INCLUDING THE EXCLUDED: THE POTENTIAL OF MICROINSURANCE TO PROVIDE LOW-INCOME EARNERS WITH ACCESS TO FINANCIAL PRODUCTS

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ABSTRACT

In a developing country such as South Africa many individuals remain excluded from formal financial products and services. In recent years the debate regarding economic growth has expanded to include the notion of financial exclusion as a barrier to economic development along with the need to build an inclusive financial system.

Reforms that promote financial inclusion are increasingly at the forefront of the international development agenda for policymakers and development institutions. In South Africa there have been a number of recent overhauls of the policy and framework in the financial services industry, chief among these is the microinsurance regulatory framework.

This paper seeks to evaluate microinsurance as a legal concept and investigate whether microinsurance has the potential to provide low-income earners with access to financial products.

In doing so a definition of microinsurance is established by canvassing various incarnations of the concept both locally and further afield. To evaluate the role of microinsurance as a formal financial service, the level of current financial inclusion amongst South Africans is evaluated. This is followed by an overview of all the recent regulatory and framework developments in the financial services sector. A discussion on microinsurance product innovation and distribution follows and an opinion is fashioned on the potential of microinsurance to assist in alleviating poverty and enhancing financial inclusion.

The paper concludes by stating that the law has a major role to play in bringing about change. The introduction of the microinsurance legal principles will indeed provide low-income earners with access to financial products and assist in the goal of financial inclusion. However, it cannot take on this mammoth task alone. In conclusion it is stated that if we are to see significant growth in financial inclusion and the financial sector as a whole, microinsurance needs to be fully integrated with other financial products and services such as microfinance and simplified banking, as once these mechanisms are combined they will prove to be much more effective in achieving the goal of financial inclusion.

LIST OF ABBREVIATIONS

ASISA	Association for Savings and Investments South Africa
CENFRI	Centre for Financial Regulation and Inclusion
FAIS	Financial Advisory and Intermediary Services Act
FSB	Financial Services Board
LTIA	Long-term Insurance Act
SADC	Southern African Development Community
SAM	Solvency Assessment and Management
SAMLJ	South African Mercantile Law Journal
SARB	South African Reserve Bank
SASSA	South African Social Security Agency
STIA	Short-term Insurance Act
TCF	Treating Customers Fairly
THRHR	Tydskrif vir Hedendaagse Romeins-Hollandse Reg
UK	United Kingdom

CHAPTER 1

MICROINSURANCE AND FINANCIAL EXCLUSION DEFINED

1.1 Introduction and problem statement[1]

In a developing country such as South Africa many individuals remain excluded from formal financial products and services. In recent years the debate regarding economic growth has expanded to include the notion of financial exclusion as a barrier to economic development along with the need to build an inclusive financial system.[2] Reforms that promote financial inclusion are increasingly at the forefront of the international development agenda for policy makers and development institutions.

South Africa has recently introduced large overhauls of the policy and framework of the financial industry. This includes the development of the microinsurance regulatory framework which has occurred against the backdrop of a host of wider regulatory reforms which include Solvency Assessment and Management (SAM), Treating Customers Fairly (TCF), as well as the Twin Peaks regulatory reforms.

The task of increasing financial inclusion for a large portion of the population who remain excluded from formal financial services is therefore a major challenge that needs to be tackled. The microfinance industry has made great strides in proving low-income individuals with access to financial products, however the task of financial inclusion cannot be left solely to one industry.

As one of the mechanisms with the potential to achieve this task, microinsurance has been considered as the next revolution in addressing risks and vulnerability in low-income markets.[3] Globally, massive investments have been made in the last decade by many development agencies in this revolutionary mechanism that has the potential to break the circle of poverty and offer reliable protection to the poor.[4]

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1 Due to the nature and discipline of this dissertation a conventional comparative analysis was not possible. Therefore various sectors from different jurisdictions will be analysed throughout the chapters.

2 Ardie, Heimann and Mylenko "Access to financial services and the financial inclusion agenda around the world: A cross-country analysis with a new data set" 2011 *The World Bank financial and private sector development* 2 (https://openknowledge.worldbank.org/bitstream/handle/10986/3310/WPS5537.pdf?sequence=1 (10-10-2015)).

3 De Bock and Gelade "The demand for microinsurance: A literature review" 2012 *International Labour Office* 2 (http://www.ilo.org/public/english/employment/mifacility/download/mpaper20_buy.pdf (07-07-2015)).

4 ibid.

Currently, many South Africans participate in activities such as stokvels and burial societies as a means to cope with risks which they may be plagued with. Although this may meet the basic needs of many low-income earners, these measures remain unregulated.

It is submitted that it is less than ideal to have a divided economy where the legal framework does not allow all South Africans to participate in a stable, regulated and inclusive market. Law should therefore be used as an agent to bring about change, to bring about the progressive realisation of financial inclusion.

The purpose of this dissertation is therefore to evaluate microinsurance as a legal concept and investigate whether microinsurance has the potential to provide low-income earners with access to financial products.

To evaluate the role of microinsurance as a formal financial service, the level of current financial inclusion amongst South Africans will be evaluated. This is followed by an overview of all the recent regulatory and framework developments in the financial services sector. A discussion on microinsurance product innovation and distribution will follow and finally an opinion will be fashioned on the potential of microinsurance to assist in alleviating poverty and enhance financial inclusion.

In order to address the research question this chapter proceeds to define microinsurance. It further asks how microinsurance fits into the financial services landscape and the discussion turns to financial inclusion and canvasses the extent of the problem. But first, a definition of microinsurance.

1.2 Microinsurance defined: South African legal framework

As microinsurance is still a fairly new concept in South Africa many do not know what it means and how it fits into the realm of the traditional insurance industry as a whole. It is a term that is not well known and even less well defined. Some even refer to the concept as a new financial service within microfinance.[5] Ingram and McCord state that without a proper definition of microinsurance a country will end up with the potential for regulatory arbitrage and a limited ability to leverage market education which will lead to challenges in tracking actual microinsurance within the market.[6] A solid definition of microinsurance is important as the

5 Khan "Microinsurance: A new concept in South Africa" 2012 *Management Today* 107.

6 Ingram and McCord "Defining 'microinsurance': Thoughts for a journey towards a common understanding" 2011 *MicroInsurance Centre* 4 (http://www.microinsurancecentre.org/resources/documents/market-development/regulations/defining-microinsurance-thoughts-for-a-journey-towards-a-common-understanding.html (02-08-2015)).

scope in which it is defined will have implications for access to and regulation of microinsurance.

A starting point in defining microinsurance will be to look at how, if at all, it differs from traditional insurance.[7] Insurance has a history which dates back to the Babylonians, however the concept did not see significant development until the growth in international trade from the fifteenth century which led to the development by states of recognisably modern methods of insurance.[8]

There are certain essential elements that form part of an insurance contract. The parties to an insurance contract must agree that the insurer will compensate the insured for his or her loss and in return the insured will pay a premium.[9] The insurer's obligation to compensate the insured will be dependent on the occurrence of an uncertain future event.[10] Furthermore, the payment of a premium will always need to be in the form of a sum of money.[11] It has been suggested that it would not be practical for payment to insurers to be in the form of something other than money[12] as any other type of payment such as services rendered or agricultural produce would first have to be quantified, which in practice would mean agreeing upon what the services or item would be worth in monetary terms.[13] As has been suggested by Millard this roundabout way of arriving at the same result would seem to be unnecessary and unrealistic.[14]

In *Lake v Reinsurance Corporation Ltd*[15] the court defined a traditional insurance contract as "[a] contract between an insurer (or assurer) and an insured (or assured), whereby the insurer undertakes in return for the payment of a price or premium to render to the insured a sum of money, or its equivalent, on the happening of a specified uncertain event in which the insured has some interest." In the narrow sense traditional commercial insurance can be defined as including a risk-pooling element. Those who are in the risk pool who do not suffer a loss during

7 The concept of insurance must further be distinguished from that of a wager. The difference lies in the fact that with insurance the risk of loss to an individual exists independently of the insurance contract. Such a risk exists whether or not there is an insurance contract. However, with a wager the risk is created by the agreement, for without it the contracting party would have suffered no loss.
8 Lowry, Rawlings and Merkin *Insurance law: Doctrines and principles* (2011) 1.
9 Both the Long-term Insurance Act 52 of 1998 and the Short-term Insurance Act 53 of 1998 in section 1 of each act define premium as "the consideration given or to be given in return for an undertaking to provide policy benefits."
10 Prozesky-Kuschke "Introduction to insurance and insurance contracts" in Nagel (ed) *Commercial law* (2011) 335 345.
11 See *Lake v Reinsurance Corporation Ltd* 1967 3 All SA 225 (W).
12 Millard *Modern insurance law* (2013) 85.
13 Millard (n 12) 85.
14 ibid.
15 (n 11) 228.

a particular period essentially pay for the losses experienced by others.[16] In this regard insurance will reduce the vulnerability of households as they will replace the uncertain prospects of losses with the certainty of making small regular premium payments.[17]

Churchill defines microinsurance as "the protection of low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved."[18] The author goes on to state that this definition is essentially the same as one might use for traditional insurance except for the specific target market: low-income individuals.[19] Microinsurance is generally intended for persons who have been ignored by mainstream commercial and social insurance schemes and who have previously not had access to appropriate products.[20]

The 2008 discussion paper on microinsurance issued by National Treasury states that microinsurance is insurance which is accessible to the low-income population, provided by numerous different providers, and managed in accordance with the generally accepted insurance practices.[21] It has further been stated that microinsurance does not operate in isolation but forms part of the broader insurance market and is distinguished by its particular market segment focus.[22]

Following the 2008 discussion paper on microinsurance[23] National Treasury published the 2011 policy document on microinsurance. This policy document indicates that microinsurance refers to "insurance products that are accessible to and/or used by low-income households."[24] The document goes on to state that "[i]t 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."[25] The policy document further states that such a definition needs to be a practical one which is wide enough to facilitate the development of a

16 Churchill "What is insurance for the poor?" in Churchill (ed) *Protecting the poor: A microinsurance compendium* (2006) 12 14.
17 ibid.
18 ibid 12.
19 ibid.
20 ibid 13.
21 National Treasury "The Future of Micro-Insurance Regulation in South Africa Discussion Paper" 2008 6 (http://www.treasury.gov.za/public%20comments/The%20Future%20of%20Micro-insurance%20Regulation%20in%20South%20Africa.pdf (28-06-2015)).
22 ibid.
23 The discussion paper states that microinsurance is intended to catalyse the market provision of risk management tools for poor households.
24 National Treasury "The South African Microinsurance Regulatory Framework Policy Document" 2011 6 (http://www.treasury.gov.za/publications/other/MicroinsuranceRegulatoryFramework/Policy%20Document%20Micro%20Insurance.pdf (28-06-2015)).
25 National Treasury "Press statement release of the microinsurance policy document" 2011 3 (http://www.treasury.gov.za/comm_media/press/2011/2011072801.pdf (07-07-2015)).

dynamic microinsurance market in South Africa. In essence this definition seeks to achieve two goals: firstly to target the features of the products towards the low-income market; and secondly to limit the prudential risk that would be associated with this category of product in order to warrant simpler regulatory requirements.[26] In achieving this the policy document proposes that microinsurance should be defined generically rather than by listing specific product types.[27] In this light the definition of microinsurance should also seek to achieve the goal of reflecting 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.[28]

1.3 Microinsurance in other jurisdictions

Let us now look at how microinsurance is defined in other jurisdictions. Financial inclusion in the insurance sphere is generally referred to as microinsurance, and this means extending access to insurance products and services to excluded and underserved populations.[29]

Throughout the Southern African Development Community (SADC) region large numbers of individuals lack access to appropriate insurance products. Growing a microinsurance market will enhance access to risk management and mitigation tools which will contribute to the reduction of poverty.[30]

In the Philippines, microinsurance has been defined as "an activity providing specific insurance, insurance-like and other similar products and services that meet the needs of the low-income sector for risk protection and relief against distress, misfortune and other contingent events. This shall include all forms of insurance, insurance-like and other similar activities…".[31] The Philippines has gone further and identified certain features of a microinsurance policy. All microinsurance policies will need to clearly identify the face amount, benefits, and terms of the insurance coverage and microinsurance providers are to

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26 Endres, Ncube, Hougaard and Van As "Regaining momentum? Update on microinsurance in South Africa" 2014 *CENFRI* 22 (http://www.finmark.org.za/wp-content/uploads/pubs/Rep_SA-MI-Update_042014.pdf (07-07-2015)).

27 Microinsurance Policy Document (n 24) 6.

28 ibid.

29 Leith, Grand, Wipf and Swiderek "Advancing data for the development of microinsurance markets in SADC" 2015 *FinMark Trust* 2 (http://www.finmark.org.za/wpcontent/uploads/pubs/Rep_SADMI_Data_Capacity_2015.pdf (19-10-2015)).

30 ibid.

