

**A report by the Panel of Enquiry on
CONSUMER CREDIT
INSURANCE IN
SOUTH AFRICA**

CONSUMER CREDIT INSURANCE IN SOUTH AFRICA

A report commissioned and sponsored by the Life Offices' Association of South Africa and the South African Insurance Association

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CONSUMER CREDIT INSURANCE ENQUIRY

REPORT OF THE PANEL OF ENQUIRY APPOINTED BY THE LOA AND SAIA

CHAPTER 1:

INTRODUCTION

1. During July 2007 reports appeared in the financial press alleging that some insurers active in the Consumer Credit Insurance market in South Africa were persistently paying commissions, to the detriment of consumers, to motor dealerships in excess of the permissible maximum rates. This practice, so it was stated, constituted contraventions of the Long-term and Short-term Insurance Acts of 1998 and the relevant regulations issued in terms thereof and would in addition contravene the industry Code of Conduct to which members of the Life Offices' Association ("the LOA"), representing long-term insurers, subscribed.¹ The chief executive of the insurer named in some of the media reports also happened to be a prominent office-bearer of the LOA. Since Consumer Credit Insurance can be written under either a long-term or a short-term licence, members of South African Insurance Association ("SAIA"), the body representing short-term insurers in South Africa, were also implicated. The negative publicity for the entire industry following on these revelations prompted the LOA and SAIA to co-sponsor a wide-ranging investigation *"to identify and eradicate undesirable practices prevalent in the consumer credit insurance market impacting negatively on consumers."*²
2. A panel of enquiry ("the Panel") was accordingly appointed. Its members were: Mr Justice Peet Nienaber, formerly a judge of the Supreme Court of Appeal and the recently retired Ombudsman for Long-term Insurance, as the chairperson; Mr Moses Moeletsi, formerly chief director Gauteng Consumer Affairs, currently a regulatory executive of the South African Bureau of Standards and chairperson of the Board of the Ombudsman for Short-term Insurance and a member of the Council of the Ombudsman for Long-term Insurance; Mr Ronnie Napier, a former SAIA

¹ A list of newspaper reports appearing at the time, of which the first report in Personal Finance of 7 July 2007 is quoted in full, is annexed hereto as Appendix 1.

² Joint LOA and SAIA media release dated 30 August 2007, annexed to this report as appendix 2.

chairperson and a senior partner at the law firm, Webber Wentzel; Mr Desmond Smith, chairperson of the LOA Board and a director of companies; and Mr Louis Wessels, the former head of legal and policy affairs of the Financial Services Board (“the FSB”).

3. Observer status was offered to nominees of the FSB and National Treasury. Ms Tholoana Makhu, Manager Insurance Registration & Policy, represented the FSB and Ms Katherine L Gibson, Senior Economist, Financial Services, represented National Treasury.
4. The terms of reference ³ included, in relation to Consumer Credit Insurance, an investigation as to:
 - whether premiums and profit margins are excessive;
 - the payment of excessive commissions or other improper fees and incentives to intermediaries;
 - the adequacy of the overall value provided to consumers;
 - questionable marketing and distribution practices;
 - the fairness of standard terms and conditions;
 - consumer awareness, more particularly whether consumers are always made aware that they are paying for cover.
5. Although the Terms of Reference refer to Consumer Credit Insurance in general, the focus of the enquiry falls on the involvement of registered insurers active in that field.
6. Invitations to make written and, if so inclined, oral submissions to the Panel were extended by the LOA and SAIA to:
 - members of the public;⁴
 - selected stakeholders, such as journalists, industry experts, intermediary representatives, consumer groups and other parties thought to have an interest in the enquiry;⁵

³ The full text of the Terms of Reference is annexed to this report as appendix 3.

⁴ A copy of the Announcement of Public hearings is annexed as appendix 4. The announcement was published on 31 August 2007 in the Daily Sun, Beeld and Volksblad, on 1 September in Personal Finance and on 2 September in City Press Business, Sake Rapport and Sunday Times Business.

⁵ A copy of the pro forma letter sent to selected stakeholders is annexed as appendix 5.

- the Long-term Ombudsman, the Short-term Ombudsman, the Banking Ombudsman, the Credit Information Ombud and the Ombud for Financial Service Providers (the “FAIS Ombud”);
 - the FSB, National Treasury and the National Credit Regulator (“the NCR”)
 - all the members of the LOA and SAIA by means of a questionnaire.⁶
7. Only one written response was initially received from a member of the public.
 8. 23 companies responded to the initial questionnaire.⁷
 9. The Panel was gratified by the number of responses it received from LOA and SAIA members and impressed with the measure of co-operation and the frankness and quality of the responses received and the evidence given by industry participants and others.
 10. A first round of public hearings was held on 3, 4 and 5 October 2007 in Johannesburg and on 16 October 2007 in Cape Town.⁸ Although some respondents indicated in advance that they preferred their submissions to be treated as confidential, only parts of the evidence of two witnesses were ultimately requested to be heard in closed session.
 11. Following the hearings the Panel, having considered the oral and written submissions received, came to the conclusion that it was necessary to ask those members of the LOA and SAIA who were active in the Consumer Credit Insurance market to complete a further questionnaire (“the follow-up questionnaire”) which was also intended to serve as a survey.⁹
 12. Nineteen responses were received.¹⁰
 13. Further invitations to respond were thereupon sent to several other organisations believed to represent consumer interests.¹¹ Only one further response was received.¹²

⁶ A copy of the questionnaire sent to members of the LOA and SAIA is annexed as appendix 6.

⁷ A list, in alphabetical order, of companies from whom responses were received to the initial questionnaire is annexed as appendix 7.

⁸ A list, in order of appearance, of the persons who testified in the first round of hearings and the capacities in which they did so, is annexed as appendix 8.

⁹ A copy of the follow-up questionnaire is annexed as appendix 9.

¹⁰ A list, in alphabetical order, of insurers from whom responses were received to the follow-up questionnaire is annexed as appendix 10.

¹¹ A list of invitees is annexed as appendix 11.

¹² East Coast Radio Consumerwatch, dated 3 December 2007, annexed as appendix 12.

