Micro Insurance

Thought Leadership

July 2021

Building a better working world

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> "Microinsurance products offer coverage to low-income households or to individuals who have little savings. It is tailored specifically for lower valued assets and compensation for illness, injury, or death"
> - Investopedia

Why is it important?

Financial inclusion is a topic that is high on everyone's agenda. Research done by the Organisation for Economic Cooperation and Development (OECD) in 2017 showed a huge insurance gap in developing countries. Those with lower income levels could not afford and could not access traditional insurance products.

Where access to insurance was previously seen as a luxury, various working groups have been working hard to ensure that the vulnerable are educated to understand that insurance is a necessity and access to it should be afforded to all. Micro insurance aims to bridge this inequality gap.

How is micro insurance regulated in South Africa?

> "16.99% - the insurance penetration rate in South Africa"

In 2008, National Treasury issued a discussion paper which was developed to address the low penetration levels of insurance products among low-income earners in South Africa. This has resulted in further discussions on introducing a regulatory framework for Micro Insurance in South Africa.

When the Insurance Act, No.18 of 2017 was enacted, it introduced Micro Insurance as a class of business in South Africa. This class of business can only be provided by persons who are licensed to do so.

Micro Insurance is regulated in the same manner as which Life and Non-Life insurance is regulated - through the Insurance Act, the Short-term Insurance Act (STIA) and the Long-term Insurance Act (LTIA). The Prudential Authority (PA) is responsibility for prudential supervision of micro-insurers while the Financial Sector Conduct Authority (FSCA) supervises from a conduct perspective.

In terms of prudential supervision, the PA has developed the Prudential Standards for Micro Insurance. This entails:

- A minimum capital requirement of 15% of net written premiums with an absolute minimum capital requirement of R4 million;
- Classes of business that may be offered are long-term, short-term and reinsurance;
- A micro-insurer cannot reinsure or retrocede more than 75% of premiums to one insurer;
- ORSA is only required if a material change is made to the risk profile or on request from the PA. The insurer must have a head of actuarial and head of internal audit function, however no risk or remuneration committee is required. The board is required to evaluate performance and monitor the governance framework every 3 years;
- Micro-insurers will also have to go through an annual audit, submit audited annual returns and unaudited quarterly returns to the Prudential Authority. IFRS 17 will also be applicable to micro-insurers, with the main calculation method expected to be the Premium Allocation Approach.

Rule 2A of The Policyholder Protection Rules under STIA and LTIA set out the Micro Insurance Product Standards, which Micro Insurance providers should consider when developing their products. These are discussed in detail in the Key Features section below.

The Governance and Operational Standards for Micro Insurers (GOM) are aligned to the Governance and Operational standards for Insurers (GOI), however, it takes the specific features of Micro Insurance into account.

Licensing requirements

Applicants must be a profit company, or a non-profit company, registered under the Companies Act, or a co-operative registered under the Co-operatives Act.

The applicant's primary business activity must be the conducting of insurance business and operations arising directly therefrom.

The applicant must demonstrate that:

(i) its key persons and significant owners meet the prescribed fit and proper requirements;

(ii) it has a sound business plan;

(iii) it has a plan to meet its stated commitments in terms of transformation of the insurance sector, including meeting the targets envisaged by the Financial Sector Code;

(iv) it has adequate operational management capabilities to conduct the classes and sub-classes of insurance business set out in Schedule 2 that it wishes to conduct;

(v) if it is a branch of a foreign reinsurer and the requirements imposed by the foreign jurisdiction in which the institution is authorised and supervised have not been determined as equivalent to this Act under section 65, the laws of the country under which the institution is authorised and supervised establish a regulatory framework equivalent to that established by this Act;

(vi) if it is part of an insurance group, that its controlling company will be able to meet the requirements for insurance groups as set out in this Act; and

(vii) it will be able to comply with the governance framework requirements, financial soundness requirements and reporting and public disclosure requirements of this Act.

Key Features of Micro Insurance in South Africa

> "The most significant difference between conventional insurance and micro insurance is the size of the premium and the insured amount. Premiums and/or coverage limits are typically low and paid in sporadic instalments because of the irregular income streams of the insureds."