31 Philippines Insurance Commission "Insurance memorandum circular" 2010 2 (http://www.insurance.gov.ph/htm/..%5C_@dmin%5Cupload%5Creports%5CIMC%201-2010.pdf (9-10-2015)).

ensure that the contract provisions can be easily understood by the insured; the documentation requirements are simple; and the manner and frequency of premium collections coincides with the cash-flow of the insured.[32]

One must bear in mind that the term microinsurance does not refer to the size of the entity providing the insurance. Although some microinsurance providers may be small, they may also be large international insurance companies. Rather microinsurance refers directly to the size of the risk of the individual. One must also note that microinsurance does not refer to the scope of the risk as perceived by the potential client. The risks that may be suffered by these households are by no means 'micro' to them.

A clear and precise definition of microinsurance is important in order to create special regulations and policies for microinsurance. The common thread among these various definitions is the element of the provision of insurance services to low-income households. Regular insurance products only cater for individuals with regular fixed income. Microinsurance largely focuses on cover to individuals working in the informal economy who may not have access to regular commercial insurance or social protection benefits provided by employers. It is easier to offer insurance to persons with predictable income than to an informal worker who has irregular cash flows. Churchill states that the latter represents the microinsurance frontier.[33]

1.4 To what extent are South Africans financially excluded?

Many South Africans are excluded from accessing a wide variety of financial products and services for a number of reasons. But where does a low-income individual start to become financially included? It can be said that the first step towards financial inclusion would be to obtain a bank account.

In 2014 Finmark Trust[34] conducted a South African consumer survey whereby they assessed the level of financial inclusion amongst South Africans aged 16 years and older.[35] Between 2004 and 2014 the percentage of South Africans who were banked increased from 46 per cent to 75 per cent. 5 per cent were financially included via non-bank products, 6 per cent were

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32 ibid.

33 Churchill (n 16) 13.

34 Throughout the years Finmark Trust has conducted various studies and surveys in this field and their mandate is to make financial markets work for the poor across Africa and beyond by increasing access to financial services for the unserved and underserved that will ultimately lead to the development of inclusive financial systems that can benefit all people.

35 FinScope "Consumer Survey South Africa" 2014 4 (http://www.finmark.org.za/wp-content/uploads/pubs/Pres_Finscope2014_FNL.pdf (14-08-2015)).

financially included via informal product offerings and 14 per cent were not financially included at all.[36]

Despite the large increase in South Africans obtaining bank accounts in recent years there was negligible growth from 2013 to 2014.[37] It seems as if the role of the banking sector in aiding financial inclusion has now reached its natural peak. The growth of the banking sector can be attributed to the growth and formalisation of the microfinance industry as well as the South African Social Security Agency's (SASSA) roll out of the social grant MasterCard initiative. Recipients of a social grant have received a SASSA-branded smart payment MasterCard after having biometrically registered on the SASSA national social grant payment system. SASSA has been a key driver in this sector as 34 per cent of the banked population now owns a SASSA MasterCard.[38] However, being banked does not necessarily translate into high levels of financial understanding as only 54 per cent of the banked population indicated that they are sure which bank account is best suited to them and only 52 per cent indicated that they understand the differences amongst banks.[39]

What raises concern, however, is that there appears to be a lack of a culture of saving amongst South Africans. The increase in the banked population has not translated into an increase in savings and investments as, of those who are banked, 33 per cent indicated that they withdraw all their money as soon as it is deposited into their account.[40] In 2014 only 20 per cent of the population had formal savings, 8 per cent had informal savings, while 11 per cent claimed to be saving at home.[41] 68 per cent of the population had no form of savings whatsoever, this exposes them to great risk should a loss causing event occur which would leave them incapable of coping with such risk. Not only does the low-income market suffer from ongoing uncertainty about whether and when a loss might occur, but they also suffer from exposure to risks that will result in substantial financial losses.[42]

Insurance levels amongst South Africans has seen significant growth over the last decade. Insurance coverage grew from 41 per cent in 2004 to 60 per cent in 2014, with a 6 per cent year-on-year growth.[43] In 2014, 38 per cent of the population had formal insurance cover which comprised of mainly funeral cover. 35 per cent of the population had informal insurance cover

36 ibid 21.
37 ibid 23.
38 ibid 25.
39 ibid 40.
40 ibid 41.
41 ibid 32.
42 Churchill (n 16) 12.
43 FinScope Consumer Survey (n 35) 26.

which comprised largely of cover from burial societies.[44] Burial societies have driven the increase in insurance amongst the most vulnerable members of society. Burial-society membership increased overall from 6 million members in 2004 to 11.7 million members in 2014.[45] Formal funeral cover saw an increase from 4.2 million members in 2004 to 12.1 million members in 2014.[46]

Overall, formal funeral cover insurance has seen the largest increase in recent years with a growth from 15 per cent in 2004 to 33 per cent in 2014. This is followed by burial society membership which has increased from 20 per cent in 2004 to 32 per cent in 2014. Life insurance saw little growth over the same period with an increase from 11 per cent to 15 per cent. According to a study conducted by the Association for Savings and Investments South Africa (ASISA), 61 per cent of low-income households do not have any life or disability insurance to safeguard them against hardship.[47] This translates into almost 20 million households who are exposed to risk without cover.[48] Household contents insurance also saw little growth over this period with an increase from 5 per cent to 6 per cent.[49] What is interesting to note is that 35 per cent of those who have funeral cover also belong to a burial society.[50]

The demand for funeral cover is largely driven by the need for a dignified funeral under traditional custom as well as the everyday reality of death.[51] Funeral service providers are a prominent part of many South African communities. By covering households against the risk and cost of a funeral, which has the potential to cripple low-income households, they fulfil an important social protection role.[52]

While these increases all sound promising, the Finmark Trust Survey indicates that there are 5.3 million South Africans who are financially excluded.[53] Of these 5.3 million, 2.7 million live in urbans areas, 2.2 million live in traditional areas, and 340 000 live on farms.[54] The major difficulty lies in the fact that it is challenging to access this sector of the population who remains

44 ibid 27.
45 ibid 18.
46 ibid.
47 True South Actuaries and Consultants and Bureau of Market Research "The South African insurance gap in 2013" 2013 12 (http://asisa.org.za/asisadocs/research-and-publications/insurance-gap-2013/True%20South%202013%20Gap%20Study%20-%20Final%20Report.pdf (20-09-2015)).
48 ibid.
49 FinScope Consumer Survey (n 35) 29.
50 ibid.
51 CENFRI "The nature of informality in the South African funeral services market – implications for policymakers and regulators" 2013 5 (http://cenfri.org/documents/microinsurance/2013/Funeral-Focus%20Notes%201%20-%2021.05.2013.pdf (16-08-2015)).
52 ibid 1.
53 FinScope Consumer Survey (n 35) 50.
54 ibid.

financially excluded. What is promising, however, is the fact that of these 5.3 million who are financially excluded, 4.3 million have access to a cellular phone.[55] Microinsurance products have the potential to provide formalised products to this large percentage of individuals who currently have no form of financial inclusion, as well as to those who only have informal financial products. As Millard phrases it, everyone is attempting to circulate the money under the mattress back into the mainstream economy,[56] and microinsurance products have the potential to do this.

From the above it is evident that significant strides have been made in financial inclusion over the last decade. However, the questions that need to be asked are how do we maintain the current levels and how do we increase this percentage and ensure that all South Africans are financially included? One of the key challenges remains to deepen financial engagement. These proposed increases in financial inclusion, however, need to be meaningful, and to do this products need to be introduced to low-income individuals that will support long-term personal development.

The Finmark Trust Survey revealed that only 20 per cent of the population have products covering all four financial services categories of formal insurance products, credit products, savings products and bank accounts.[57] It is submitted that microinsurance products can assist in providing tailored insurance products to low-income households which will assist in financial inclusion and help increase this number. In addition thereto the consumer education programs that will be rolled out with the introduction of microinsurance products will assist in consumers' general understanding of financial products and the value such products can add to their lives. These programs also have the potential to teach South Africans the importance of instilling a saving culture and how formal financial products can assist in this regard.

One threat that will impact the potential of microinsurance to penetrate the low-income market in particular, and one which is often overlooked, is the high levels of over-indebtedness[58] of South African consumers. In 2014, 4.9 million consumers were showing signs of being over-indebted and 2.2 million of those consumers have considered cancelling their insurance and investment policies in order to pay back borrowed money.[59]

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55 ibid 51.

56 Millard "Harnessing the informal economy: Some reflections on national treasury's policy document on the South African microinsurance regulatory framework" 2012 *THRHR* 665 665.

57 FinScope Consumer Survey (n 35) 39.

58 A consumer will be deemed to be over-indebted when, having regard to all his financial means, prospects and obligations, the consumer is or will be unable to satisfy, in a timely manner, all the obligations in terms of all the consumers credit agreements to which the consumer is a party.

59 FinScope Consumer Survey (n 35) 47.

However, where credit is for instance a financial service which has instant appeal to the low-income market, insurance remains a grudge purchase and it is not immediately obvious why the law should promote and endorse a very specific framework for insurance products for low-income earners.

The next chapter maps current developments in the financial services landscape and asks whether microinsurance can sit comfortably in this realm.

CHAPTER 2

REGULATORY AND POLICY FRAMEWORK

2.1 Background

The regulation of microinsurance in South Africa is still in its embryonic phase. The microinsurance industry in South Africa has operated largely without the benefits or challenges of a regulatory framework.

However, significant steps have been taken in recent years to formalise the microinsurance sphere. In 2008 National Treasury released a discussion paper on the future of microinsurance in South Africa for public comment. The paper was also supported by a written-comments period and a National Treasury roadshow where the proposals were evaluated and feedback was gauged from informal and less formalised participants.[60] The launch of the 2008 discussion paper on the future of microinsurance regulation signalled the regulator and policymakers' dedication to the development of the microinsurance sector by proposing a formalised path for informal providers as well as a proportionate regulatory regime for formal providers.[61]

Following the release of the 2008 discussion paper, National Treasury held countrywide roadshows whereby they tested the proposals with both formal and informal providers. This was followed by a further round of public stakeholder engagements and consultations in 2010. This ultimately culminated in National Treasury publishing a microinsurance policy document in July 2011. This policy document expanded and built on the proposed regulatory framework which was outlined in the 2008 discussion paper. The policy document also sets out a comprehensive policy framework to encompass microinsurance underwriting and intermediation, consumer education and regulatory enforcement.[62]

In addition to the policy document on microinsurance, the financial services industry as a whole has seen many significant changes recently. This includes the introduction of the Twin-Peaks regulatory model, the Treating Customers Fairly regime, a new Solvency Assessment and Management project, as well as the introduction of the Insurance Bill. Each of these new regulatory and framework developments will be discussed below. However, as a point of departure, it is important to first determine how microinsurance will fit into the current financial services landscape.

60 Microinsurance Policy Document (n 24) 6.
61 Endres *et al* (n 26) 2.
62 Microinsurance Policy Document (n 24) 3.

2.2 How does microinsurance fit into the current financial services landscape?

Once it has been determined what microinsurance is, it is imperative to establish how microinsurance will fit into the existing insurance landscape in South Africa. An in-depth discussion of the existing legal framework governing the South African insurance industry is however beyond the scope of this paper and this section therefore contains a brief overview of the legislative landscape regarding insurance in South Africa and how microinsurance will fit into the existing landscape.

The South African insurance industry is highly regulated and is primarily governed by the Long-term Insurance Act [63] (LTIA), the Short-term Insurance Act[64] (STIA), and the Financial Advisory and Intermediary Services Act[65] (FAIS). The main purpose of the Long-term Insurance Act is to regulate the long-term insurance industry. The Act concerns itself with the registration of long-term insurers and the control of certain activities of long-term insurers and intermediaries. The main purpose of the STIA is to regulate the short-term insurance industry. A single company is not allowed to have licences under both the LTIA and STIA. All policies that relate to life events are captured under the LTIA, whereas the STIA predominantly covers losses relating to property. The main objectives of the STIA are the registration of short-term insurers and the control of certain activities of short-term insurers and intermediaries. The main purpose of the FAIS Act is to regulate the activities of financial service providers who advise or provide intermediary services to consumers of financial products. The Act primarily concerns itself with regulating the rendering of certain financial advisory and intermediary services to clients. As Millard states, the activities of insurance providers and their intermediaries would clearly fall within the scope of FAIS and therefore a thorough understanding of its main provisions is essential for the insurance industry.[66]

Another important recent development in the insurance industry is the introduction of the Insurance Bill.[67] The Insurance Bill is intended to come into effect in the beginning of 2016 and intends to provide a consolidated legal framework for the prudential supervision of the insurance sector and seeks to replace and consolidate certain parts of the LTIA and STIA relating to prudential supervision.

63 52 of 1998.
64 53 of 1998.
65 37 of 2002.
66 Millard (n 12) 19.
67 GG 38724 (20 April 2015).

A further piece of legislation which is relevant in this context is the Friendly Societies Act.[68] It provides for the registration, incorporation, regulation and dissolution of friendly societies. A friendly society is any association of persons established for any of a number of specified objects,[69] or any business carried out under a scheme or arrangement instituted for any of those objects. These objects include, *inter alia*, the relief or maintenance during minority, old age, widowhood, sickness or other infirmity;[70] the granting of annuities to members or to nominees of members, or the endowment of members or nominees of members;[71] the insurance of a sum of money to be paid or other benefit to be provided during a number of specified events.[72]

As has been stated by Millard, one can see from the above that there is a certain amount of overlap between the objectives of a friendly society and that of an insurer.[73] Generally, however, friendly societies have not been able to compete with insurers, and friendly societies have been plagued with difficulties regarding administration and regulation.[74] It is envisaged that the introduction of the microinsurance framework will signal the end for friendly societies in South Africa.