14. The Panel had discussions with the FSB's Chief Executive, Mr Barrow, and members of his staff on 12 December 2007 which was followed by a meeting with the NCR, Mr Davel, and a member of his staff on 13 December 2007.
15. A further hearing was subsequently held in Johannesburg also on 13 December 2007.¹³
16. On 3 April 2008 the Panel met with Mr Jonathan Dixon, newly appointed deputy executive officer responsible for insurance at the FSB and until 1 April 2008 the chief director for financial sector policy at National Treasury.
17. In this report we refer to the debtor under a credit arrangement involving Consumer Credit Insurance (who may be the policyholder, the life insured or the beneficiary) as either "the debtor", "the insured" or more generally as "the consumer"; to the Long-term and Short-term Insurance Acts of 1998 as the LTIA and the STIA respectively; to the National Credit Act, 2005 and the National Credit Regulator as the NCA and the NCR respectively; and to consumer credit insurance as simply "credit insurance" or more accurately as "CCI".

¹³ A list, in order of appearance, of the persons who testified and the capacities in which they did so on 13 December 2007, is annexed as appendix 13.

CHAPTER 2

ISSUES AND TOPICS

1. The Terms of Reference raise a wide range of issues the Panel is required to consider. Some of these issues imply criticism of the conduct of various parties in the CCI distribution chain. Much if not most of the criticism levelled against the CCI industry in South Africa, and more particularly against the conduct of insurers, is in fact criticism of insurance practices in general. These criticisms, implicit in the Terms of Reference, also appear from comments in the financial press, from the responses of consumer groups and ombudsmans' offices and from the submissions made and evidence given by interested parties at the hearings conducted by the Panel.
2. The topics to be considered by the Panel can conveniently be bracketed together in the following manner.
3. Intermediary remuneration
 - 3.1. The issues:
 - to what extent is the remuneration payable to intermediaries currently being regulated and limited?
 - if limited, are such limitations being contravened by insurers and, if so, to what extent and by whom?
 - as a matter of regulation, should there be intermediary remuneration limitation and, if so, to what extent?
 - are incentives to intermediaries currently being regulated?
 - as a matter of regulation, should incentives be regulated and, if so, what criteria should be employed to distinguish between proper and improper incentives?
 - 3.2. These matters are discussed in chapters 6, 7, 8, 9 and 10.
4. Cell captives, underwriting managers and profit share arrangements
 - 4.1. The issues:
 - are these arrangements, involving cell owners, intermediaries and insurers, conducive to conflicts of interests to the detriment of consumers?
 - can they be exploited to circumvent intermediary remuneration restrictions?
 - do they tend to inflate premiums or are they otherwise harmful to consumers?

4.2. These matters are discussed in chapter 9.

5. Market misconduct

5.1. The issues:

- lack of proper disclosure to consumers;
- consumer lack of awareness of the existence of the policy;
- foisting policies on consumers: lack of free choice in offering collateral security;
- failure to highlight and explain sensitive terms and conditions;
- pre-sale misselling of policies by intermediaries;
- obscure and misleading policy language;
- excessively wide limitations and exclusion clauses effectively neutralising or minimising the extent of cover;
- direct marketing malpractices;
- unreasonable time barring clauses.

5.2. These matters are discussed in chapters 11 and 12.

6. Value proposition

6.1. The issues:

- are the profit margins in the CCI delivery chain excessive?
- are premiums too high?
- are consumers getting fair value for the premiums they pay considering their risk profiles?
- are the claims/ ratios per product line too high?
- are the rejection of claims ratios per product line too high?

6.2. These matters are discussed in chapter 13.

7. Consumer awareness and education

This is discussed in chapter 14.

CHAPTER 3

THE CONCEPT OF CONSUMER CREDIT INSURANCE

1. WHAT IS CONSUMER CREDIT INSURANCE?

11. *The ordinary meaning of consumer credit insurance*

1.1.1. Consumer credit insurance¹, simply stated, is the insurance a consumer takes out to cover a debt he or she has incurred. It is more often than not taken out at the insistence of the credit provider as a form of collateral security. The indebtedness can be to a finance house or a retailer or a motor car dealership or to some other credit provider in case the consumer should die or become disabled, suffer critical illness or is retrenched before the debt is repaid; and, at least in South Africa, in case the asset in respect of which the debt is incurred is lost, destroyed or damaged.

1.1.2. The cover can consist of the redemption of the balance of the debt or of the maintenance of the credit repayments.

1.1.3. CCI can take various forms. For example:

1.1.3.1 Mr A applied to a bank for a credit card. He was persuaded to take out CCI that would cover the outstanding balance of his credit card debt should he die or become disabled or is retrenched. Shortly thereafter, when the accumulated debt on his card had reached R9,000, he is retrenched. (His claim on the policy is repudiated on the ground that he had good reason to suspect, when he took out the policy, that he would soon be retrenched. He complains to the Ombudsman for Long-term Insurance.)

1.1.3.2. Ms B purchased a house for R1m and takes out a bond for R900,000. She also takes out, at the insistence of the bank, a credit life policy. When, some time later, she is killed in a motor vehicle accident, the debt had reduced to R750,000. The debt is settled with minimum delay. (Her other option was to cede an existing life policy as security for the mortgage debt. In that case the proceeds of the life policy would have reduced by the amount of the debt and the balance paid to her estate with all the delays typical of the liquidation of deceased estate.)

¹ As opposed to what is known as “corporate credit insurance” or “credit guarantee insurance.”

- 1.1.3.3. Mr C bought a second hand motor vehicle for R100,000. The money for the purchase was advanced by the dealership on condition that he took out a credit life policy as well as a motor vehicle warranty with Insurer X, a sister company of the dealership. He signed a number of documents which he did not bother to read. What was highlighted for him was the monthly instalment, a composite amount that included the instalment on the sale, the finance charges and the premiums on the policies. The motor vehicle warranty listed a string of components and a limit on the cover for each. When the car breaks down, he claims. His claim is met by a double defence. The first is that the breakdown was caused by the fuel management system of his fuel injected vehicle whereas the component listed in the policy only included a carburettor with which the car was not fitted. The second defence was that he had missed the last month's instalment and the warranty had accordingly lapsed. He complains to the Ombudsman for Short-term Insurance.)
- 1.1.3.4. Mrs D, paying a deposit of R340, bought a TV set for R1,139, and a Hi-fi set for R876. The term of the contract was 24 months. With certain add-ons the total cash price amounted to R2,955. But the instalment balance was R7,140, made up of the cash price, product insurance of R844, credit insurance of R741, finance charges of R1,847, handling, delivery and other charges of R630, sales tax of R463, totalling R4,525, less the deposit. (Mrs D complains to the FAIS Ombud that these additional items were never explained to her by the sales staff of the furniture retailer.)
- 1.1.4. The elements of consumer credit insurance are:
- (i) an agreement, embodied in a policy, between
 - an insurer and a debtor (as the policyholder) or
 - an insurer and a credit provider (as the policyholder) with the debtor as the life insured or
 - an insurer, a debtor (as the policyholder) and the credit provider as the nominated beneficiary or
 - an insurer and a third party such as an employer (as the policyholder) with the debtor as the life insured,

in terms of which

(ii) the policyholder (or a third party who so agrees) undertakes to pay the insurer a premium or a series of predetermined premiums, and

