TO MICROINSURE OR NOT?

An Overview of the Microinsurance Regulatory Environment in South Africa.

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ISSUE 01 | OCTOBER 2018
Whilst the South African insurance market is by some measures one of the most advanced in the world\(^1\) and the country boasts high insurance penetration relative to other countries, the insurance market itself is faced with specific challenges. Comprehensive financial inclusion remains a challenge with a high proportion of the population being uninsured\(^2\) or underinsured. In addition, the South African insurance market is characterised by a unique feature in that it is split into a formal and an informal sector. A significant portion of the insured population’s insurance cover is funeral cover (particularly the informal sector’s) but there is lower emphasis on often necessary non-funeral insurance solutions\(^3\).

To promote better access to affordable insurance products that meet the needs of potential policyholders and to increase financial inclusion for all South Africans in the formal sector in an environment with augmented consumer protection, the Microinsurance Regulatory Framework was developed. This culminated in a new class of insurance under the Insurance Act 18 of 2017 (the Insurance Act).

Whilst the Microinsurance concept itself is not new (existing insurers already offer products that would qualify as Microinsurance), the new distinct Microinsurance class comes with specific regulatory, product design and governance features for insurers that will register under the Microinsurance category.

The Microinsurance Network defines Microinsurance as “insurance services offered primarily to clients with low income and limited access to mainstream insurance services and other means of effectively coping with risk”\(^4\).

The target market generally comprises of individuals with little to no savings, low valued assets and often encompasses individuals who have had no previous access to insurance products in the formal sector.

Because of these characteristics, this market segment demands, amongst other things, unique approaches in terms of product standards as well as regulatory statutory and governance considerations when compared to the mainstream insurance market.

The key characteristics of the licencing process, regulatory product standard requirements, statutory valuation approach and governance requirements for Microinsurers are summarised below.

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### 1. The Microinsurance License

#### Who is eligible?

A Microinsurance license can be obtained by profit or non-profit companies registered under the Companies Act 71, 2008, as well as co-operatives registered under the Co-Operatives Act 14, 2005. This is in contrast to other insurance licenses, which can only be obtained by public or state-owned companies as well as co-operatives.

#### Which product types are covered?

Microinsurers will be able to offer both life as well as non-life Microinsurance products under the same licence, with the products themselves being restricted to the following classes of business as further defined in the Insurance Act:
The notable absentees are fund as well as savings and annuity type business on the life side, and commercial lines and classes not expected to fall within the typical Microinsurance target market on the non-life side.

The reduced product scope relative to the complete suite of insurance products talks to the features of the Microinsurance target market, as well as objectives of the framework.

<table>
<thead>
<tr>
<th>Life Insurance</th>
<th>Non-Life Insurance</th>
<th>Personal Lines</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Risk Business</td>
<td>• Motor</td>
<td></td>
</tr>
<tr>
<td>• Credit Life</td>
<td>• Property</td>
<td></td>
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<tr>
<td>• Funeral</td>
<td>• Agriculture</td>
<td></td>
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<tr>
<td>• Reinsurance (as applicable to the included classes)</td>
<td>• Legal Expense</td>
<td></td>
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<tr>
<td></td>
<td>• Consumer Credit</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Accident and Health (individual)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Liabilities (only to the extent that related to included classes)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Reinsurance (as applicable to the included classes)</td>
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</tbody>
</table>

2. Microinsurance Product Standards

The above-mentioned insurance classes in isolation do not classify a policy as a Microinsurance policy. Further product standards are assigned via the Policyholder Protection Rules (Long-Term Insurance), 2017 in terms of Section 62 of the Long-Term Insurance Act of 1998 and the Policyholder Protection Rules (Short-Term Insurance), 2017 of Section 55 of the Short-Term Insurance Act, 1998 (collectively referred to as the PPR’s).

**Contract terms**

Microinsurance policies may not have a contract term of more than 12 months, with automatic renewal or termination after the initial contract term.

**Benefits**

The benefits offered under Microinsurance products are subject to the following limits (prescribed by the Prudential Authority in Prudential Standard GOM):

- Life insurance: a maximum benefit of R 100 000 per life insured, escalating annually at CPI (from 1 July 2018)

- Non-life insurance: a maximum benefit of R 300 000, per policy, escalating annually at CPI (from 1 July 2018)

Unless otherwise approved by the Prudential Authority, Microinsurers may also not issue policies with loyalty benefits or no-claims bonuses and short-term insurance policies may not provide that any benefits are subject to the Principle of Average. Where benefits are expressed as anything other than a sum of money, a
Microinsurance policy must enable the policyholder to receive a fixed sum of money in lieu of the relevant benefit and state such fixed sum of money. Where this is not possible, additional requirements apply.