Microinsurance further needs to be distinguished from social insurance as microinsurance is a form of private insurance. The essential difference between social insurance and private insurance is that the former serves the interests of society whilst the latter serves the interests of an individual.[75] Social insurance schemes are implemented on a compulsory basis by the state, whilst private insurance schemes protect the health, life or property interests of individual consumers of insurance products.[76] A particular individual may however be eligible for benefits from social security institutions as well as from private insurers.

Although microinsurance is still insurance in the traditional sense, it is perhaps necessary to alter the traditional insurance standards as set out in the LTIA and STIA as these pieces of legislation are unsuited to microinsurance.[77] These two Acts serve an important purpose for products which are designed towards and purchased by the middle and high income market. However, the proposed microinsurance regime needs to achieve certain policy objectives which the other two Acts are not capable of achieving. These objectives include, *inter alia*, the

68 25 of 1956.
69 The listed objects are specified in s 2 of the Friendly Societies Act 25 of 1956.
70 s 2(a) of the Friendly Societies Act.
71 s 2(b).
72 s 2(d).
73 Millard (n 12) 24.
74 ibid.
75 ibid 25.
76 ibid.
77 ibid 24.

need to extend access to formal insurance products and thereby improve financial inclusion, to formalise the insurance products offered by informal providers, and to lower the barriers to entry for providers in order to promote competition.[78]

2.3 Microinsurance Policy Document: Features and goals

At this stage, it is now necessary to unpack the finer details of National Treasury's policy document on microinsurance. The policy document identifies three features of the insurance industry that need urgent policy address. These are: the need to promote better access for South Africans to affordable insurance products that meet the risks they face; the need for consumers to better match the products that they buy with their insurance needs; and the strengthening of consumer protection.[79]

The policy document further has the potential to create a sound legal framework which allows all South Africans to participate in a regulated and inclusive insurance sector.

In light of the new policy reform of the financial services sector, National Treasury's broad policy agenda rests on five pillars, namely; financial stability, consumer protection, better access to financial services, improved regulatory coordination, and comprehensiveness.[80]

In order to obtain these goals the policy document sets out to achieve certain objectives, these include:

- the objective to extend access to a variety of good-value formal insurance products which are appropriate to the needs of low-income households, thereby supporting financial inclusion;[81]
- to facilitate formalised insurance provision by currently informal providers and thereby promote the formation of regulated insurance providers;[82]
- to lower the barriers to entry which will support broader participation in the market and which will in turn support poverty alleviation through economic growth and job creation;[83] and
- to ensure the protection of consumers of microinsurance through appropriate prudential and business conduct regulation as well as consumer education

78 Microinsurance Policy Document (n 24) 3.
79 ibid 1.
80 ibid 2.
81 ibid 3.
82 ibid.
83 ibid 4.

interventions which are targeted at understanding insurance along with its risks and benefits.[84]

The policy document proposes that once a license is issued to a microinsurer, such an insurer will be able to write both life and non-life insurance business. This will mean that microinsurers will be able to provide a range of insurance cover which is required by the low-income market under one microinsurance license, thereby avoiding the additional regulatory costs of obtaining both a long-term and a short-term insurance license, as is required under the current regulatory regime. Such a provision is to be welcomed and will go a long way in assisting to create appropriate products for the low-income market, which will, in turn, assist in the goal of financial inclusion.

Microinsurance has also seen significant growth throughout Africa and is often characterised as an industry which is up-and-coming. There are studies which support this notion; throughout Africa 44.4 million lives and properties are covered in 39 countries.[85] South Africa alone covers more than 60 per cent of all lives and properties covered in Africa.[86] Despite these numbers there is still significant room for expansion for microinsurance in South Africa and the African continent as a whole.

Throughout Africa the microinsurance sector is as adverse as the continent itself. Sixteen countries in Africa have already adopted some form of microinsurance-specific legal frameworks, while another nine are working on developing appropriate frameworks.[87] Fourteen of these countries are also part of the Inter-African Conference on Insurance Markets Zone which has recently adopted specific and separate microinsurance rules for its member countries.[88] In addition thereto Kenya and Mozambique have addressed microinsurance regulation specifically within their insurance legal frameworks. Uganda has adopted an evolutionary approach to the development of microinsurance within its legal framework and is currently addressing microinsurance at a high level in insurance law.[89]

The narrative around microinsurance regulation essentially centres on the choice between over-regulating and consumer protection versus under-regulating and loss of confidence in

84 ibid.
85 McCord, Steinmann, Tatin-Jaleran, Ingram and Mateo "The landscape of microinsurance in Africa 2012" 2012 *Munich Re Foundation* 5 (http://www.munichre-foundation.org/dms/MRS/Documents/Microinsurance/2012MILandscape/2013LS_MI_AfricaFull_E_web.pdf (07-07-2015)).
86 ibid.
87 ibid 26.
88 ibid.
89 ibid.

financial products. It is however submitted that the two do not need to be mutually exclusive, and that a balance can be struck. Some argue that a more flexible approach to regulation will enhance financial inclusion in South Africa.[90] However, it is submitted that the framework as set out in National Treasury's policy document strikes an appropriate balance between regulating the industry and being sufficiently flexible to allow for innovation which will aid financial inclusion.

2.3.1 Impact of the policy document on the insurance industry

The introduction of the microinsurance framework will bring about a change in the way that many insurers operate. The new microinsurance regulatory framework will focus on the formalisation of unregulated players in the microinsurance industry.[91] While this will see an increase in the number of competitors that existing insurers will face, it will also 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.[92]

Once the microinsurance framework comes into effect no person or institution will be able to offer microinsurance products without being licensed as a microinsurer. All microinsurers will be required to use the word "microinsurance" or any derivative thereof in their registration name.[93] It is hoped that this measure will assist the target market, who generally have lower levels of literacy and experience with financial products, to easily identify insurers that offer products to suit their needs.

Provision has also been made for existing licensed long-term and short-term insurers who currently target low-income consumers with products that fall within the definition of long-term and short-term insurance business, as they can continue to provide these 'microinsurance' products under their existing licenses.[94] If these existing insurers however wish to offer composite microinsurance products or wish to qualify for any of the regulatory concessions which are applicable to microinsurers they will be required to apply for a microinsurance license.[95] These existing insurers will also be required to set up a separate public company for this purpose.[96] Going forward, registered microinsurers may only conduct insurance business;

90 Lawack "Mobile Money, financial inclusion and financial integrity: The South African case" 2013 *Washington Journal of Law, Technology and Arts* 317 319.
91 Microinsurance Policy Document (n 24) 55.
92 ibid.
93 ibid 21.
94 ibid.
95 ibid.
96 ibid.

other business operations such as the provision of funeral services or credit will not be permitted within the same legal entity.[97]

The microinsurance framework further intends to make it possible for informal insurance providers, who find the current registration requirements under the LTIA and STIA too onerous, to be able to register with reduced but appropriate requirements that will still enable them to meet a minimum acceptable bar from a risk management and consumer protection point of view.[98] It is hoped that these requirements will encourage establishments that are currently offering insurance beyond the law to formalise their operations.

This formalisation of informal insurance providers creates the opportunity for existing formal providers to partner with funeral parlours as the forced formalisation of informal providers will create a sustainable, non-abusive microinsurance industry that will operate on a level playing field.[99] In the current legislative framework, formalised providers may be hesitant to enter into such an agreement with informal providers due to the regulatory risk of being held accountable for the informal providers' actions. Formalisation will address any potential wariness of possible regulatory backlash.[100]

However, the need to formalise may not be a concern for most informal players as they may not necessarily be aware of the changes to the regulatory framework. It is therefore suggested that there be extensive education initiatives whereby existing informal providers are brought up to speed with the regulatory developments and educated about the benefits of formalising their operations.

A possibility in this regard would be for existing long-term insurers to have information session with burial societies in order to discuss possibilities for burial societies to merge with group schemes and to operate within the proposed legal framework. This will have the benefit of the law defining the rights and duties of the members, which will ultimately benefit the members. This is in contrast to the current position with burial societies where the members are often unaware of what their rights and duties are.

It will also be a requirement that microinsurers secure actuarial sign-off on the total premium, and not only the risk premium, for all new products as well as any changes in

97 ibid 23.
98 ibid 5.
99 Endres *et al* (n 26) 18.
100 ibid 19.

pricing.[101] Actuarial sign-off on the total premium will allow for scrutiny regarding the proper allocation of expenses as well as for profit and investment income.[102]

Lastly, a transition period of three years from the enactment of the microinsurance legislative framework has been proposed. During this period burial societies and other risk-pooling institutions that provide guaranteed benefits or that have membership above the proposed *de minimis* threshold of 2 500 members have to register and comply with the new microinsurance legislative framework.[103]

Whilst these measures seem amicable on paper the practical implication is likely to be that there will be significant costs involved in setting up and running microinsurance providers. Unfortunately these cost will inevitably filter down to the consumers.

2.3.2 Envisaged product features and standards

In order to achieve the aims and objectives of the microinsurance policy document, certain product features and standards are envisaged. The policy document outlines certain product features and standards by which products will have to comply in order to qualify as microinsurance products. These features and standards typify products as microinsurance and will further determine the prudential requirements that will apply to microinsurance products.[104]

Firstly, the policy document proposes that only risk benefits[105] with no surrender value be included in the microinsurance product category.[106] A risk-only product thus provides cover against a particular risk or combination of risks. Risk benefits will provide cover against a certain risk event and no savings component will be included.[107] Microinsurance policies will therefore be categorised as whole-life insurance, whereby the policy benefit is paid upon the death of the life insured as opposed to endowment insurance, where there is a policy term and a maturity date.[108] By excluding endowment policies from the microinsurance framework National Treasury envisaged that the target market does not have a need for a combined, more sophisticated product.[109] It is, however, submitted that not all low-income individuals can be

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101 Microinsurance Policy Document (n 24) 29.
102 ibid.
103 ibid 18.
104 Millard (n 56) 666.
105 The concept of risk in the insurance context refers to the possibility of loss or harm resulting from the occurrence of a defined event.
106 Microinsurance Policy Document (n 24) 7.
107 ibid.
108 Millard (n 56) 666.
109 ibid.

painted with the same brush and such a combined product may well be suited to low-income individuals and will go a long way to assist in the ultimate goal of financial inclusion.

The next feature is that all microinsurance policy benefits should be defined on a first loss or sum assured basis.[110] First loss insurance refers to insurance which provides a defined benefit upon a defined event, as opposed to indemnity insurance which will pay benefits according to the actual value of the loss suffered.[111] National Treasury considered this restriction to be necessary since the loss adjustment process which is required for indemnity insurance is deemed too costly for microinsurance.[112] This means that asset microinsurance policies, liability policies, and accident and health policies must disclose to the consumer how many claims may be made within the contract period as well as what the monetary limit of these claims may be.[113] This is a simplification of the existing insurance products, and due to the fact that this feature has the potential of making products more user friendly, it will be better suited to the intended low-income target market.[114]

Defined benefits caps are the next feature outlined in the policy document and these caps will define financial limits depending on the nature of the microinsurance policy. These caps are intended to keep microinsurance products within the limits of special intermediation regulation.[115] The proposed benefits caps 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 then apply severally to each insured and not collectively to the policy as a whole.[116] The proposed benefit caps are intended to apply to three different categories of policies, and they are as follows:

- a maximum benefit of R50 000 per insured life per insurer for any insurance related to a death event;[117]
- a maximum benefit of R100 000 per person, per insurer, per contract period for all insurance on assets only[118] (this means an individual may insure an asset such as a car with an insurer for no more than R100 000);[119] and

110 Microinsurance Policy Document (n 24) 7.
111 ibid.
112 A consequence of this limitation, however, is that asset microinsurance policies, liability policies, and accident and health policies must disclose how many claims may be made within the contract period.
113 Microinsurance Policy Document (n 24) 7.
114 Millard (n 56) 667.
115 ibid.
116 Microinsurance Policy Document (n 24) 8.
117 ibid.
118 ibid.
119 Millard (n 56) 667.

- a maximum benefit of R50 000 per insured life, per insurer, for all other risk events.[120]

There is no minimum limit set for any policy benefit. Therefore, a single microinsurance policy may provide any benefit totalling up to the cap in each of the categories. Claims may also be paid in single sums, lump sums or in instalments.[121] One can appreciate such a caps system as it supports several policy objectives such as the provision of good value products and lower barriers to enter the insurance market.[122] These caps will also assist a consumer who previously may not have considered purchasing insurance but may now be lured into the formal market as a result of clear and well-defined products.[123]

Having said that, it is questionable whether such monetary limits are appropriate for all low-income households as the extent of their income can still differ significantly within this market. This is especially so when it comes to household buildings and contents. It is thus suggested that there be different limits for different risks, and that there be consideration given to current market practice. The inclusion of setting different limits will not be burdensome and would not be impractical or add complexity.