(iii) the insurer undertakes to redeem, in whole or in part, the debtor's indebtedness to the credit provider

(iv) by rendering the policy benefit to the policyholder or the beneficiary (as the case may be)

(v) in the event, in the case of credit life insurance, of the debtor's death, disability, critical illness or retrenchment; or

(vi) in other cases of CCI, in the event of the loss of or damage to the asset in respect of which the debt was incurred for which the insurance was taken out.

- 1.1.5. Should the policy, in terms of a separate agreement, have been ceded, the policy benefit is to be rendered to the cessionary.
- 1.1.6. Credit *life* insurance is a subspecies of both life insurance and CCI. The insured event, strictly speaking, is the debtor's death but this type of policy is commonly expanded to encompass, in addition, the debtor's disability, critical illness and retrenchment. Credit Life insurance differs from ordinary life insurance in providing coverage not for a lump sum when the insured event occurs but for the payment of the then outstanding balance of the insured debt. By the same token there is no maturity value in the policy.
- 1.1.7. While the underlying purpose of CCI is undoubtedly to indemnify the consumer and, in the process, to conserve and strengthen the position of the credit provider as a means of collateral security against the risk that the consumer, due to the occurrence of the insured event, will be unable to discharge the indebtedness which is the subject matter of the insurance, it is not a prerequisite for claiming the policy benefit that the consumer should be unable, but for the insurance, to discharge the indebtedness.

1.2. *The meaning of consumer credit insurance in terms of the LTIA*

- 1.2.1. The LTIA refers to consumer credit insurance only obliquely in section 44 (the insured is to be given a free choice to select the policy where a policy is required,² inter alia, to protect the interests of the credit provider) and in the definition of “*credit scheme*” in Part 3 of the regulations.
- 1.2.2. “*Credit scheme*” is defined as “*a group scheme under which every life insured is indebted to or a surety of the policyholder whose insurable interest as policyholder arises solely from that indebtedness or suretyship.*”
- 1.2.3. The policyholder in the case of a scheme is by definition the credit provider and the debtors are the lives insured. Upon the happening of the insured event, payment is to be rendered, depending on the terms of the policy, to the life insured concerned (as the beneficiary) or to the credit provider as the policyholder who will be obliged to account to the life insured for the surplus, if any, once the debt has been redeemed.
- 1.2.4. To qualify as a “*credit scheme*” it must in the first place be a “*group scheme*”. The exact meaning of “*group scheme*” is obscure.³ It is defined as “*a scheme or arrangement which provides for the entering into of one or more policies, other than an individual policy, in terms of which two or more persons without an insurable interest in each other, for the purposes of the scheme, are the lives insured.*”
- 1.2.5. The main reason why credit schemes are singled out in the regulations is not to clarify the concept of credit insurance but to identify certain transactions in respect to which different levels of intermediary remuneration would apply. That being so, this somewhat technical topic is best discussed in the context of intermediary remuneration regulation in chapter 6 under the heading “the LTIA.”⁴

² See chapter 11 section 2.

³ The point was made by **Capital Alliance** in its initial written submission: “*The commission regulations in terms of the Long-term Insurance Act, contain a definition of “group scheme” (of which credit schemes are treated as a subset) which we believe to be vague. We recommend that this definition be reviewed, to provide certainty as to the legal status of these schemes. Currently we believe that there is uncertainty in the industry as to which types of structures are included in this definition, resulting in inconsistent commission practices.*”

⁴ Chapter 6 section 3.

1.3. *The meaning of credit insurance in terms of the STIA*

The STIA has a section, section 43, which corresponds to section 44 of the LTIA but otherwise makes no express reference to credit insurance.

1.4. *The meaning of credit insurance in terms of the NCA*

- 1.4.1. The NCA, in terms of section 1(1) applies, subject to certain exceptions not relevant for present purposes, to “*every credit agreement between parties dealing at arm’s length and made with or having an effect within, the Republic...*”
- 1.4.2. One of the main purposes of the NCA, as is stated in the long title, is “*to provide for the general regulation of consumer credit*”. “*Consumer*” is defined in the Act and so is “*credit*”. The consumer, broadly speaking, is the party to whom credit is extended under one or more of a variety of defined transactions of which sale agreements and personal loans are for present purposes doubtless the most relevant. “*Credit*” is basically described as the deferral of the payment of money owed to a credit provider who in turn is described as the party who supplies goods or services or extends credit under a credit agreement. “*Credit agreement*” is defined with reference to the criteria set out in section 8.
- 1.4.3. Section 8 distinguishes between, and elaborates on, various categories of credit agreements, many of which would give rise to the kind of credit for which in the normal course of events CCI would be taken out at the insistence of either the consumer or the credit provider or both of them. These categories include a credit facility, a credit transaction, a credit guarantee, or any combination thereof.
- 1.4.4. Of particular relevance is “*credit facility*” which refers to transactions where goods and services are provided on credit and “*credit transaction*” which would include loans, for all of which a charge, fee or interest is payable to the credit provider.
- 1.4.5. A distinction is drawn in section 9 between large, intermediate and small credit agreements. A small agreement includes a credit facility or other credit transaction of R15,000 or less while the corresponding poles of an intermediate agreement are between R15,000 and R250,000.