As required by the PPR Microinsurance Product Standards, the key feature of Micro Insurance include:

- Benefits offered are limited to risk only and cannot have a surrender or investment value;
- Policies are limited to R100 000 for life insurance and R300 000 for non-life insurance.
- Rider benefits cannot be more than 20% of the total primary insurance obligation under a policy;
- Micro insurance policies must have a contract term of not more than 12 months.
- Waiting periods are 3 months in the case of death due to natural causes i.e. it can not be more than a quarter of the contract term. There is no waiting period for accidental death, renewed or replacement policies.
- Exclusions are only permitted for non-funeral products and may not exceed 12 months for suicide. Exclusions are not permitted for pre-existing health conditions for funeral products.
- Claims must be finalized within 2 business days after all required documentation is received.
- Commission across all microinsurance products is uncapped except for credit life products.

In addition,

- Insurers may impose only one standard excess per risk event covered which may not exceed 10% of the benefit or R1 000, whichever is lower.
- No loyalty benefits may be offered without the approval of the Prudential Authority.

Delivery models

Microinsurance is typically delivered in 4 ways:

- **Partner-agent model**
  A partnership between the micro-insurer and an agent i.e. intermediary, where the insurer designs and develops the product and is responsible for the underwriting, and the agent provides marketing and delivery to clients.
- **Full-service model**
  The micro-insurer is responsible for design, development, marketing and delivery of the product.
- **Provider-driven model**
  The policyholders can pay premiums directly to the service provider e.g. a hospital, who takes on the responsibility of design, development and delivery of the service to policyholders.
- **Community-based/ mutual model**
  The policyholders are responsible for all aspects of the scheme, effectively being both the insurer and insured.

In the African context, microinsurance is mainly delivered via financial or microfinance institutions. Brokers and/or agents remain a key feature in selling products to clients.

While the use of Mobile Network Operators (MNOs) gained momentum in the past, the use of MNOs has started to decrease due to the limitations on the range of products an MNO might offer.

Mobile money has made payments of premiums much easier in non-developed countries. While customers in these regions may not always have access to banking services, mobile money has helped by allowing people to store money in mobile wallets. Certain regions also allow for automated deductions from these mobile wallets.

What is the opportunity/ benefit for insurers?

In countries such as South Africa, where a large segment of the population cannot afford traditional insurance products, insurers who offer microinsurance have a significant market to tap into. Additionally, if microinsurers are innovative in their approach and use mobile technology to reach their customers and deliver their products, they will grab the attention of those customers who traditional insurers cannot reach.

While profitability is a major driver of insurers, environmental, social and governance factors are also becoming a focal topic globally. The social responsibility aspect ties in directly with the focus on financial inclusion, especially on the African continent. By providing affordable insurance products to people who really need it, insurers are making a positive contribution to society.

Global regulatory landscape/context

According to the Insurance Information Institute (III), developing countries are seeing a growing number of insurers make their way into the insurance market through microinsurance projects.

In its online article titled "Background on: microinsurance and emerging markets", the III notes that, as a result of limited growth prospects in the insurance market in developed countries, insurers see the potential in emerging economies for growth and profitability.

Global initiatives and studies

There are various global initiatives aimed at promoting microinsurance and ensuring that the lower income segment of society is provided with access to the insurance products they typically would not be able to access or afford. One example of this is the Blue Marble Microinsurance Group whose mission statement, according to its website, is to "provide socially impactful, commercially viable insurance protection to the underserved". They have various programs in Africa and Latin America through which they are addressing financial vulnerability. Their very first initiative was a project launched in 2016 in Zimbabwe. This project was aimed at providing affordable crop insurance to smallholder farmers in Zimbabwe. The Group is currently expanding and adapting these solutions across Africa by applying the learnings from the Zimbabwe project.

Another significant global organization is the Microinsurance Network, a nonprofit organization made up of 80 members from over 40 countries. The Network believes that "access to responsible insurance is essential to sustainable development and global well-being and is key to achieving financial inclusion".

The Network conducted a study called "The Landscape of Microinsurance 2020" in which 194 insurance providers across 27 countries in Africa, Asia, Latin America and the Caribbean participated. The study, based on data from 2019, included the following findings:

- Across the 27 countries, the 194 insurers have provided between 41 and 102 million people with microinsurance products in 2019, which represents between 3% and 7% of the low- and middle-income population of these countries;
- A total of USD 1,060 million was collected in premiums, which makes up about 5% of the estimated potential market for microinsurance in these countries;
- It was found that across all these regions, life and credit life microinsurance products were most popular, while there was also significant take up of personal accident and funeral products;
- Africa and Asia have shown that another key microinsurance offering in those regions are low-cost health products, particularly hospital cash products;
- There have been significant developments in regulations across all these regions, with regulators supporting innovation in the microinsurance sector. Tools such as regulatory sandboxes are being used to foster digital innovation and financial inclusion;
- The use of microinsurance licenses to regulate this market is becoming more popular and is currently being used in South Africa;
- The use of cell captives as an option to ease formalization and entrance into the microinsurance market is gaining popularity. It is currently being used in South Africa and is being explored by other countries such as Ghana.