The policy document also sets certain limits regarding the maximum contract term for microinsurance policies. It is proposed that microinsurance policies should have a contract term of up to but not exceeding 12 months,[124] and in order to facilitate uninterrupted cover it has been proposed that these 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.[125] Millard raises concern with these provisions as it would be possible for an insurer who wants to lure new policyholders to under-quote for the first year, then renew the contract, and subsequently increase the premium significantly.[126] There are, however, countermeasures for such behaviour in that insurers should not be able to selectively cancel individual policies within a group and that an actuary should certify initial and subsequent pricing.[127]

The next area that the policy document addresses is that of waiting periods. The vast majority of microinsurance products currently in the market contain waiting periods. Such waiting periods are introduced in order to reduce the risk of adverse selection in situations

120 Microinsurance Policy Document (n 24) 8.
121 ibid 9.
122 Millard (n 56) 667.
123 ibid.
124 Microinsurance Policy Document (n 24) 9.
125 ibid.
126 Millard (n 56) 667.
127 Microinsurance Policy Document (n 24) 10.

where no individual underwriting occurs. The policy document proposes to restrict waiting periods in microinsurance policies to a maximum of six months for death or disability due to natural causes for policyholders who are younger than 65 upon entry.[128] This provision applies for any other long-term insurance product and there is no differentiation for microinsurance. As the risk of adverse selection falls away in the case of accidental death or disability no waiting periods will be allowed for policies that cover these risks.[129]

The imposition of waiting periods have the potential to adversely affect policyholders who move between insurers. In this instance the risk of adverse selection has largely been dealt with, and therefore the rationale for imposing a waiting period will fall away. To address this the policy document states that, 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 insurer must then request the previous insurer to issue a certificate to it, upon which the new insurer may not impose a waiting period.[130]

A particularly interesting feature of microinsurance products is that such products are to prohibit exclusions for pre-existing conditions. Only standard exclusions for suicide will be allowed in order to ensure that there is consistency and fairness.[131] Exclusion clauses in long-term insurance products have previously led to costly litigation,[132] and therefore it has been submitted that this prohibition will potentially restore the much-needed confidence in insurance products and should be extremely beneficial to consumers.[133]

It is possible for an insurer to pay out an insurance benefit in kind. For low-income earners this means that an insurer will be able to pay out a policy by, for example, delivering goods from cash builders to a low-income household when they suffer a loss which has an impact on their home. The policy document makes an interesting proposal that a microinsurance policyholder must be given the option, when making a claim, to receive a monetary benefit which is equal to the stated value of the in-kind benefit, had it been provided. The policy document states that in order to ensure the fair treatment of consumers, a monetary option should be equal to the cost that would have been incurred by the insurer had the in-kind benefit been provided.[134] As such a practice is prone to abuse, it is required that an insurer disclose the

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128 ibid 12.
129 ibid.
130 ibid.
131 ibid.
132 See for eg *Michael v Linksfield Park Clinic (Pty) Ltd* 2001 3 SA 1188 (SCA); *Concord Insurance Co Ltd v Oelofsen NO* 1992 4 SA 669 (A); and *Rabinowitz v Ned-Equity Insurance Co Ltd* 1980 1 SA 403 (W).
133 Millard (n 56) 669.
134 Microinsurance Policy Document (n 24) 13.

value of the monetary benefit upfront and that the face value of the in-kind benefit and the monetary option provided be the same.[135] The policy document also sets out that all valid microinsurance claims should be paid within a period of 48 hours after the insurer has received all the required documentation.[136]

The final innovative feature of microinsurance products is that they will contain a grace period for premium payments. Many low-income earners work in the informal sector and are likely to have irregular income streams which may make it difficult to maintain regular premium payments, these intended grace periods are therefore a welcomed innovation. To ensure that policyholders are not disadvantaged by their irregular cash flow, the policy document proposes that microinsurance policies be subject to a grace period if a premium is not paid when it is due.[137] As a minimum it is proposed that cover will continue for one month after the due date of the premium.[138] The outstanding premium may then be paid any time during that month without compromising the cover; if the premium is not paid within the month of grace then the cover will cease after that month.[139] It is interesting to note that if a policy has been in force for one year or more the grace period will then be extended by one month for each completed 12 month period that the policy has been in force and there will be no reduction in cover.[140] The maximum grace period will, however, be six months.[141] The grace periods for microinsurance appear to be more lenient than those for traditional insurance.

Overall these product features and standards are to be welcomed as they create a legal minimum standard in terms of which all microinsurers will be held to account. This legal certainty creates rights which are not dependent on arbitrary decisions by, for example, members of a burial society as may currently be the case in the low-income market. It allows consumers to know exactly what they are entitled to and when they are entitled to it. It also entrenches their rights and seeks to ensure that they do not suffer abuse from insurers.

2.4 Twin Peaks

The Twin Peaks framework will seek to significantly enhance South Africa's financial regulatory and supervisory framework by enabling a proactive, pre-emptive as well as risk-based approach to regulating and supervising the financial sector.

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135 ibid.
136 ibid 14.
137 ibid.
138 ibid.
139 ibid.
140 ibid.
141 ibid.

In February 2011 the Minister of Finance announced that the South African model of financial regulation would be shifting to a Twin Peaks model. This shift will see a series of wide-ranging reforms which intend to improve the institutional structures that support financial regulation in order to deal with system-wide macro-prudential risks. These objectives will be achieved by separating the oversight of market conduct regulation, which regulates how financial institutions conduct their business, design and price their products along with how they treat their customers, from prudential regulation, which regulates financial institutions' solvency and liquidity. In July 2011 Cabinet approved this proposed shift to a Twin Peaks model. This framework gives effect to the government policy paper entitled "A safer financial sector to serve South Africa better" which sets out the proposals to reform the financial sector's regulatory system.

In broad terms the Twin Peaks approach entails two major shifts from the current regulatory regime. Firstly a "prudential authority" will be created and will be housed in the South African Reserve Bank (SARB). It will be headed by a deputy governor of the Reserve Bank. The prudential regulator will maintain and enhance the safety and soundness of regulated financial institutions and will further be responsible for the prudential regulation and supervision of banks and insurers.[142]

Secondly, the Financial Services Board (FSB) will be transformed into a dedicated market conduct regulator, namely the "financial sector conduct authority". This market conduct regulator will seek to protect consumers of financial services and promote confidence in the South African financial system. In addition thereto it will also be responsible for regulating the market conduct of banks, insurers, financial intermediaries and financial markets.[143] It will be a stand-alone institution.

The Twin Peaks framework ideally seeks to achieve two main objectives. The first is to create a more stable financial system, the second is to strengthen South Africa's approach to market conduct regulation. Through this framework the financial sector will be aiming to improve consumer confidence and thereby increasing employment, development and economic growth, and ultimately creating a more sustainable financial sector.[144] This will in turn mean

[142] Scholtz "Consumer credit institutions" in Scholtz (ed) *Guide to the National Credit Act* (2014) 3 3-2-11.
[143] ibid.
[144] KPMG "Twin Peaks" 2014 2 (http://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Financial-Services/Documents/KPMG%20Twin%20peaks.pdf (28-09-2015)).

that financial institutions need to have effective risk and compliance functions; this will involve adopting a forward-looking judgment-based approach on an assessment of risk.[145]

The source of this regulatory overhaul can be traced back to the 2008 financial crisis which exposed a culture of non-compliance which previously existed globally. The implementation of Twin Peaks is not unique to South Africa and many countries, including Australia, New Zealand, Belgium, the Netherlands, and the United Kingdom (UK), have chosen a Twin Peaks approach to financial sector regulation. In the UK the prudential regulatory authority operates as a subsidiary of the Bank of England and is responsible for the prudential regulation of systematic institutions which include banks, insurers and asset managers, while the Financial Conduct Authority is responsible for market conduct supervision of credit and all other financial institutions.[146] In Australia the structure is slightly different as the prudential regulatory authority is completely separate from the Reserve Bank of Australia.[147]

Such a vast increase in regulation may have both a positive and a negative impact on the financial services industry. It will increase compliance costs and increase the need for additional staff to monitor compliance. This may in turn mean reduced risk management services.[148]

There are also concerns that attempting to implement such a sophisticated regulatory system will not sit well with the simplified nature of microinsurance. This significant regulatory change will mean that it will become increasingly burdensome for financial institutions to operate in the financial services sector and can ultimately increase the cost of doing business in this sector.

Having said that, will Twin Peaks be the framework that solves South Africa's financial sector problems? Such regulatory reform pins its hope on the belief that reshuffling regulatory authority by itself will improve the effectiveness of regulation. Is it not, however, more important for policymakers to rather focus on the rules regulators would adopt and how they would be enforced, than renaming authorities or being concerned about what sectors of the

145 KPMG "Twin Peaks: The new landscape" 2012 9 (https://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Financial-Services/Documents/Twin%20Peaks%20Regulation%20Key%20Changes%20and%20Challenges%20-%2019%20Oct%2012.pdf (28-09-2015)).

146 National Treasury "Twin Peaks in South Africa: Response and explanatory document" 2014 8 (http://www.treasury.gov.za/public%20comments/FSR2014/2014%2012%2012%20Response%20document.pdf (05-10-2015)).

147 ibid.

148 KPMG (n 144) 1.

financial industry they would oversee?[149] Are the calls for massive regulatory overhaul misplaced?

It is submitted that the implementation of Twin Peaks is not misplaced and such a system is needed in South Africa. Financial regulators need to have a broader authority over financial institutions that pose systematic risks to the financial markets in order to prevent a recurrence of any financial market failures or collapses.[150] The task in South Africa now is to strike an appropriate balance between the cost of regulation and that of economic growth, as it would not be desirable to end up with a situation where the financial services sector is over-regulated at the expense of providing individuals with access to financial products. Overall, the increased cost of doing business may have a negative impact on microinsurance and this is a challenge that should be borne in mind.

It is envisaged that the Twin Peaks model will be gradually phased in in order to minimise the risks associated with the change. The model will also introduce the Treating Customers Fairly and Solvency Assessment and Management regimes to South Africa. It is anticipated that the reform of the current industry-specific law will take place over 2016-2018.[151]

2.5 Treating Customers Fairly

The Treating Customers Fairly (TCF) regime is the new mantra in the financial services industry. The FSB has been given an unequivocal mandate by National Treasury to introduce the TCF regime as a key mechanism to drive the policy priority of ensuring consumer protection through strengthened market conduct regulation.[152]

The concept of TCF seeks to ensure that the fair treatment of customers is embedded within the culture of financial institutions and it is based on a combination of market conduct principles as well as explicit rules which will drive the delivery of clear and measurable fairness outcomes. TCF has best been described as "a combination of market conduct principles and explicit rules, designed to drive the delivery of clear and measurable fairness outcomes."[153]

The TCF regime envisages six fairness outcomes, positioned from the perspective of the consumer, and seeks to ensure, *inter alia*, the supply of appropriate financial products and

149 Jones "Back to basics: Why financial regulatory overhaul is overrated" 2010 *Entrepreneurial Business Law Journal* 391 401.
150 ibid 392.
151 National Treasury (n 146) 46.
152 Bezuidenhout "A compliance paradigm shift" 2012 *Without Prejudice* 32 32.
153 ibid.

services to consumers as well as improved consumer confidence.[154] Outcome one requires that the fair treatment of consumers be central to the culture of the financial institution. The remaining five outcomes flow from this and include that the products and services which are marketed and sold are designed to meet the needs of the targeted group; that consumers are provided with clear information and are kept informed throughout the contracting process; that advice which is given to consumers is suitable and takes account of their circumstances; that products which are provided perform as the financial institutions have led the consumers to expect; and lastly, that consumers can reasonably change products, switch providers, submit a claim or lay a complaint. The TCF regime will essentially require financial institutions to contemplate the fair treatment of consumers at all stages of their relationship with the consumer, from the product design and marketing stage right through to the advice and after-sale stages.[155]

When it comes to financial services, consumers are particularly vulnerable to unfair treatment. Financial institutions will typically have far more expertise and resources available to them when it comes to designing, distributing and servicing financial products than consumers would have available to them in making decisions about financial transactions.[156] The nature of financial services and products often have the result that any consequences of unfair treatment by providers, or poor decisions by consumers, are only felt some time in the future – often many years after the initial transaction had been concluded. These issues are aggravated by the fact that many low-income consumers in South Africa also have low levels of both basic and financial literacy, thereby worsening the potential for abuse and exploitation of consumers.

The TCF regime will see the responsibility of regulatory decisions moving to more senior management levels and will ultimately challenge financial institutions' compliance, risk management and internal audit functions. The successful implementation of TCF will require evidence that fair customer treatment has been embedded in a financial institution's culture at all levels. Financial institutions must be able to demonstrate that they have identified and are managing any risks of unfair treatment of customers in their business and that there are actual improvements in customer experience.

154 Financial Services Board "Treating Customers Fairly roadmap" 2011 7 (https://www.fsb.co.za/feedback/Documents/Treating%20Customers%20Fairly%20-%20The%20Roadmap%202011.pdf (27-09-2015)).
155 ibid.
156 ibid 6.