- 1.4.6. The regulations (especially regulations 28 and 29) and the corresponding prescribed forms (especially forms 20 and 20.1 and 20.2) relate to elaborate pre-agreement statements and quotations which would apply to any credit agreement involving a consumer who is a private individual. Section 92 requires a pre-agreement statement and quotation to be provided to the consumer by the credit provider. Section 76, dealing with advertising practices, lays down the requirements and content of advertisements as specified in regulation 21. These provisions are aimed to ensure full disclosure to the consumer of the cash price of goods or the cost of credit advanced, the deposit to be paid, the number and total of the instalments with all the add-ons, including any initiation or monthly service fees, as well as the payment for credit life insurance.
- 1.4.7. In this manner it is envisaged that the consumer will be in a position, from the very outset, of comparing, as between different suppliers, not only the cash price but also the cost of every item loaded on the transaction and making up the final instalment, including the cost of credit life insurance.
- 1.4.8. In terms of sections 101 and 102 fees and charges may be raised in a credit agreement for the account of the consumer when the principal debt is deferred. Allowance is made for an initiation fee (as defined), a service fee (as defined), interest and other charges. Section 101(e) permits a charge for the *“cost of any credit insurance provided in accordance with section 106.”* Section 102(1)(b) allows the cost of an extended warranty agreement to be included in the principal debt and 102(1)(f) does likewise *“subject to section 106”* in respect of *“the premiums of any credit insurance payable in respect of that credit agreement”*.
- 1.4.9. Section 105(1) provides for ministerial scrutiny and maximum rates of interest, fees and charges taking into account, in terms of section 105(2), inter alia, *“conditions prevailing in the credit market, including the cost of credit and the optimal functioning of the consumer credit market”* as well as *“the social impact on low income consumers”*.
- 1.4.10. What has been said above, relates to *“credit agreements”* and not to insurance agreements or even to credit insurance agreements. That is because section 8(2) provides:

“An agreement, irrespective of its form, is not a credit agreement if it is – (a) a policy of insurance or credit extended by an insurer solely to maintain the payment of premiums on a policy of insurance;...”

While credit insurance is invariably incidental to and associated with some or other form of credit agreement, and as such forms an integral part of credit regulation, it has thus been deliberately separated from the concept “*credit agreement*”.

1.4.11. But there is one section dealing specifically with credit insurance. It is section 106. It contains a number of provisions dealing with a variety of matters relating to credit and credit life insurance.

1.4.12. For the purpose of that section “*credit insurance*” and “*credit life insurance*” are defined as follows:

“*Credit insurance*” means

“an agreement between an insurer, on the one hand, and a credit provider or a consumer or both, on the other hand, in terms of which the insurer agrees to pay a benefit upon the occurrence of a specified contingency, primarily for the purpose of satisfying all or part of the consumer’s liability to the credit provider under a credit agreement as at the time that the specified contingency occurs, and includes –

(a) a credit life insurance agreement;

(b) an agreement covering loss of or damage to property;

(c) an agreement covering-

(i) loss or theft of an access card, personal information number or similar device;

or

(ii) any loss or theft of credit consequential to a loss or theft contemplated in subparagraph (i).”

1.4.13. In terms of this definition the policyholder can be either the debtor or the credit provider. The word “both” presumably refers to the situation where, by agreement, the one is the policyholder and the other is the nominated beneficiary.

1.4.14. Subparagraph (b) extends the normal meaning of CCI beyond that described in par 1.1 above. A policy to cover the insured against the theft, loss or damage of an asset is not a credit policy but a property policy. What is

presumably envisaged is that a debtor may combine property and CCI in one package so that, if the asset is stolen or destroyed or damaged, the insured is not only paid out for the loss but is also relieved of the liability of continuing paying for an asset which is no longer available to the debtor; or it could be a separate stand-alone product insurance agreement entered into in the course of a credit arrangement with the credit provider. The point is mentioned again below.⁵

- 1.4.15. *“Credit life insurance”* is separately defined to include *“cover payable in the event of the consumer’s death, disability, terminal illness, unemployment, or other insurable risk that is likely to impair the consumer’s ability to earn an income or meet the obligations under a credit agreement.”*
- 1.4.16. The above definition, by enlarging the contingencies that would activate the rendering of the policy benefit beyond the life insured’s death alone, also extends the meaning ascribed to credit life insurance in par 1.1 above.
- 1.4.17. Section 106 amounts to a legislative recognition of the fact that CCI and aspects of the regulation thereof cannot be divorced from credit and its regulation. But to the extent (i) that the NCA relates to *“credit agreements”* and expressly not to insurance, and (ii) that credit insurance is a subset of insurance, it would seem to follow that section 106 must be read as a self-contained provision and that the other provisions of the Act do not apply to credit insurance unless they can be said to do so either expressly or by necessary implication.
- 1.4.18. In terms of subsection 106(1)(a) a credit provider may insist that the consumer take out credit life insurance *“not exceeding, at any time during the life of the credit agreement, the total of the consumer’s outstanding obligations to the credit provider...”* as well as, in terms of subsection 106(1)(b), *“insurance cover against damage or loss of any property...not exceeding, at any time during the life of the credit agreement, the total of the consumer’s outstanding obligations to the credit provider in terms of their agreement.”* The latter part of the section has been criticised in evidence on the grounds that it refers to property insurance and property insurance

⁵ See section 2.2 and chapter 12 section 10.

does not reduce commensurately to the reduction of the outstanding indebtedness.

- 1.4.19. What is noteworthy about subsection 106(1)(a) is that it refers not to credit insurance but to credit life insurance. Elsewhere in the section, as well as in the corresponding regulation 33, reference is made to “*insurance*” or “*a policy of credit insurance*”. One must therefore conclude that unless the context indicates otherwise the legislature had the narrower concept of credit life insurance in mind. This is not too surprising since credit life insurance, which can be arranged under either the LTIA or the STIA, is the more usual type of CCI with the regulation of which one would have expected the legislature to be most concerned.
- 1.4.20. Subsection 106(2) is of particular importance. It provides that the credit provider may not offer or demand that the consumer purchase or maintain insurance that is unreasonable or unreasonably costly to the consumer “*having regard to the actual risk and liabilities involved in the credit agreement.*” The section does not provide for ministerial regulation of credit insurance by means of the imposition of maximum rates across the board. The reasonableness of the insurance or the costs will thus have to be determined by the NCR on an *ad hoc* basis. The subsection implies that a consumer would be entitled to refuse, notwithstanding subsection 106(1)(a), to agree to credit life insurance that is unreasonable or unreasonably costly.
- 1.4.21. Subsection 106(3) allows the credit provider to offer the consumer, without being able to insist on it, optional insurance in relation to the indebtedness or the property or services concerned.
- 1.4.22. Subsection 106(4) deals with the consumer’s right to be informed of, and to substitute, a policy of the consumer’s own choice in the circumstances envisaged in subsections (1) and (3). The policy issued must provide for the payment of premiums on a monthly, or in a certain case, annual basis. In effect the subsection outlaws the payment of an upfront single premium over the duration of any such policy.
- 1.4.23. With effect from 1 June 2007 subsection 106(4)(b) of the NCA eradicated a controversial practice of the past, single premium credit insurance. Prior to