Life insurance Microinsurance policies may not prescribe that the benefits payable as a sum of money are payable directly to a service provider.

**Reviewability**

The terms, conditions or provisions of a Microinsurance policy may not be varied in the first 12 months unless the variation is to the benefit of the policyholder or there are actuarial grounds to do so. Upon variation, the relevant Sections of the Policyholder Protections Rules (PPR’s) apply.

Where policies are underwritten on a group basis, the insurer may not selectively cancel or decline to renew individual policies.

**Waiting periods**

Waiting periods on death, disability or health events for Microinsurance policies are limited to 6 months. No waiting periods may be imposed on death, disability or a health claim due to accidental causes and waiting periods may not be re-imposed on renewal.

In addition, no waiting periods are to apply where the policyholder had cover for similar risks with the same or another insurer at least 31 days prior and had completed the waiting period under the previous policy. Where the previous waiting period had not yet been completed, the new policy can allow for the remaining unexpired waiting period (provided risks are similar).

**Exclusions**

No exclusions for pre-existing health conditions are allowed under Microinsurance policies in the Funeral class of the Insurance Act and suicide exclusions for all relevant Microinsurance policies are limited to 12 months.

The PPR’s prescribe the exclusions that can be applied to Microinsurance policies covering non-life benefits that have an aggregate benefit value of R120,000 or less and set out the principle that is to be applied for additional exclusions on aggregate benefits values in excess of R120,000.

**Excess under non-life benefits**

Microinsurance policies may only provide one standard excess per risk event covered, with the following limits (escalating at CPI):

- Aggregate value of policy benefits <= R120,000: Min(10% of benefit payable, R1,000)
- Aggregate value of policy benefits > R120,000: Limited to a maximum of 10% of the benefit payable

**Reinstatement**

Reinstatements after lapse must be on at least the same terms as the original policy, with further restrictions on waiting periods.

**Claims**

Microinsurers need to act quickly on claims, with claims decisions having to be reached within 2 business days after receipt of the claims information.
**Reporting of a New Product**

The Policyholder Protection Rules require that Microinsurers inform the Authority of the intention to launch a new product at least 31 days prior to launch. This will be accompanied by:

- Summary of benefits, exclusions and conditions
- Proposed commission
- Advertising material

These requirements also apply to any material change in product design, including a change to the benefits or terms or conditions under an existing policy.

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**3. The supervision of Microinsurers**

**Reporting requirements and Financial Soundness Standards**

Like all insurers, Microinsurers will also have to undergo an annual audit, submit audited annual returns and unaudited quarterly returns to the Prudential Authority.

Whilst Microinsurers must also at all times maintain a financially sound condition by holding eligible own funds that are at least as high as the prescribed capital requirements, their statutory reserving and capital requirements do not follow that of other insurers but have been tailored to reflect the underlying characteristics of the products.

IFRS 17 will also be applicable to Microinsurers, with the main calculation method expected to be the Premium Allocation Approach.

**Types of Assets**

Microinsurers may only invest in cash, cash equivalents and investment funds restricted to money market funds. An application can, however, be made to the Prudential Authority for a wider investment allocation.

**Asset Spreading**

Only 25% of a Microinsurer’s total net of reinsurance liability and capital requirements invested in any one financial institution are recognisable as an asset for the purpose of determining eligible own funds. Any excesses above this are not recognised for solvency purposes unless approval has been obtained from the Prudential Authority. Applications to exceed this limit will be dealt with on a case by case basis.

Deferred taxes are not recognised as either an asset or a liability and are to be valued at nil.
**Technical Provisions**

The method for calculating technical provisions (policyholder liabilities) for Microinsurance policies are prescribed and made up of the following components:

- Unearned Premium Reserve (UPR)*
- Outstanding Claims Reserve (OCR)
- Incurred But Not Reported Reserve (IBNR)**
- Unexpired risk provision (URP)

*Calculated using a prescribed formula  **Minimum % of premium prescribed

Reinsurance is allowed for on a consistent basis, without a requirement to adjust for counterparty default in the standard formula.

A Microinsurer may apply to the Prudential Authority to use a different methodology or underlying parameters where this is a better reflection of the value of technical provisions. Similarly, the Prudential Authority may require the same.

**Capital Requirements**

The Minimum Capital Requirement (MCR) is based on the maximum of:

- The absolute minimum floor of R4 million and
- 15% of the greater of the amount of net written premiums in respect of policies entered into:
  - 12 months preceding the current reporting date; or
  - 12 months preceding the previous reporting date.

Where Microinsurers apply to the Prudential Authority to invest excess assets in assets not comprised of cash, cash equivalents or money market funds, additional capital requirements to capture market risk may apply.

Additional requirements apply to cell captive Microinsurers.