The TCF regime further includes credible deterrence measures which ensure that market participants are aware of the fact that unfair treatment of consumers will be detected and that those responsible for such unfair treatment will face consequences. However, in order for the outcomes of TCF to be achieved, financial institutions must know that the regulator is in a position to enforce their TCF accountabilities.[157] Consumers also need to be aware and have confidence that the regulator has the necessary enforcement powers.

In this regard it is encouraging to note that the FSB has various enforcement mechanisms available to it which can be used against financial institutions or individuals who are responsible for TCF failures. These include administrative fines and penalties, the declaration of business practices as undesirable, and the suspension or withdrawal of regulatory licenses.[158] In addition thereto the risk of public disclosure of TCF enforcement action being taken against a financial institution has the potential to be an effective deterrent against unfair customer treatment.

TCF rules originated in the UK and have been taken unapologetically and unchanged from English law. The Financial Services Authority in the UK believes that principles-based regulation will sustain a rigorous regulatory environment but with better and more effective outcomes.[159] This copy-and-paste endeavour does, however, raise eyebrows as such a set of rules may not be best suited to the South African financial services industry.

The case of *Susanna Aletta Grobler v Direct Axis (Pty) Ltd*[160] illustrates the need for adequate disclosure when a financial product is sold, especially when consumers with low levels of literacy are concerned. In this case the insurer failed to pay out a claim made by the consumer and the Financial Advisory and Intermediary Services Ombud found that the rendering of financial service over the phone took "no more than two minutes and two seconds".[161] The ombud remarked that the insurer should have explained in more detail the exclusionary clause contained in the policy and was subsequently ordered to meet its obligations in terms of the agreement and ordered to pay out the policy.[162] This case highlights the need for full disclosure of all the conditions, exclusions, limitations and other restrictions that apply to financial products. This case is a classic example where financial customers are currently not adequately protected and more needs to be done to ensure that the providers of

157 ibid 25.
158 ibid 27.
159 Bezuidenhout (n 152) 32.
160 FOC 1434/05 NP of 19 January 2006.
161 ibid 19.
162 ibid.

financial services treat their customers fairly. This case further showcases that, even though TCF may have been copied and pasted from UK law, there is a place and a need for it within the South African financial services industry. In addition thereto, in 2014, the ombudsman for long-term insurance received 8 per cent fewer written requests for assistance than in 2013.[163] The ombud has identified TCF as one of the factors which assisted in this reduction.

All financial institutions that are regulated by the FSB will be subject to TCF scrutiny. This includes long-term and short-term insurers as well as microinsurance providers. These TCF requirements do, however, add an extra layer of administration and compliance that needs to take place in order to meet the necessary requirements. Financial institutions need to prove that they are implementing TCF principles and that they have used a risk-based approach. This in turn will require resources, and resources cost money. While the TCF regime will undoubtedly ensure that consumers are better protected, many of the insurers will inevitably become frustrated with this ongoing increase in legislation and regulations that need to be complied with. An increase in regulatory requirements will see an increase in the cost of doing business and these costs will ultimately filter down to the consumer.[164]

The main principle behind the TCF philosophy is the fair and ethical treatment of customers and it essentially encourages a behavioural change in the way that financial institutions conduct business and treat customers throughout the life cycle of the product. It is therefore suggested that financial institutions test their products before they are launched in order to ensure that they meet customer expectations. They should also conduct product risk assessments to ensure that existing products will not be seen as taking advantage of consumers and that they can be demonstrated to provide value and benefit.[165]

TCF can therefore be used as a catalyst to infuse fairness in the financial services industry. It can also be used as a tool to attract consumers who are used to more informal structures of product offering.

The TCF regime provides for a broad set of outcomes and requirements which may be difficult and costly for microinsurers to comply with. However, the inclusion of such a regime

163 Ombudsman for Long-term Insurance "2014 Annual Report" 2014 2 (http://www.ombud.co.za/publications/annual-reports/download/544/648/19 (28-09-2015)).

164 The TCF regime reiterates that consumers have become a priority for everyone in the financial services industry. This means that financial institutions need to have stringent TCF programs in place and will not simply be able to tweak a few processes and controls. Financial institutions will also no longer be able to shift responsibility to advisors by stating that they did not directly interact with the retail consumer. The TCF principles will apply across the value chain.

165 KPMG (n 145) 5.

in the financial services industry is necessary and financial institutions ultimately need to recognise that the fair treatment of consumers will be to their advantage.

Finally, it is submitted that the TCF principles are of paramount importance in the microinsurance realm and are to be welcomed as they have the potential to safeguard the rights of an extremely vulnerable group of consumers.

2.6 Solvency Assessment and Management

Almost six years ago the FSB and the South African insurance industry commenced the task of establishing a risk-based regulatory regime for the prudential regulation of both long-term and short-term insurers in South Africa – this was subsequently entitled the Solvency Assessment and Management (SAM) project.

SAM is a risk-based supervisory framework with the primary objective of improving policyholder protection as well as contributing to financial stability through aligning insurers' regulatory capital requirements with the underlying risks of the insurer. It also has the objective of providing incentives to insurers to adopt more sophisticated risk monitoring and risk management tools.[166] The implementation of SAM will mean that the South African insurance industry is aligned with international standards.

As with any significant financial regulatory reform, it is essential to understand the wider implications for both the insurance industry and the economy as a whole. The FSB therefore conducted an economic impact study on the effects that SAM would have on the industry. The study indicated that SAM is likely to lead to better risk management at a direct cost that will be considered small when seen in context of the size of the South African insurance industry. This additional cost to the insurance industry is expected to lead to a slightly positive impact for the economy as a whole, while also contributing to a more sustainable and stable financial sector.[167]

It is expected that SAM will cost R2.5 billion to implement with further estimated ongoing costs of R500 million per year.[168] Insurers anticipate that the costs of SAM implementation will likely be borne by shareholders in the short term and subsequently passed on to consumers in the medium term.[169] What raises concern is that the costs of implementing SAM may further see an increase in premiums. As SAM is a risk-based framework, the higher the risks of a

166 Financial Services Board "Solvency Assessment and Management Economic Impact Study" 2015 4 (https://www.fsb.co.za/Departments/insurance/Documents/SAM%202015%20Update.pdf (27-09-2015)).
167 ibid.
168 ibid 9.
169 ibid 11.

product, the more regulatory capital the insurer will need to hold for that product.[170] This means that a higher risk consumer is most likely to see an increase in premiums. This does not bode well for low-income individuals as they are most likely to be classified as high risk consumers and in turn this will probably see an increase in premiums in the microinsurance realm as insurers attempt to cover their costs of providing products to the low-income sector.

While the SAM regime has been welcomed by many, there is concern that the higher capital requirements and fixed expenses that it will bring about will act as a barrier to entry, reducing competition as well as innovation.[171]

Unfortunately SAM has the potential to impede on the objective of financial inclusion. Higher costs of doing business will ultimately filter down to the consumer and will lead to an increase in the premiums charged by those insurers that offer insurance products with low benefit levels.[172] This may have the unfortunate consequence of lowering financial inclusion of low-income earners as the target market consumers will be less likely to be able to afford insurance products.[173]

Some further criticisms that have been levied against SAM is that some of the smaller insurers feel that SAM is more beneficial to larger companies and that the costs of training and development as well as obtaining skilled resources is more of a challenge for the smaller players with smaller budgets.[174]

The microinsurance framework is however aimed at mitigating such a risk by placing simpler regulatory requirements on simple products. The microinsurance framework will also facilitate innovation by insurers who would otherwise not have been able to provide simplified products under the SAM framework.

Overall the SAM framework can be commended as it not only increases compliance with international standards but also facilitates a forward-looking and risk-based approach to insurance supervision.[175] The alignment of this risk to capital and the enhanced management

170 ibid.
171 ibid 12.
172 ibid 14.
173 The implementation of SAM ultimately facilitates a forward-looking and risk-based approach to insurance supervision. The alignment of risk to capital as well as the enhanced management and supervision of risk is expected to lead to a more financially stable insurance industry. This is then expected to lead to a more financially stable financial sector due to the interconnectedness of the South African financial sector. In turn this will ultimately be to the benefit of policyholders and overall economic development.
174 Financial Services Board (n 166) 13.
175 SAM further has the potential for a decrease in the probability or severity of insurance failures. If a large insurer were to collapse it would have a systematic impact in South Africa, given the interconnected nature of the South African financial sector. Therefore, if one takes into account the potential financial stability risks that such a failure could result in, the costs that SAM will bring about are small in comparison to the

and supervision of risk is ultimately expected to lead to a more financially stable insurance industry as well as a more stable financial sector, due to the interconnectedness of South Africa's financial sector.[176]

In addition thereto SAM will assist microinsurers in maintaining a sustainable operation by ensuring that their regulatory capital is aligned with their underlying risks. However, whilst SAM will be one of the drivers that will stabilise the financial markets it will also drive up the cost of doing business. The more sophisticated risk monitoring and management tools that SAM will bring about will result in increased operational costs for insurers which in turn will ultimately mean an increase in costs for consumers.

It is envisaged that SAM will come into operation during the first half of 2016 and will be facilitated mainly through the enactment of the Insurance Bill and additionally supported by subordinate legislation.

2.7 Insurance Bill

On 15 April 2015 Cabinet approved the release of the Insurance Bill of 2015 (the Bill) for public comment and the consultation process subsequently ended on 29 May 2015. The Bill has been in development for five years and establishes a consolidated legal framework for the prudential supervision of the insurance sector which is consistent with international standards for insurance regulation and supervision.[177] In addition, the Bill will give effect to the SAM framework.

The Bill introduces a new group-wide supervision regime for insurers and enhanced reinsurance arrangements. The objective of the Bill has been stated as follows:

> "to promote the maintenance of a fair, safe and stable insurance market for the benefit and protection of policyholders by establishing a legal framework for insurers and insurance groups that
>
> - facilitates the monitoring and preserving of the safety and soundness of insurers;
> - enhances the protection of policyholders and potential policyholders;
> - increases access to insurance for all South Africans;

cost of a financial sector collapse. In 2008 with the global financial crisis the damage that the collapse of a financial institution can cause became evident.

176 Financial Services Board (n 166) 16.

177 Financial Services Board "Solvency Assessment and Management 2015 Update" 2015 4 (https://www.fsb.co.za/Departments/insurance/Documents/SAM%202015%20Update.pdf (10-09-2015)).

- contributes to the stability of the financial system in general."[178]

The Bill largely deals with the regulatory gaps which were identified by the World Bank's Financial Sector Assessment Program evaluation of South Africa, and seeks to promote the maintenance of a fair, safe and stable insurance market by establishing a legal framework for insurers which intends to achieve a number of listed goals. These goals include enhancing financial soundness and oversight through higher prudential standards, increasing access to insurance through the dedicated microinsurance framework, strengthening the regulatory requirements in respect of governance, risk management and internal controls for insurers, and finally to align with international standards in accordance with South Africa's G20 commitments.

The Bill essentially entrenches the principle of proportionality which means that regulatory requirements will be applied in a manner which is proportionate to the nature, scale and complexity of the risks that are inherent in the business of an insurer – this is so that requirements imposed on small and medium sized insurers are not too onerous.[179]

It is envisaged that the Bill will replace those sections of the LTIA and STIA relating to prudential supervision with effect from the first half of 2016. Overall the Bill ties together all the new regulatory developments as discussed above and will give effect to National Treasury's policy document on microinsurance. The Bill will give a voice to microinsurance and will ensure that the microinsurance framework is cemented in the South African financial services industry.

However, it is still uncertain at this stage whether microinsurance will spread out and have its own piece of legislation or whether it will incorporated into the Bill. Nevertheless the fact remains that microinsurance will be regulated by a sound legal framework.

2.8 Conclusion

Whilst all the recent framework and regulatory updates are welcomed, it is imperative that a balance be struck between costs and benefit – a balance between those regulations which are necessary to make a safer financial sector and those which will assist in an improved economy with increased levels of financial inclusion.

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178 National Treasury "Memorandum on the objects of the Insurance Bill, 2015" 2015 8 (http://www.treasury.gov.za/public%20comments/DraftInsuranceBill2015/Annexure%20B.pdf (27-07-2015)).

179 ibid.

It is imperative that microinsurers and regulators keep in mind that over-regulation will ultimately impose a negative impact on low-income earners and will not do the goal of financial inclusion any favours.

Overall these regulatory developments are welcomed, however, the objectives they seek achieve will be fruitless if they result in an over-regulated financial services industry which is unable to foster the inclusion of low-income individuals due to ever increasing costs.

CHAPTER 3
MICROINSURANCE PRODUCTS

3.1 Introduction

The introduction of the microinsurance framework has seen commercial insurers who traditionally served the high-end of the market now begin to increase their targeting towards the low-income market. The considerable strides made in product and distribution innovation have made insurance offerings more appropriate and attractive to the low-income market.[180]

This chapter overviews microinsurance products currently in the market and consists of an investigation and discussion of two existing microinsurance products.

The discussion will then move on to ways in which microinsurance can bring innovation to product design and distribution in the insurance industry. In addition to the product features and standards mentioned in section 2.3.2 above, this section outlines innovative ways in which microinsurance products can be produced and ultimately assist in the goal of financial inclusion.