that date it was possible for an insurer to debit the entire premium at the beginning of the credit period, with interest on the outstanding debt being capitalised, and to retain these benefits even if the policy had not run its course. This is seen by the NCR as a significant advance in consumer protection. The debiting up-front of the entire premium for the entire period of insurance was seen as a major contributing factor in ratcheting up the consumer cost of CCI in the past.

- 1.4.24. Subsection 106(5) prohibits the credit provider from charging a fee or premium above the actual cost of the insurance; requires the credit provider to disclose *“in the prescribed manner and form”* the cost to the consumer of the insurance supplied as well as *“the amount of any fee, commission, remuneration or benefit receivable by the credit provider , in relation to that insurance...”*; and also requires the credit provider to explain the terms and conditions of the policy to the consumer and provide him with a copy thereof. Finally, it is provided that the credit provider must pay over any surplus to the consumer after the proceeds of the policy had been employed to discharge the consumer’s indebtedness.
- 1.4.25. Subsections 106(6) and (7) contain some tidying-up provisions arising from the above provisions.
- 1.4.26. The NCA does not prohibit the payment of incentives for soliciting credit insurance.
- 1.4.27. In terms of subsection 16(1)(f) the NCR is responsible for monitoring trends in the market *“for credit insurance, patterns of sale of credit insurance, costs of credit insurance, performance of credit insurers in meeting the obligations of consumers, and loss ratios of insurers in respect of credit insurance...”*. To this end the NCR may require an insurer, in terms of subsection 16(2)(a) and regulation 72, to provide periodic synoptic reports of aggregate information relating to credit insurance policies issued by it, using the prescribed form 45. These measures are designed to enable the NCR to detect and react to significant discrepancies in credit insurance practices e.g. an inordinately high rate of claims repudiations.

1.4.28. Most, if not all, the credit insurance transactions with which the Panel is concerned fall within the purview of the NCA.⁶ The significance of the NCA and the NCR for credit insurance is dealt with further in chapters 6 and 11 below.

2. TYPICAL CONSUMER CREDIT INSURANCE PRODUCTS

2.1. Credit Life

2.1.1. This product can be issued under a long-term or short-term policy. It is designed to cover the outstanding balance of the life insured's indebtedness to the credit provider in respect of any of the following credit transactions:

- personal loans;
- overdraft facilities;
- student loans;
- credit card facilities;
- home owner's cover;
- asset financing;

in the event of the life insured's death, total permanent disability, critical illness or retrenchment.

2.1.2. In terms of section 106(1) of the NCA, referred to above, the credit life insurance is not to exceed "*the total of the consumer's outstanding obligations to the credit provider in terms of their agreement*". The policy may stipulate a maximum amount as a ceiling.

2.1.3. In the case of total and permanent disability the outstanding balance of the debt is paid.

2.1.4. In the case of temporary disability the cover is in respect of the life insured's relevant monthly instalments.

2.1.5. In the case of retrenchment a benefit equal to the monthly instalment for a stipulated period is normally paid.

⁶ Although the NCA has only been fully operative since 1 June 2007, its effect on the industry was already noticeable by the end of October 2007 when the responses were received to a survey, forming part of the Panel's follow-up questionnaire referred to in chapter 1. See too chapter 12 section 1.4.

2.1.6. A hospitalisation benefit equal to monthly instalments for a given period may be payable if the consumer is unable, because of hospitalisation, to earn an income.

2.2. **Extended warranty**⁷

2.2.1. This is a short-term policy. It is marketed by motor dealerships on behalf of the insurer concerned (or, for that matter, a retailer in respect of brown or white goods sold) and is designed to indemnify the consumer against the risk of mechanical breakdown of the insured vehicle or goods, as defined in the policy.

2.2.2. It normally comes into effect on the expiry of the manufacturer's warranty and remains effective for the period stated in the policy.

2.2.3. What is envisaged is (i) the sale of an asset (ii) a credit arrangement in terms of which the sale is financed⁸ and (iii) an undertaking by an insurer, against payment of the premiums in advance, that in the event of any specified component becoming defective, the insurer will assume responsibility for its repair or replacement.

2.2.4. Doubt has been expressed by the office of the Short-term Ombudsman in its presentation to the Panel, and indeed by others as well,⁹ whether warranties covering mere mechanical breakdown can properly be termed insurance

⁷ See sections 1.4.8 and 1.4.12-14 above as well as chapter 12 section 10.

⁸ Extended warranty can of course also be a stand-alone product.

⁹ In particular by Mr **Shaw** in evidence. He argued: "*Extended warranty: There was an issue at the time too, is extended warranty an insurance product or is it not an insurance product? There were certain confusing situations. You had the motor extended warranty, which is mechanical breakdown insurance, is an insurance product. Certain of the retailers said the extended warranty is an insurance product. Advice given to them at the time was, do it as an insurance product rather than a stand-alone product. And of course they had their other add-ons.*

Post NCA, asset cover was now offered as an optional cover only. It has its complications to that and I'll address it further, and Credit Life or personal benefit is on the outstanding balance cover only and the premiums are calculated on reducing balance to comply with the Act.

Extended warranty in terms of Section 102 of the National Credit Act is no longer an insurance product, it's a separate product. It's an anomaly because the Registrar decreed that motor extended warranties is an insurance product whereas white goods type of extended warranty is not an insurance product.