Microinsurance in Africa

The highest penetration of traditional insurance among countries on the continent are South Africa and Namibia, which had penetration rates of 13.4% and 10.44% respectively in 2020. While a few other countries such as Mauritius, Namibia, Zimbabwe and Lesotho have insurance penetration rates of between 4% and 7%, more than half of African countries have rates lower than 2%. These low penetration rates have been upended by the emergence of microinsurance.

A key feature that helped make microinsurance popular is the ability of micro-insurers to deliver their products to customers via mobile phones, which is cost effective and allows the insurer access to a segment of society that often only have mobile phones to access technology.

The Microinsurance Network study indicates that, out of 11 countries surveyed in Africa (Cote d' I'voire, Ghana, Kenya, Egypt, Morocco, Nigeria, Rwanda, South Africa, Tanzania, Zambia and Zimbabwe), between 9.1 million and 28.3 million people were covered by microinsurance products.

In Ghana, market conduct regulations were issued for microinsurance and mobile insurance in 2013 and 2017 respectively.

Kenya has included a definition of microinsurance in its insurance regulatory law. The introduction of this definition will allow for the issuing of separate regulations on microinsurance in the future.
The Kenyan Regulator has published regulatory guidelines have been in place for microinsurance product approvals since 2017.

How can EY Help?

EY has a dedicated Financial Services Consulting practice, which includes Risk Management, Technology, Process and People. This gives us deep industry knowledge in all aspects of the financial services industry, allowing us to tailor integrated solutions to our clients' specific needs.

Our Financial Services Risk Management (FSRM) consulting practice, has experience with financial services companies and regulators in various jurisdictions, and comprises of a variety of skills across the insurance and banking sectors. We combine local regulatory and legislative knowledge with best practices in global prudential regulation as well as governance, risk and compliance (GRC).

Through our fully integrated global Prudential, GRC and Actuarial networks, we ensure that we are at the forefront of global regulatory developments. We leverage this to approach compliance and risk management not only from a regulatory perspective, but also from a strategic perspective.

Market Conduct:

The FSRM team can assist in helping financial services organisations design their interactions with customers and counterparties, to deliver fair outcomes and market integrity, and effectively manage associated regulatory, reputational and strategic risks. We can do this by:

- Assisting our clients with the design and development of market conduct and organisational frameworks, and assist in implementation thereof, and
- Performing gap analyses against the regulatory requirements and benchmarking compared to local and global practice of existing market conduct frameworks.

Governance, Enterprise Risk and Compliance:

Within the GRC space, our FSRM team can assist in:

- Reviewing Governance Policy and Control Adequacy,
- Assessing the maturity of Risk / ERM and Compliance,
- Functions (including benchmarking to best practice),
- Developing or assessing 3rd Party Risk and Binder Risk Management Frameworks,
- Designing, implementing or enhancing Credit Risk Frameworks,
- Establishing ESG governance frameworks and design disclosure,
- Developing, implementing or enhancing Model Risk Management,
- Setting up or reviewing Recovery and Resolution Planning,
- Assisting in preparing for the requirements under the Financial Conglomerate Supervision/ Regulation,
- Assisting in selecting GRC solutions and implementing these, and
- Establishing and management of Regulatory Inventories and risk controls.

Prudential Risk:

The services offered to banks and insurers include:

- Reviewing Regulatory Capital Requirements (BA Returns and Quantitative Returns),
- Reviewing or performing ICAAP/ORSA,
- Assisting in Capital and Balance Sheet Optimisation/Management,
  - Developing Economic Capital models,
  - Performing reviews of Pillar 3 Requirements for Banks,
  - Supporting in IBOR/JIBAR transition implications and preparation,
  - Optimisation of overall financial resources

EY can assist with defining the prudential regulatory framework and the pro-active strategic response to mitigate the implications of these regulations on key financial indicators.

EY's global regulatory network leverages regulatory knowledge on an international scale. We can support our clients in understanding and addressing the most critical financial and compliance impacts for their business as a result of regulatory change, and help them to implement solutions on a cross-border basis to support compliance wherever they operate.

In today's environment of heightened and evolving regulation and structural changes, our professionals can work side by side with our clients to interpret new rules as they are issued. Through this collaboration, any compliance and operational changes that are required can be identified quickly and processes can be established to implement them efficiently.

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Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

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