Lastly, the need for various consumer education and protection mechanisms will be discussed as well as the role that innovation can play in this realm.

3.2 Case study: Overview of existing microinsurance products in the market

The following discussion is based on a study conducted by the Centre for Financial Regulation and Inclusion (CENFRI) in 2010 titled "Reaching the client: Update on microinsurance innovation in South Africa" whereby they investigated various microinsurance products in the market.

In the current microinsurance market in South Africa three alternative categories of insurance intermediaries have emerged. They are retailers (both food and clothing), retail payment networks partnering with formal and informal vendor networks, and cell phone networks and airtime distributors.

In March 2006 Hollard insurance launched an insurance product aimed at low-income individuals in partnership with Pep.[181] The insurance products are placed on a shelf in Pep

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180 Smith, Chamberlain, Hougaard, Smit and Carlman "Reaching the client: Update on microinsurance innovation in South Africa" 2010 *CENFRI* 3 (http://cenfri.org/documents/microinsurance/2010/Update%20on%20innovation%202010/Update%20on%20innovation_Synthesis%20note.pdf (28-07-2015)).

181 Pep is a low margin, high volume, clothing retail store with a network of 1 159 stores throughout South Africa.

stores near cashier queues and the products are not actively sold by the staff. If a consumer decides to purchase the product the cashier will capture the client's contact details and the client will then be contacted within 72 hours by the Hollard call centre in order to obtain more details and activate the cover. The product packaging has been designed to look similar to that of a cell phone starter pack as this is a format that the target market is familiar with. Consumers are then able to pay their premiums at the till-point in cash when they present their policy card, and consumers are also reminded of their monthly payment that is due through an SMS.[182]

This sales model does not rely on the active marketing or selling of the product and consumers are the ones who are required to initiate the transaction. Pep staff have also not been trained to provide any advice or verbal information on the product. More information regarding the product is however available through the Hollard call centre.[183] This product only offers funeral cover with a variety of different options and has more than 200 000 active policies.[184]

The success of this model can be attributed to the low distribution costs through Pep's network of stores as well as the fact that costs have been kept low by provision of limited information and absence of advice to consumers. Hollard's experience with venturing into previously unexplored markets has also helped in this regard.[185] Despite this success and high amount of active policies, the model has only been able to sell funeral insurance, something which the low-income market is already very familiar with. The model has not been able to create markets for new types of financial products for the low-income market.[186]

Shoprite supermarket has been another retail innovator in the low-income insurance market. Shoprite displays insurance products in-store and consumers are able to purchase a policy initiation pack at the cashier. However, all premiums have to be paid at a separate money market counter.[187]

Old Mutual launched the innovative Pay-when-you-can flexible insurance top-up package at Shoprite stores in 2007.[188] It is available at Shoprite money market counters and allows consumers to buy insurance on a top-up basis to a maximum cover amount of R20 000. The product is sold off the shelf in the form of a starter pack.[189] The starter pack itself contains an

182 Smith *et al* (n 180) 9.
183 ibid.
184 ibid 11.
185 ibid 10.
186 ibid.
187 ibid 13.
188 ibid 14.
189 ibid.

information booklet and two insurance policies: family funeral cover and family accidental cover.

After purchasing the starter pack the accidental cover component of the policy will be activated once a consumer registers at the money market counter in the Shoprite store. This is done by presenting their identity document as well as the client card that was placed in the starter pack. Once activated the policyholder will be entitled to 60 days accidental death cover. The consumer also has the option to increase the accidental cover in increments of R5 000, up to a maximum of R20 000, for each 60 day period.[190]

The funeral cover component of the policy is sold on a top-up basis for a period of 12 months. Once the consumer has registered for the accidental death component of the policy they are able to buy top-up funeral cover from the money market counter. Each top-up purchase that the consumer makes constitutes a separate policy, each has a six month waiting period for death by natural causes, and will increase the length of time that the consumer is insured as well as the total cover that the individual will have.[191] A cause for concern however is that the product only provides cover for a specified 12 month term, and a six month waiting period applies, therefore the consumer will effectively only have six months coverage for death due to natural causes for each top-up purchased.[192] In essence this means that the consumer needs to top-up the funeral cover every six months in order to enjoy continuous cover for death due to natural causes. This is something that a consumer may not initially be aware of unless it was expressly explained to them, and they may be misled into believing they will be covered for a full 12 month period after each top-up. As was discussed in section 2.3.2 above, the microinsurance policy document stipulates that there should be no new waiting period in such an instance and such a provision will go a long way to ensure that low-income individuals receive appropriate cover.

As can be seen from the products discussed above, South Africa's stringent market conduct regulatory regime has contributed to the fact that most of the innovation that has occurred in microinsurance distribution has been in the space of passive distribution models.[193] Passive distribution requires a consumer to be aware of the insurance available and what its value proposition is.[194] This model has only found success in selling funeral insurance and has struggled to break through into other sectors.

190 ibid 15.
191 ibid.
192 ibid.
193 ibid 16.
194 ibid.

What was also evident from the analysis of the microinsurance products currently in the market is that retailers are increasingly being used as distribution channels. The different approaches used in labelling of the products is also interesting to note. Pep in partnership with Hollard chose to white label their product. Whilst Shoprite has decided to offer insurance products with clear Old Mutual branding.

Smith *et al* raise concerns over retailers' decisions to partner with insurers as this raises questions about their capacity to make product choices on behalf of consumers or advise consumers on the most appropriate products for them in the absence of agents or staff who are qualified to do so.[195] This strong brand association that many consumers have with retailers may result in a situation whereby a consumer may be induced into buying an insurance product simply because it is being offered by a trusted brand rather than it being appropriate to the consumer's needs.[196]

There is also a concern that combining a complex product with a simple channel may not meet the clients' needs appropriately.[197] Insurance is generally a very complex product which is often explained in complex language, this can result in even the simplest policies being difficult to understand.[198] By attempting to sell these products through a simple channel which offers no advice or verbal disclosure, consumers may not be able to understand how exactly the product will work or they may be unable to see the value of the product.[199] This in turn may result in them deciding not to purchase the product.

From this analysis of the microinsurance products that are currently in the market two prevalent issues stand out. The first is the need for education of consumers in the low-income market. In order for microinsurance to succeed, consumers need to be aware of the benefits that these products can provide them. The second is the need for plain language in all policies and documents relating to microinsurance products. Microinsurance products are targeted at low-income individuals who often have low levels of education and literacy. They are also unfamiliar with the complexities of insurance products. There is therefore a strong need for the terms and conditions of the products to be explained to the consumer in a simple manner.

195 ibid 17.
196 ibid.
197 ibid 19.
198 ibid.
199 ibid.

3.3 Product innovation

It has been said that South Africa has one of the most innovative insurance markets in the world and it is considered to be one of the leading microinsurance jurisdictions.[200]

However, as the low-income market does not generally have access to the traditional distribution channels like the higher income market does, it is difficult for insurers to reach the intended target market and this requires innovative ideas to be implemented.

Of the surveyed participants in the 2014 Finmark Trust Survey, 90 per cent indicated that they communicated via cell phones and 25 per cent indicated that they communicate via the internet.[201] As such a large percentage of the population have access to cell phones, incorporating cell phone technology into the microinsurance sphere will support social development as well as connectedness and social structure support. Of those who are using cell phones only 24 per cent utilise them for cell phone banking and 44 per cent of cell phone users indicated that technology is too complicated to use for financial activities.[202] The survey also questioned whether those who use cell phone banking are more engaged with the financial sector.[203] Of those who utilise cell phone banking 17 per cent have switched banks in the past year, versus 11 per cent overall, and only 24 per cent take out all their money as soon as it deposited into their bank account, versus 33 per cent overall.[204]

This high use of cell phones amongst the South African population can assist microinsurers to collect premiums via airtime from consumers' cell phones.[205] However, a particular issue with this innovation is that the airtime needs to be converted into hard currency by a wireless access service provider.[206] Generally these entities will charge a large fee on the conversion process.[207]

As was mentioned in section 3.2 microinsurance products that are currently available for the low-income market feature a unique distribution model. This model involves the sale of microinsurance products through intermediaries and worryingly most of these models do not provide any advice or verbal communication during the sales process. Due to this feature the insurer will rely on the client to initiate the transaction and the intermediary will thus take a

200 ibid 1.
201 FinScope Consumer Survey (n 35) 14.
202 ibid 42.
203 ibid 43.
204 ibid.
205 This model may be effective in reaching low-income individuals in remote locations that are difficult to reach via the more conventional models and is currently being used by the Metropolitan Cover2go product.
206 Smith *et al* (n 180) 18.
207 ibid.

passive role in the sales process.[208] The FAIS Act does not require intermediaries to provide advice but does require the intermediaries to provide the necessary information for the consumer to make an informed decision. When advice is provided, the Act sets out certain requirements for how this must be done. Doing so has certain added costs and has created uncertainties regarding what is required in the low-income sphere.[209]

Smith *et al* state that by making advice more expensive and by opening up the opportunity for non-advice-based selling, FAIS has inadvertently led to the dominance of the non-advice and passive sales model in the microinsurance market.[210] These developments have resulted in a divergence in the insurance market as a whole between advice-based sales to the high-income market on the one hand and tick-box selling to the low-income market on the other.[211] As a result of this microinsurers have favoured the 'tick-box' style selling techniques that do not require any active sales or verbal disclosure by a sales person.[212] This has further led to microinsurers focusing on retailer and other distribution partnerships to sell 'commoditised' insurance products to the low-income market without any advice.[213]

The problems with this distribution model recently came to light when Lewis, one of South Africa's largest furniture chain stores, was accused of selling insurance policies to consumers who were not eligible for the intended cover. The National Credit Regulator has referred the matter to the National Consumer Tribunal, with a request that it imposes a fine on the Lewis Group, orders the company to refund the affected consumers, and conduct an audit of the group.[214]

It cannot be denied that the distribution models should be simplified in the microinsurance sphere, but this should not come at the expense of the consumer. By simplifying the model we should not see a simplification of consumer protection. Product innovation and simplification should work to the benefit of and not to the detriment of consumers.

A further method for innovation in the microinsurance sphere is to embed a simple life-cover product into an airtime purchase for cell phones. Such a model is currently being followed in Ghana, Namibia, Tanzania and Zimbabwe.[215] This provides an effective delivery

208 ibid 5.
209 ibid 6.
210 ibid.
211 ibid.
212 ibid 7.
213 ibid 7.
214 Knowler "Lewis will 'co-operate fully' with insurance probe" 2015 *Business Day* (http://www.bdlive.co.za/business/financial/2015/07/10/lewis-will-co-operate-fully-with-insurance-probe (31-07-2015)).
215 McCord *et al* (n 85) 24.

channel to get microinsurance products to the broad population and will be an important driver for growth in this segment. However, adequate consumer education is needed to ensure that consumers are aware of the existing limitations and benefits of such embedded products.

When it comes to marketing and consumer awareness of products, there are several unique options that exist in the microinsurance sphere. One such option, which is often overlooked by microinsurers, is the important role that community groups play in assisting microinsurers reach their target market. Burial societies, stokvels, church groups, and clients of specific stores can all be used as aggregators allowing commercial insurers to reach their members in a cost effective manner.[216] The trust placed in the group by the members plays an important role in facilitating insurance uptake amongst the members. Such groups will often drive the product innovation process along with the help of the insurer and the products will be tailored to meet the needs of the members.[217]

Building on this, Mpedi and Millard put forward the suggestion that microinsurance be marketed amongst those individuals who are already receiving social assistance grants. In doing so the authors suggest that there be a partnership with the South African Social Security Agency (SASSA) whereby a number of selected insurers, who have been authorised by the FSB to do so, start marketing a limited number of products among those individuals who are registered on SASSA's system.[218]

Insurance company Zurich has embarked on another approach to innovation by moving away from the term 'microinsurance' and using 'emerging consumer' instead. "The company feels it better reflects the customer's needs, which are not micro (at least from the customer's perspective), nor does the prefix 'micro' adequately describe the scale of this business. The initiative thus does not see low-income households as 'poor', but as ambitious and 'emerging' consumers, as evidenced by the growing middle class in emerging markets. Insurance protects assets and income – and emerging consumers have both."[219]

It will be wise for insurance companies to invest in the low-income market from an early stage as these low-income consumers have the potential to earn higher incomes over time and

216 Smith *et al* (n 180) 5.
217 ibid.
218 Mpedi and Millard "Bridging the gap: The role of micro-insurance in a comprehensive social protection system in South Africa" 2010 *Obiter* 497 516.
219 Angove, Herrndorf and Mathews "Teaching elephants to dance: the experiences of commercial insurers in low-income markets" in Churchill and Matul (eds) *Protecting the poor: A microinsurance compendium* (2012) 399 405.

will then graduate to larger policies and higher margin products once they are more familiar with the benefits of insurance.[220]

Whilst product innovation and simplification is important in the microinsurance sphere it must not lead to watered-down consumer protection. Product design should be focused on consumers' needs evidenced through data or research. This design should follow from consumer insight and focus on meeting consumers' expectations as well as achieving commercial targets. It is also important that ambiguity is removed from the products and that consumers are made aware of exactly what they are purchasing and the extent to which the product will cover their risks. Getting this information across to low-income consumers who generally have lower levels of education and literacy can be tricky and will require the use of plain language, consumer education programs and other innovative methods to ensure that consumers are empowered to make product choices that are best suited to their needs.