And then the add ons are offered as needed and as required and requested as an ... insurance cover only. Certain problems have been noticed. You see there the cost of extended warranty product can be added to the principal debt and there's been lots of legalise about the whole issue of Section 106 because in terms of what you can add as part of the principal debt, section 102 makes reference to the fact that premiums and ... insurance payable in terms of the agreement and yet it seems to be a contradiction in 106. It must be offered optionally, it must be offered on a monthly basis and so there's an element of a contradiction. I've just abridged the issue here."

business. If not, they need not be issued or underwritten by registered short-term insurers.¹⁰

2.2.5. The contention is that such warranties lack the element of risk, of uncertainty, of a contingency, that is the hallmark of insurance.¹¹ That is particularly so in the case of second-hand vehicles, according to the Short-term Ombudsman, where mechanical breakdown, on the one hand, is almost a certainty¹² and exclusions are so widely framed, on the other hand, that liability in terms of the policy is virtually illusory.¹³

2.2.6. But that is not necessarily true for all cases of motor vehicle warranties subject to a term. The common law test for determining whether it is insurance business, not always an easy one to apply in practice, is whether the contract, requiring the payment of a premium, imports an element of risk or whether it is simply an undertaking of maintenance and repair, such as a warranty against latent defects. Each case must be decided on its own facts.

¹⁰ For regulatory purposes the FSB has determined, in its directive 97.A.(ii) originally issued on 30 January 2004, that (a) the issuing of motor vehicle warranties and extended motor vehicle warranties constitutes short-term insurance business; and (b) such cover shall form part of the class “motor policy” as defined in section 1 of the Act.

In his evidence Mr **Shaw** commented:

‘Well, this is the anomaly. The Short-Term Insurance Act directive in terms of motor extended warranty, it's insurance. In terms of the National Credit Act it's a product and there's a vagueness attaching to the issue. Is it because the Registrar of Insurance hasn't directed otherwise, although the National Credit Act says an extended warranty is a product, it's not an insurance operation. Those parties that deal with what we refer to as extended warranty for motor vehicles continue to be regarded as an insurance product, whereas an extended warranty on white goods, if you buy a television and there's an extended warranty which you then buy it's a separate product, it's not insurance. So it's a bit of an anomaly, as it were in the structure of the industry as things stand at present.

As I mentioned earlier on, in 1982 there was a directive from the Registrar of Insurance and updated again on 30 January 2004 about motor warranty business, again confirming its classification as motor insurance. A separate policy has to be provided showing premiums and stamp duty, commissions of 12% and an unusual situation, no inspection fees to be paid by an insurer or underwriting manager in respect of a dealer to inspect the vehicle and a very strange situation, period of insurance, maximum 24 months.’

¹¹ The essential characteristics of a contract of insurance may be said to be:

an undertaking by the insurer to assume the risk and render the promised benefit on the occurrence of the defined insured event; a provision for payment by the insured of a premium or premiums geared to the nature of the risk assumed by the insurer; an insured event that is subject to the risk of uncertainty either as to the fact, the continued existence or the timing of its occurrence; an interest of the insured, deemed by law to be worthy of protection, in the non-occurrence of the insured event.

¹² As it was put by Mr **Viljoen** of the Short-term Ombudsman's office: *“...the product itself is almost defective, in that it is intended to provide cover for wear and tear but insurance doesn't cover wear and tear. So basically insurance is supposed to be for an uncertain event whereas we know that wear and tear is going to happen, so there is no uncertainty, the only issue is when it will happen and how big the claim will be, but that you will have problems on old motor vehicles is a given.”*

¹³ As the last point was put in the Short-term Ombudsman's presentation: *“We point out that in the event of a claim being successful, the insurer is unlikely to ever be fully compensated for his loss and in fact the benefit received is likely to be but a small portion of the total cost of repair.”*

2.2.7. If the contract is indeed one of insurance, a further issue is whether it can properly be termed *credit* insurance rather than *product* insurance. After all, at the time the contract is effected there is as of yet no indebtedness for repairs to be effected, forming the subject matter of debt insurance. The indebtedness (to pay for the repairs) will not arise before a mechanical breakdown, as defined, actually occurs. The contemplated indebtedness is thus at best a future contingent one which, if a breakdown does occur, is pre-empted by the insurer's undertaking to effect the repairs up to the stated limit. One can thus only speak of CCI in an extended sense. The point is also mentioned in paragraph 1.4.14 above in connection with the definition of "credit insurance" in the NCA.

2.3. **"Top-up" or shortfall cover**

This policy, also a short term policy, is designed to cover the shortfall in the event of loss of or damage to the asset sold (be it a vehicle or furniture or appliances, so-called white goods) between what remains owing on the asset and what is recoverable under a comprehensive motor vehicle or other comparable policy. The policy "tops up" the difference between the insurance pay out and the balance of the debt. It may also provide cover for an unintended violation of the underlying policy or for the return of the deposit paid in terms of the underlying policy.

2.4. **Minor "chips and dents" cover**

This policy, also issued under a short-term licence, provides cover for minor damage to the bodywork of a motor vehicle during the term of the policy. It covers the type of damage that may well fall within the excess of a comprehensive policy. Here again, it can be questioned whether this is truly an insurance product, and particularly a credit insurance policy, or simply a warranty.

2.5. **Asset insurance**

As discussed earlier¹⁴ the NCA has extended the meaning of "credit insurance" to include "*an agreement covering loss of or damage to property.*" For the purpose of the NCA this extended meaning, although atypical, must be taken into account.

¹⁴ Section 1.4 12-14.

3. CONSUMER CREDIT INSURANCE IS DIFFERENT

- 3.1. Credit insurance, as the name implies, presupposes credit: an indebtedness by the consumer arising from a separate transaction between the consumer and a credit-provider, be it a personal loan, a mortgage, or the balance of the purchase price owing to a retailer or a motor dealer for the purchase of furniture or a motor vehicle or some other article. CCI as such is transaction-related. The insurance is essentially designed to protect both the insured and the credit provider against the eventuality that the insured may not be able, due to death, accident, critical illness, disability or loss of occupation, to redeem the debt.¹⁵
- 3.2. CCI differs from other forms of insurance in a number of significant respects:
- (a) it is contingent on credit having been granted to the insured by someone other than the insurer;
 - (b) the insurance contract is ancillary and subordinate, essentially a side-issue, to
 - (i) the loan or sales agreement between the lender and the borrower or the retailer/dealer and the purchaser;
 - (ii) a possible parallel financing agreement in the case of a sale;
 - (c) the cost of supplying insurance is often not separated from the cost of supplying credit;
 - (d) there is little or no active involvement by the insured in the initiation of the insurance;
 - (e) there is little if any broker-involvement, either in the initiation of the insurance (usually initiated by the salesman) or in the rendering of intermediary services (usually provided by the retailer/dealer or the credit-provider);
 - (f) there is little or no active involvement by the insurer in the initiation or management of the insurance;

