy wording, lack of understanding of product terms, poor-compliance by intermediaries of regulatory requirements.	Standardised & simplified requirements, tailored to proportionately meet risks associated with regulated microinsurance product to improve conduct & compliance. This complimented by "Treating Customers Fairly" strategy. Targeted consumer education campaign to hold insurance providers & intermediaries accountable.
Effective recourse	Although required of regulated entities, poor regulatory coverage & enforcement challenges mean that for much of the market consumer recourse channels do not exist or, if they do, are ineffective.	Full regulatory coverage and level playing field for insurance providers to ensure all consumers, irrespective of provider, have recourse mechanisms available to hold wrongdoing accountable. Simplified standardised policy wording to better inform consumers of rights and channels to hold the provider accountable. Targeted consumer education campaign, & inter-agency enforcement campaign addressing prudential, market conduct and tax issues, across the market spectrum, at provider, administration and intermediation levels.

Benchmarking South Africa's present and future microinsurance regulation against desired consumer protection

Lessons learnt by the policymaker

- Understand the market
  - Participation on demand & supply side, its functioning & failure, should inform mischief to be addressed, & will assist policy prioritisation
- Know what you want
  - Clarify policy objectives which may be "competing"
- Acknowledge change
- Prioritise stakeholder engagement
- Obtain political buy-in & get the process right
- A holistic solution
  - Gov's broader policy framework eg tax, idiosyncrasies of local market, dif. reg. response options, international standard setters, shared country experiences
- Balancing policy trade-offs
  - Consumer protection measures may have transaction costs, potentially working against inclusion efforts

Thank you