3.4 Consumer protection and education

3.4.1 Consumer protection

Adding to the anxiety clouding the introduction of a microinsurance framework is the increasing efforts to strengthen consumer protection mechanisms. It cannot be doubted that consumer protection is critical for the long-term success and sustainability of microinsurance. However, as was seen in the case study in section 3.2, much of the existing microinsurance industry in South Africa has been built on the premise of removing many of the 'protections' that more sophisticated insurance markets or products enjoy, which include complicated policy documents, complicated claims processes and many exclusions.[221]

The need for consumer protection is rife, especially where low-income consumers are concerned. Therefore the principles of the FAIS framework as well as the policyholder protection measures envisaged in the LTIA and STIA should not be compromised.[222] The policy document on microinsurance sets out that microinsurance is to be accommodated in a way that will increase financial inclusion while still protecting consumers.[223] This is to be achieved by tailoring the FAIS Act's requirements to fit the simplified and standardised product profile of microinsurance. There will be particular focus on creating the regulatory space to

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220 Iravantchi and Wenner "Microinsurance in Brazil, Columbia, Mexico, and Peru" 2012 *Inter-American Development Bank* 4 (http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=36941792 (05-08-2015)).
221 McCord *et al* (n 85) 28.
222 Microinsurance Policy Document (n 24) 36.
223 ibid.

bring back verbal disclosure and advice into the low-income market.[224] This will mean that the narrative will shift from the current trends in the microinsurance market.

With this shift in the narrative an attempt will be made to bring salespersons into the microinsurance realm. Fit and proper salespersons will be essential to ensure consumer protection. As was seen in the case study discussion in section 3.2, the current sales process in the microinsurance market has been structured to avoid advice-based sales as this is regulated under FAIS. This has resulted in the potential benefit of gradually improving the qualifications and skills of salespersons being lost and in turn the underlying goal of consumer protection being undermined.[225] In this light it is intended that a separate fit and proper category for salespersons will be created under the FAIS fit and proper determination to cover all microinsurance financial service providers, key individuals and representatives.[226]

The importance of providing verbal disclosure and advice to the low-income market cannot be underestimated. The low-income market generally has little experience with formal insurance. As a result, there is a strong need to facilitate the provision of disclosure and appropriate advice to these consumers. The challenge, however, is to 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.[227] In an attempt to resolve this issue the policy document envisages a dedicated FAIS code of conduct which will be developed for microinsurance financial service providers, key individuals and representatives which will be tailored to the specific characteristics of microinsurance.[228] This will then be referred to as a basic advice regime and will seek to facilitate the provision of low cost advice to potential microinsurance consumers. In this regard a simple, short list of scripted questions that could be asked to the consumer that do not entail a full financial need analysis based on the consumer's budget could be developed,[229] as well as a simple, short template for a microinsurance record of advice.[230]

With all of this in mind it has been questioned whether the goal of achieving the ideals of a proper code of conduct may be a step too far for the microinsurance regime, "[m]aybe the old adage *goedkoop is duur koop* will prove to be true of microinsurance and maybe the suggested requirements for simplified disclosure are simply too ambitious."[231]

224 ibid.
225 ibid 37.
226 ibid.
227 ibid 39.
228 ibid.
229 ibid.
230 ibid.
231 Millard (n 56) 673.

Ultimately these legal principles are to be welcomed as they will create certainty and will ensure that consumers' rights are protected. Furthermore, they will act as a mechanism to enhance and enforce the protection of consumers.

3.4.2 Consumer education

In addition to consumer protection, consumer education programs are also necessary in order to show individuals in the low-income market why insurance can be valuable. Insurance literacy is therefore one of the biggest hurdles that needs to be overcome in the low-income market.[232] The readiness of consumers to pay for receiving a definite amount will allow a strong microinsurance market to emerge. But before this can happen low-income consumers need to have an understanding of how the concept of insurance works. It is also important that low-income individuals increase their financial literacy levels so that they can be empowered to make informed decisions when purchasing financial products.

In an environment where many consumers may be unfamiliar with formal insurance products, insurance providers may face difficulties in convincing the consumers of the potential benefits of such an investment.[233] In this instance the level of trust will have an impact on the demand for such products. Consumers need to be convinced that they will receive the promised payment when the adverse event occurs. One way for the microinsurance companies to win the trust of consumers is to ensure that they pay out claims regularly to ensure that there is a feeling of reciprocity amongst consumers. It is also possible that past shocks which a consumer has experienced can drive them to purchase insurance products and the perception of risk will increase the demand for insurance.[234]

An unconventional method of educating consumers is the influence of fellow community members. Fellow community members can spread information about microinsurance to others and in terms of financial literacy training this is a potentially valuable way to reach untrained individuals,[235] particularly those in rural areas who may be hard to reach via conventional education methods. There is also the potential that when one community member purchases a microinsurance product, fellow community members may imitate and do the same. As most of the low-income market is unfamiliar with microinsurance contracts and the value that they provide, the signalling by a few members of their community of the value that microinsurance

232 Chummun and Bisschoff "Validating a theoretical model to measure the business success of microinsurance (MI) in South Africa" 2015 *Journal of Social Science* 143 145.
233 De Bock and Gelade (n 3) 4.
234 ibid 22.
235 ibid 7.

products bring by purchasing them could have a substantial impact on the rest of the community and may indeed influence them to also purchase such products.

Educated consumers who know their rights are more easily protected against abuse as they would be more empowered to seek redress and will also be in a position to make effective product choices in order to cover the material risks that they face.[236] The implementation of the microinsurance regulatory framework will coincide with the introduction of a consumer awareness and education campaign which is to be implemented by the FSB.[237] The campaign will focus on creating awareness of insurance and its value proposition amongst consumers. It will also focus on consumers' rights and responsibilities and alert them to any potential abuses they may encounter.[238]

However, given the nature of the low-income market, a certain amount of innovation is needed when implementing such education programs and it seems we can look to China for a solution. A particularly novel and innovative way of educating consumers about microinsurance is to play insurance games with them. Now this is not the typical game that one might think of. Such an experiment was recently conducted in China, and during these games households were asked whether they would like to buy the intended insurance product in the hypothetical future year and then played a lottery to see whether there would be a risk causing or suffering event in that year.[239] After the game was played for a couple of rounds the conductor helped to calculate their income from that year according to their insurance purchase decisions and showcased how having such an insurance contract in place would help them cope with such a loss. A couple of days later these households were revisited again to enquire whether they would actually purchase the insurance product. By playing such a game the outcome showed that insurance up-take increased by 9.6 per cent.[240]

A lack of experience in and understanding of insurance products contributes to consumers not taking up microinsurance products. This novel method to educate consumers as outlined above has shown that it is an effective method of educating consumers about the benefits of microinsurance and will be particularly effective in educating illiterate consumers. This method will be more effective than the traditional method of simply explaining the benefits to consumers.[241] Consumer decision-making can therefore be influenced by simulating their

[236] Microinsurance Policy Document (n 24) 46.
[237] ibid.
[238] ibid.
[239] Cai and Song "Insurance take-up in rural china: Learning from hypothetical experience" 2012 2 (http://ssrn.com/abstract=2161649 (01-10-2015)).
[240] ibid.
[241] ibid 4.

experiences. Financial education combined with simulated experiences can go a long way in educating South African consumers about microinsurance.

Another method of consumer education and awareness which is often overlooked is that of social networks. Social networks can have a large and significant effect on microinsurance up-take decisions. This is evidenced by the fact that households will be more likely to buy a particular insurance product if their friends, relatives or persons living in their communities have purchased such a product or if such a person attended a meeting whereby the microinsurance contract was introduced to attendees and the benefits of such products were explained.[242] This notion is increased when it is applied to leaders in the community. There is further the potential for an increase in low-income consumers' understanding of insurance and an increase in up-take of insurance where they were exposed to fellow friends, relatives and community members who have high levels of financial education.[243]

Social networks therefore have a positive influence on the up-take of insurance by increasing the knowledge of insurance benefits. If consumers are empowered to understand the benefits of taking out a costly microinsurance product there is likely to be an increase in their willingness to purchase such products.

Owing to the high rate of cell phone usage amongst low-income earners it is submitted that South African insurers can embark on consumer education programs that are distributed via cell phones. In Kenya, market education efforts are also increasing and they are beginning to implement innovative methods to educate the public about microinsurance products, which include featuring products on soap operas and talk shows in order to help the population understand microinsurance and the benefits it may bring about.[244]

Lastly it is submitted that a microinsurance financial literacy roadmap,[245] similar to what has been implemented in the Philippines, be developed by the FSB whereby key stakeholders in the microinsurance realm are identified to whom advocacy and literacy programs should be directed.

While the TCF regime as discussed in section 2.5 will go a long way in assisting to level the bargaining position between consumers and financial institutions, the only way to truly do

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242 Cai, De Janvry and Sadoulet "Social Networks and insurance take-up: Evidence from a randomized experiment in China" 2011 *International Labour Office* 4 (http://www.ilo.org/public/english/employment/mifacility/download/repaper8.pdf (18-08-2015)).

243 ibid.

244 McCord *et al* (n 85) 37.

245 "Assessment of Microinsurance as emerging microfinance service for the poor the case of the Philippines" 2013 *Asian Development Bank* 14 (https://openaccess.adb.org/bitstream/handle/11540/844/assessment-microinsurance-service-for-poor.pdf?sequence=1 (08-10-2015)).

away with this inequality is to empower and educate consumers by increasing their financial literacy levels. One element which plays a pivotal role in empowering consumers is the use of plain language in financial products and services.

3.4.3 Plain language

The need for plain language in microinsurance products cannot be stressed enough. The microinsurance policy document states that microinsurance policies must be simple and easy to understand. Furthermore, the policy documentation must be provided in plain language, avoid uncertainty or confusion, and should not be misleading.[246]

But what exactly is plain language? Cutts defines plain language as "[t]he writing and setting out of essential information in a way that gives a co-operative, motivated person a good chance of understanding the document at first reading, and in the same sense that the writer meant it to be understood."[247] Plain language, however, does not mean language that is anti-intellectual or anti-literary.[248] It is language that avoids obscurity, inflated vocabulary and convoluted sentence construction – it uses only as many words as are strictly necessary and it is understood by the intended audience the first time they read or hear it.[249] Plain language provisions do not only refer to grammar but also to visual aspects and illustrations.

One of the main benefits of plain language is that it "allows people to visualise themselves as subjects of the law and to imagine themselves in the circumstances with which the law deals."[250] It is vital that low-income consumers who are parties to microinsurance contacts are able to understand the contents of such contracts, this will enable them to understand what they are entitled to, as well as what their rights and obligations are. Consumers will be placed in a better position to protect their own interests if they fully understand a document.

Can it still be said that the parties have agreed to the terms of an agreement if the consumer cannot understand the meaning of technical legal jargon and other unpronounceable phrases in the agreement? Gouws is of the view that in such an instance there will be no agreement between the consumer and supplier.[251] The learned author is of the view that it is imperative that consumers understand the contents of the agreement so that they understand what they are

[246] Microinsurance Policy Document (n 24) 12.
[247] Cutts *Plain English Guide* (1995) 5.
[248] Kimble "Answering the critics of plain language" 1995 *Scribes Journal of Legal Writing* 51 52.
[249] Gouws "A consumer's right to disclosure and information: Comments on the plain language provisions of the Consumer Protection Act" 2010 *SAMLJ* 79 81.
[250] Reported in 1995 by Phil Knight, Joseph Kimble and Christopher Balmford, all plain language experts who advised the Constitutional Assembly in relation to drafting South Africa's new Constitution.
[251] Gouws (n 249) 81.

entitled to or what they are required to do.[252] The author's view was confirmed in the case of *Standard Bank of South Africa Limited v Dlamini*.[253] In this case the court held that the bank and its agents caused the defendant to enter into a credit agreement without reading, interpreting and explaining the material terms to him which he did not understand. The question was whether he could, nevertheless, in law be held to have assented to the agreement by virtue of his signature. The defendant was illiterate and did not understand English. The court held that suppliers and their agents should assist consumers in understanding the documents before they sign them. Reasonable measures should be taken by suppliers to ensure that consumers understand the material terms of the agreement. The court held that mutual consent is absent when a party is unaware of the terms of the agreement.[254] As a result, the court held that the agreement was void due to the fact that the consumer had no understanding of the terms of the agreement. The court said that for a person like the defendant, who did not read, write or understand English, there might just as well have been no written agreement at all.[255]

The use of plain language in the marketing as well as disclosure phases of microinsurance products is therefore essential in order to ensure that the consumer understands the benefits of the products as well as the manner in which the product operates and any terms and conditions that apply to the use of the product.

3.5 Conclusion

Microinsurance products which are currently in the market are not correctly aligned with the needs of low-income households. In addition thereto they are sold through passive sales models which struggle to convey the benefits and features of the products to consumers.