¹⁵ In paragraph 1 of its submission to the Panel, appendix 16 to this report, **FinMark Trust** puts it neatly as follows:

“Credit or credit life insurance insures the value of any outstanding debt in the case of a policyholder’s death, but may include riders varying from insurance on the value of the product if lost or damaged, to funeral insurance for the purchaser. It is considered indispensable by credit providers and, more specifically, furniture retailers offering consumer credit. It affords credit retailers protection against payment default in the case of a debtor’s death or (in some cases) disability, while protecting the deceased borrower’s family from repossession and potential entry into or furthering deepening of a state of poverty.” (A “rider”, so it is explained in a footnote, is defined as “an amendment to an insurance policy that modifies the policy by expanding or restricting its benefits or excluding certain conditions from coverage.”)

- (g) the immediate beneficiary of the policy is the credit-provider, either as nominated beneficiary or as cessionary, and not the insured.
- 3.3. Because of its unique characteristics it follows that CCI should preferably be treated as a category separate and distinct from other forms of insurance, especially when it comes to the regulation of intermediary remuneration and the regulation of market conduct.

CHAPTER 4

THE CONSUMER CREDIT INSURANCE INDUSTRY IN SOUTH AFRICA

1. Furniture retailers in South Africa, according to the evidence submitted to the Panel on behalf of SAIA,¹ initiated the product that over time developed into a significantly lucrative sector of the insurance industry. In 1969 they began selling tailor-made insurance products providing themselves and their customers with cover for the eventuality that instalment purchasers should die before their outstanding debts were paid off.
2. In terms of this product furniture retailers named themselves as co-insured which enabled them to collect and pay over premiums to the insurer on the understanding that the insurer would refund “97% or 98%” of the premiums to them for the purpose of settling claims.
3. When the Registrar of Insurance outlawed this practice as an undesirable practice in 1990 it led to the formation, by a number of retailers, of their own insurance companies specializing in the field of CCI.
4. The main drive for furniture groups establishing their own insurance companies instead of placing their business with existing insurance companies was, so it was explained, the inability of existing insurers to provide countrywide branch infrastructures catering efficiently for the CCI needs of their customers. An insurer within the same group as the retailer, by contrast, would be able to utilize the dealer or store to provide the necessary administrative services to it, in consideration for which it paid it both the prescribed commission and, in addition, an administrative fee. The latter fee, it is claimed, was not charged to the customer.
5. Nowadays the four major groups transacting business in “white and brown” (furniture and domestic appliances) goods between them have a total market premium, according to Mr **Shaw**, of approximately R3 billion and operate through 2700 “quasi branches” being the dealer floors.

¹ By Mr **Shaw**.

6. Over time, and latterly at an accelerating rate, CCI developed to provide cover not only to credit providers in the furniture trade but also to other forms of credit advanced to consumers.
7. In his 2000 Annual Report at page 17 the Long-term Ombudsman, referring to credit life insurance, wrote:

“Credit life arrangements have proved to be very popular in the South African long-term market. The insurance industry finds the schemes easy to administer and, furthermore, they can be efficiently marketed as they make use of the lender’s – usually banks – vast distribution outlets. This business is of such a size that some insurers have established separate companies dealing exclusively in credit insurance.

The bulk of the business is written on a group basis. Under a group arrangement the contract will be evidenced by a master policy which is issued by the insurer to the credit provider. This policy will set out the terms and conditions of the contract. Individual lives receive a certificate of insurance which usually features a summary of the benefits and some of the policy conditions. This certificate, which is sometimes printed on the reverse side of the application form, will include a reference to the master contract. The summary invariably states that all benefits conferred by the certificate are subject to the terms and conditions contained in the master policy issued by the product provider.

Credit life assurance is often the emerging market consumer’s first encounter with the life insurance industry and it is in the interests of the industry to create confidence in these products. This is not always achieved. A high proportion of credit life assurance will be sold by unqualified individuals such as furniture salesmen or in a motorcar showroom. One can well imagine that the euphoria accompanying the purchase of a new car or a new lounge suite will result in scant attention being given to the declaration which the proposed life assured signs.”

8. A survey conducted at the instance of the NCR in December 2006 revealed growth in all the categories of household credit between January 2004 and September 2006, including mortgages, overdrafts and other loans, instalment sales, leases and credit cards. The fastest growth occurred in credit cards (138%) and leases (123%), followed by mortgages (87%) and instalment sales (81%). In terms of values, household credit increased by R305 billion over the 2¾ year period.
9. As could be expected, this significant growth in household credit advances stimulated the demand for CCI to cover the associated risks. This was demonstrated by a research conducted in credit life and bank assurance by the Reinsurance Group of

America, Incorporated (RGA) in 2006. Most of the major and smaller credit life insurance providers in South Africa were included in the RGA survey. Also as part of the bancassurance angle of the study, all the major banks were included as well as one of the smaller banks.

10. The results showed astonishing growth in the credit life insurance market in 2005. The growth in annual premium income (a.p.i.) on credit life insurance covering micro-loans (a.p.i. R1,1 billion) was 219%; vehicle financing a.p.i. R1.3 billion, growth 73%; mortgages a.p.i. R0.7 billion, growth 31%; credit cards a.p.i. R0.2 billion growth 88%; personal loans a.p.i. R0.4 billion, growth 315%. On average the annual premium income in 2005 to the participants in the survey was R3.6 billion, and the growth was 127%.
11. The RGA survey (as it was conducted before the advent of the NCA) also contains useful information on the credit life insurance market as it existed at the time. What is relevant for purposes of the report may be summarized as follows:
 - 11.1. Companies make use of both short-term and long-term insurance licences in selling credit life and bancassurance products; one of the major attractions of a short-term licence being lower reserving requirements (allowing insurers to release profits earlier).
 - 11.2. CCI is prevalent mainly in the lower end of the market. The average sums being insured R5,026 in the case of micro-loans, less than R83,000 on average in vehicle financing, less than R200,000 mortgages, R8,000 in credit cards and R10,000 in the case of personal loans.
 - 11.3. Conventional underwriting is the exception in this sector of the market i.e. where full upfront medical underwriting is done. The key to credit life, so it was testified by Mr **Ross** on behalf of RGA, is process. Instead of going through the time-consuming process of ordinary underwriting, the majority of market players would manage the risk by setting pre-existing conditions of different types.
 - 11.4. Participants, across the spectrum, believed that credit life and bancassurance products were more profitable than other insurance products.²