**Governance and Operational Standards**

The Governance and Operational Standards for Microinsurers (GSMs) are aligned to the principles applicable for all insurers, but are applied in a proportionate manner, taking the features applicable to the Microinsurance environment into account. Whilst stringent governance requirements still apply to Microinsurers, these are not as onerous as those for the other insurers. A summary of the main requirements is given below:

- No need to establish a separate risk or remuneration committee, if the relevant function is performed by the board or another appropriate committee of the board,
- Where an insurer’s board of directors needs to review the adequacy and effectiveness of the insurer’s governance framework at least annually, this requirement is reduced to every three years for Microinsurers.
- Similarly, the requirement to review the effectiveness of the board of directors in relation to discharging its roles and responsibilities is reduced from annually to every 3 years.
- The minimum requirements for Microinsurers’ control functions are limited to an internal audit and actuarial function. Other insurers also require a risk management and compliance function.
• A comparison of the minimum board-approved risk management policies that Microinsurers need to have compared to other Insurers is given in the table below ("X" – required as a minimum):

<table>
<thead>
<tr>
<th>Policy</th>
<th>Microinsurer</th>
<th>Other Insurers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset-Liability Management</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Capital Management</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Concentration</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Credit</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Fitness and Propriety</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>IT</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Insurance Fraud</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Investment</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Liquidity Management</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Operational</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Outsourcing</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Reinsurance and Other Forms of Risk Transfer</td>
<td>X*</td>
<td>X</td>
</tr>
<tr>
<td>Remuneration</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

• Microinsurers’ ORSA requirements are also less onerous, with the main differences being as follows:
  - Financial soundness is only required to be assessed on the regulatory basis (i.e. an economic basis assessment is not required)
  - Other insurers need to assess at a minimum the risks arising from underwriting, credit, market, operational and liquidity, as well as any material additional risks arising from the insurer’s activities and operations and group risk. The ORSA requirement for Microinsurers, on the other hand, is scoped to the latter two, encompassing the reasonably foreseeable and relevant material risks arising from the Microinsurer’s activities and operations, and risks resulting from the Microinsurer being part of an insurance group.

• The responsibilities of a Microinsurer’s Actuarial Function are reduced mainly as a result of the proportionate reporting and governance requirements.

• Whilst the Head other insurer’s Actuarial Function must be a fellow of the Actuarial Society of South Africa (ASSA), a Microinsurer’s Head of Actuarial Function can also be an Associate Member of ASSA.
To Micro insure or not to Micro insure?

The introduction of the new Microinsurance license and regulation brings new possibilities for both policyholders and insurers:

- opportunity for new and existing insurers to tap into this segment of the market by lowering capital and prudential requirements, whilst still maintaining effective supervision;
- opportunity to sell both life as well as non-life products under one license;
- allows for greater competition by making it easier for more entities to become Microinsurers, which should result in greater innovation and competitive premiums for policyholders;
- introduces consumer protection in a sector where regulation was previously absent (where previously unregistered entities will now apply for a license).

A factor standing between these opportunities and their realization is the trust deficit that exists between the low-income population and the formal insurance sector, as well as possible risk aversion on the part of insurers. For the Microinsurance regulation to achieve its objectives, low-income policyholders need to be willing to move from the informal sector to the formal one, which requires trust to be established between the two parties and insurers need to be willing to create and sell products in this market.

Existing insurers can continue to offer Microinsurance type products using their current licenses, however should they wish to offer composite Microinsurance products or gain from the regulatory framework applicable to Microinsurers they will need to apply for a new Microinsurance license or convert their existing license to a Microinsurance one. Some of the PPR product standards applicable to Microinsurance products also apply to Funeral policies even if written on a Funeral licence and insurers have until 1 July 2021 to comply.

The decision of whether to acquire a Microinsurance licence is likely to be unique to each insurer - the various implications of product standards, regulation and governance standards will play out differently for each insurer and considerations will extend beyond the prudential aspects of the Microinsurance framework.

If you would like to discuss any aspects of this article further please contact the author.

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2. According to FinScope South Africa 2017, only 58% of adults are insured

3. FinScope South Africa 2017 estimates the proportion of adults insured for non-funeral cover at 22%

4. https://microinsurancenetwork.org/microinsurance/key-concepts

5. UPR - the amount equal to the sum of premiums corresponding to the time period remaining on a policy as at the valuation date and must be calculated at a policy level. OCR- the amount which the Microinsurer estimates will become payable in respect of claims incurred under policies which are reported but not yet fully paid IBNR- the amount which the Microinsurer estimates will become payable in respect of claims that have been incurred but have not been reported to the Microinsurer. URP - the amount required to cover the excess of the reserve required to cover the expected claims and expenses over the UPR.