The low-income market traditionally has lower levels of literacy and education and are unfamiliar with insurance and financial products. It is therefore essential that consumer education and protection mechanisms are at the forefront of the development of the microinsurance industry. Product innovation can also play a role in this regard as consumer education campaigns can be distributed via cell phones to consumers.

Ultimately it will be wise for insurance companies to invest in the low-income market from an early stage as low-income consumers have the potential to earn higher incomes over time and will then graduate to larger policies and higher margin products once they are more familiar with the benefits of insurance.

252 ibid.
253 2013 JOL 30897 (KZD).
254 See par 54.
255 See par 53.

CHAPTER 4

MICROINSURANCE AS A MEANS TO ALLEVIATE POVERTY

4.1 Introduction

Insurance contracts fulfil and important social function, especially when it comes to life insurance contracts.[256] In the life insurance context the breadwinner of a family would take out an insurance policy on his or her life which would be for the benefit of his or her dependents. Upon his or her death, the family will receive a lump sum from the insurance company and this money would help the family from sinking into poverty and would prevent them from relying on state handouts.[257]

In addressing the case for extending insurance to the low-income sector and the potential of it to mitigate the poverty which is faced by these individuals, a number of key questions need to be answered. One such question is whether insurance is the most effective way to manage the risks of the poor and assist in the alleviation of poverty, or whether other more suitable means are available. This chapter attempts to answer this and other burning questions.

4.2 Microinsurance as an effective tool in alleviating poverty

There are three main social-protection interventions that exist in South Africa, namely social assistance, social insurance[258] and private insurance. South Africa currently has one of the largest social-assistance programs in Africa covering more than 16 million beneficiaries.[259]

There are however many South Africans who fall through the holes of the 'safety net' intended to protect vulnerable persons. The current social protection interventions are failing to adequately protect every person in need of such protection.[260]

In an attempt to fill this gap, microinsurance emerges from three distinct entry points. The first is from low-income earners themselves who have formed their own mutual-benefit associations and burial societies.[261] The second being development agencies such as the International Labour Organisation which has encouraged those who are excluded from

256 Millard (n 12) 1.
257 ibid.
258 Social insurance includes schemes such as unemployment insurance and workers compensation.
259 See https://africacheck.org/factsheets/separating-myth-from-reality-a-guide-to-social-grants-in-south-africa/ for more information on South Africa's social assistance program.
260 Mpedi and Millard (n 218) 500.
261 Churchill (n 16) 12.

commercial and social insurance to create risk-pooling mechanisms.[262] The third is the group of commercial insurers who have identified the large group of low-income earners as a new market opportunity.[263]

All members of society face risks which threaten their life and possessions. However the impact of such risks is particularly worse for low-income individuals and they are often unable to recover from a severe incident resulting in them being unable to escape poverty or which results in them falling into an even more severe state of poverty. A low-income earner will not be able to accumulate enough savings in order to cover such a loss-causing event when it occurs. However such an individual may well be able to pay premiums towards covering such risks if such a product is designed so as to be affordable and appropriate to the needs of the poor.[264] This is where microinsurance can step in and be an effective tool that manages the risks of low-income households.

As the low-income insurance market in South Africa is still growing, insurers can look to microinsurance as a tool that will not only enhance access to such mechanisms for risk management and mitigation but will also contribute to the reduction of poverty and improve the welfare of individuals, as well as enhance economic growth.[265]

Low-income individuals often struggle to improve their socio-economic situations as they are generally reluctant to invest excess income into productive physical capital. Instead they tend to accumulate 'rainy day' funds which generally consists of savings in cash that can be accessed if a risk event occurs. As a result of this their savings tend to yield only limited returns which are not adequate to build a better life and escape poverty.[266]

Low-income individuals are particularly prone to becoming marooned in a perpetual cycle of vulnerability and risk aversion,[267] and as a result thereof they tend to fall into a widening gap of coverage that exists between social protection schemes and regular commercial risk covering products. This is where microinsurance can step in and be an effective instrument for overcoming such a scenario. Microinsurance should be viewed as having the ultimate goal of reducing the vulnerability of people living on low incomes by enabling them to manage risks

262 ibid.
263 ibid.
264 National Treasury (n 21) 12.
265 Finmark Trust (n 29) 2.
266 Deblon and Loewe "The potential of microinsurance for social protection" in Churchill and Matul (eds) *Protecting the poor: A microinsurance compendium* (2012) 40 40.
267 ibid.

more efficiently. Microinsurance is just one possible social protection tool that should be embedded in a country's overall social protection framework.[268]

By providing access to financial services such as microfinance and microinsurance, low-income individuals are empowered to make decisions and are provided with the opportunity to make their own choices for their future.

Another area which has the potential to negatively affect the poor and which is often overlooked is that of climate change. While climate change affects all segments of society its negative impacts are more severely felt by the low-income sector. Many efforts that have gone into poverty alleviation can easily be eroded by a catastrophic incident. While integrating adaption to climate change processes into poverty reduction programs may mitigate such potential losses, there is still a strong need to identify and expand the options of the poor in order to reduce their vulnerability, and this is where microinsurance can be of assistance.[269]

It has recently been revealed that 30 per cent of South Africans rely on support from government grants.[270] This statistic is worrying as it will be less than ideal for South Africa to become a country of dependants. As microinsurance contracts are a product of dialogue between insurers and the target low-income groups, microinsurance can be responsive to the specific needs and preferences of low-income earners.[271] This is in contrast to social security schemes which are often created from a purely top-down process.

Low-income individuals face many risks, some are managed by government whilst others fall squarely within the private sphere. Mpedi and Millard state that the management of risks should take place in a coordinated manner that takes the real needs of communities into consideration, and it is here that microinsurance may prove to be useful.[272]

One must keep in mind, however, that a one-size-fits-all approach does not work when it comes to low-income earners, due mainly to the diverse array of risks that they are exposed to. It should also be borne in mind that, at the end of the day, microinsurance remains insurance, irrespective of the intended target market, and for that reason the risks that are to be covered must be insurable.[273]

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268 ibid 42.
269 Asian Development Bank (n 245) 23.
270 FinScope Consumer Survey (n 35) 9.
271 Deblon and Loewe (n 266) 49.
272 Mpedi and Millard (n 218) 504.
273 ibid.

"Overcoming poverty is not a gesture of charity. It is an act of justice."[274] There is a constitutional duty on the state in South Africa to take reasonable legislative and other steps, within its available resources, to achieve the progressive realisation of everyone's right to access to social security.[275] In this regard the state is assisting by setting up an appropriate regulatory framework for microinsurance which will extend social protection to low-income individuals. Building on from this the state can further serve as a facilitator and assist in forging linkages between excluded individuals, as well as their informal coping mechanisms, the state and formal private role players.[276]

Much can be learnt from South Africa's microfinance industry in this regard. Previously it was a largely unregulated field where many providers would take advantage of low-income individuals. Once government stepped in with regulatory interventions the scheme changed dramatically and a sense of order and security was instilled for the low-income sector.[277] The regulation of this industry also led to financial institutions stepping into the market place and rendering microfinance products and services. As was mentioned in section 1.4 this led to a vast increase in the financial inclusion of many low-income individuals. Microinsurance now has the potential to build upon the success of microfinance.

Large commercial insurers are beginning to recognise that there are vast amounts of cash that never see a bank and that is not invested or used for insurance or social protection purposes.[278] Commercial insurers can thus play the role of assisting low-income earners to escape the cycle of poverty whilst at the same time increasing growth and profits of their company.

Microinsurance should however not be seen as the final answer to the social protection needs of the poor but rather as part of the solution that should exist alongside other social protection interventions such as social assistance and social insurance.[279]

Therefore there is a need for *ex-ante* and *ex-post* measures to work together in alleviating poverty.

274 Quote from Nelson Mandela's speech in London's Trafalgar Square for the campaign to end poverty in the developing world on 3 February 2005.
275 s 27(2) of the Constitution of the Republic of South Africa, 1996.
276 Mpedi and Millard (n 218) 507.
277 ibid.
278 ibid 509.
279 ibid 507.

4.3 The need for ex-ante and ex-post measures to alleviate poverty

As has already been seen, microinsurance is an effective tool that can be used to assist in alleviating poverty, however, it cannot tackle the task alone. There is a strong need for *ex-ante* and *ex-post* measures to be in place to assist with poverty alleviation.

Although social security schemes are effective safety nets which provide protection to low-income individuals, they are not perfect solutions. Such safety nets are only able to offer support once a risk causing event has already occurred and caused serious hardship. From the point of view of low-income individuals the current safety nets are at best a source of uncertainty, and at worst such individuals are excluded or support comes too late.[280]

These issues which cloud safety nets as well as broader insurance provision suggest that a complementary balanced approach which incorporates both elements would be best suited to low-income individuals.[281]

Ex-ante measures would be effective in providing incentives and means for low-income individuals to protect themselves against hardships. Insurance products that cater specifically for the needs of the poor would be the first step, but there is also the potential for microinsurance products to work with microfinance products so that low-income individuals can be empowered to take on a level of self-insurance via savings and access to credit in order to facilitate asset accumulation and properly manage risks that may affect income.[282] Microcredit products can assist in diversifying the source of income of low-income households and assist in building up their assets. In addition thereto *ex-ante* measures should also focus on reducing the risk itself.

Ex-post measures should in turn provide an effective safety net that is appropriately targeted at low-income individuals and which is sufficient to provide a minimum sustainable standard of living for low-income individuals.[283] These measures should also be part of a broader social security support system which responds specifically to risk-related hardships.[284]

The lack of insurance has an impact on cyclical poverty as adverse events can generate income shocks that can drive the poor further into poverty and destroy or force the liquidation of assets they may have accumulated during their lifetimes.[285] The negative shock and the

280 Dercon, Bold and Calvo “Insurance for the poor?” *Oxford working paper* 15 (http://www3.qeh.ox.ac.uk/pdf/qehwp/qehwps125.pdf 10/09/2015 (10-09-2015)).
281 ibid.
282 ibid 16.
283 ibid.
284 ibid.
285 Iravantchi and Wenner (n 220) 3.

reduction of human capital that occurs when an individual suffers a loss can lead to persistent poverty.

4.4 Conclusion

Measures that have the potential to prevent any hardships or losses occurring in the first place can go a long way in assisting low-income individuals from suffering losses. Such measures should directly address the risks faced by the poor and include policies addressing basic health care and sanitation and information systems on weather conditions.[286]

While microinsurance can play a large role it would not be a step in the right direction to say that it should now replace all other forms of social protection. Rather it should be used as a tool that works in conjunction with social security measures and aids in reducing the level of poverty experienced by many low-income households until they no longer need to rely on social security measures. Ultimately there should be a combination of poverty alleviating measures, both *ex-ante* and *ex-post*, which work together as part of a comprehensive system in order to protect low-income individuals and households against risk.

286 Dercon *et al* (n 280) 16.

CHAPTER 5

CONCLUSION: MICROINSURANCE HAS THE POTETIAL TO PROVIDE LOW-INCOME EARNERS WITH ACCESS TO FINANCIAL PRODUCTS

The dissertation sets out to ask whether the exposition in the previous chapters show that microinsurance has the potential to improve the access of poorer and economically vulnerable households to financial services and in doing so, whether it can ensure that the financial services sector better supports economic and employment growth as well as assist in the alleviation of poverty.[287] Microinsurance does indeed have such potential, however, it cannot take on this mammoth task alone.

The extent of financial exclusion amongst South Africans is worrying. Even though the microfinance industry has made great inroads there is still a long path that needs to be travelled. It is submitted that microfinance and microinsurance need to work together, not just in increasing financial inclusion, but also in assisting to alleviate poverty.

Furthermore, education campaigns need to be stepped up and there needs to be an increase in financial literacy amongst low-income individuals as well as instilling a culture of savings before we will see a significant increase in financial inclusion. Flowing from this an insurance culture should be promoted amongst the low-income sector. Low-income individuals need to become proactive money managers. Ultimately they should be able to consider microinsurance as one of several financial instruments that they can use effectively to build their assets and improve their income position.[288]

It is also suggested that regulators engage with the insurance industry to get a better sense of their own capacity constraints and challenges they face when attempting to enter the microinsurance market.[289]

Whilst all the recent framework and regulatory developments are welcomed, it is imperative that a balance be struck between costs and benefit - a balance between those regulations which are necessary to make a safer financial sector and those which will assist in improving the economy with increased levels of financial inclusion. Microinsurers and regulators need to keep in mind that over-regulation will ultimately impose a negative impact on low-income earners and will not do the goal of financial inclusion any favours.

The law has a major role to play here in bringing about change. The introduction of the microinsurance legal principles will indeed provide low-income earners with access to

[287] Microinsurance Policy Document (n 24) 61.
[288] Asian Development Bank (n 269) 24.
[289] Finmark Trust (n 29) 11.

financial products and assist in the goal of financial inclusion. However, if we are to see significant growth in financial inclusion and the financial sector as a whole, microinsurance needs to be fully integrated with other financial products and services such as microfinance and simplified banking, as once these mechanisms are combined they will prove to be much more effective in reaching the goal of financial inclusion.

The stage is set and the tools are available, the time for microinsurance to increase financial inclusion is now.

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