² The following passage, illustrating the point, appears from the evidence of Mr **Kemp**:

- 11.5. The biggest three players made up almost two-thirds of the market in 2005 and almost 90% of the business is dominated by the top six writers of business.
12. The evidence tendered to the Panel on behalf of SAIA and RGA was substantially corroborated by the evidence of two knowledgeable individuals who had no personal interest in the CCI business, Mr **Casserly** who gave evidence in his private capacity but from an intermediary perspective and Mr **Ketola**, an analyst. Salient points made by them are noteworthy in assessing the present status of CCI business in South Africa:
- 12.1. The size of the business is significant. For the first six months of 2007 new business premiums were R456 million. (This figure was released by the LOA which from the beginning of 2007 accounted separately in their new business statistics, for credit life business. According to LOA figures the credit life market accounts for 9% of the total individual recurring new business in the half year to June 2007, comparing favourably with retirement annuities which yielded R747 million by way of new premiums over the same period).
- 12.2. The average premium per policy, according to Mr **Ketola**, is R140 per month which is significantly lower than that for ordinary endowment or life policies. 1,317 million new policies written during these six months were attributable to credit life.
- 12.3. Large players are dominant in the market.
- 12.4. The business is extremely profitable. Mr **Ketola** suggested that this line of business is possibly seven times more profitable than products sold into the affluent market. A number of reasons, so it was suggested, account for the profitability of this business. One reason is the lack of true “freedom of choice” which, so it was said, exists more in theory than in practice, the

Mr Smith: *You made a very, very interesting observation. You said that the Credit Life insurance business in the furniture industry has always been very profitable.*

Mr Kemp: *Oh, it has.*

Mr Smith: *Now, that can only be for one reason and that is that the premiums are higher than what are required.*

Mr Kemp: *I couldn't genuinely comment on it, it definitely is very profitable business, there's no question that it is very profitable business. In fact, the reason why the furniture traders are involved in financial services is I believe that they make a portion of their business from selling furniture and a portion of their business from financial services including their credit transactions on hire purchase and also the furniture traders make money from insurance”.*

- provisions of the NCA notwithstanding.³ It is simply impracticable for the consumer to use an external insurer due to the time and inconvenience factor. Moreover, the systems of credit providers are not geared, according to the testimony of Mr **Casserly**, to accommodate external policies.
- 12.5. It is probably more common, Mr **Ketola** said, for CCI to be written under a short-term licence which is regarded as more flexible than a long-term licence.
 - 12.6. The claims ratio of insurers owned by retailers is roughly 10 cents in a Rand whereas normal short-term insurers pay 65c to 70c per rand premiums received in claims.
 - 12.7. The high non-commission expense of as much as 45% of premium paid to dealers for additional service, in addition to regulated commission, are, so it was said, a reason for concern.⁴
 - 12.8. There is no independent intermediary involved in CCI. The credit provider is both the “intermediary” and the beneficiary of the policy proceeds.⁵
 - 12.9. Credit Life insurance plays a secondary role to a credit agreement;⁶ it is invariably linked to a loan or credit sale and the party who provides the credit, sets up the scheme and controls it.
 - 12.10. Sophisticated consumers, leaving aside mortgages, are rarely part of CCI and arrange their credit provisions in other ways not readily accessible to financially more modest consumers.
13. The introduction of the NCA, with effect from 1 June 2007, has had a severely negative impact on the CCI business. This has become apparent from the responses received from insurers to the follow-up questionnaire.⁷ The decrease in CCI business may be attributable mainly to the clamp down on the liberal credit extension to consumers provided for in the Act, which has had a ripple effect on concomitant CCI business.

³ This issue is further discussed in chapter 12 paragraph 2.

⁴ This aspect is further discussed in chapters 6-10.

⁵ This aspect is further discussed in chapter 6.

⁶ This aspect is discussed in chapter 3 section 3.

⁷ See chapter 12 section 1.4.

14. By way of contrast the NCA has (for the first time in legislation) given recognition to CCI as a distinct category of insurance business. Subject to the provisions of section 106, the cost of credit insurance is permitted as a legitimate charge in a credit agreement. It may thus be anticipated that this line of business has come to stay and is likely to continue into the foreseeable future, notwithstanding a reported setback in growth after the advent of the NCA and a consequent slow down in credit advances.

CHAPTER 5

CONSUMER CREDIT INSURANCE REGULATION AND MISCONDUCT IN THREE OTHER JURISDICTIONS

1. INTRODUCTION

- 1.1. This chapter is intended to be a brief survey of CCI regulation and misconduct in some other jurisdictions, most notably the United Kingdom, Australia and the United States. These countries were chosen, firstly because each represents a different intermediary remuneration model and, secondly because information about them was more readily available to the Panel than was the case with others.
- 1.2. The purpose of the comparison is to put the South African experience with CCI, discussed in the chapters that follow, in broad perspective.¹ We have elaborated a little where the experience elsewhere has special resonance for CCI in South Africa.
- 1.3. The emphasis of the survey is three-fold:
 - (i) the regulation, if any, of intermediary remuneration for CCI;
 - (ii) conduct regarded as inappropriate;
 - (iii) the measures taken to deal with such conduct.

2. THE UNITED KINGDOM ²

- 2.1. CCI in the UK goes under the name Payment Protection Insurance (PPI) and is the subject of considerable regulatory attention both by the Financial Services Authority (FSA) and the Competition Commission (CC).
- 2.2. What is not regulated in the UK is intermediary remuneration.
- 2.3. In the UK the belief is, as it was put by someone knowledgeable about PPI: *“Insurance markets characterised by free trade and competition are likely to facilitate the provisions of insurance cover that meets client requirements at affordable prices. Regulatory restrictions on rates of*

¹ In evidence Mr **Shaw** said: *“Another thing which is not publicly known is that if you were to compare the furniture retailing industry in South Africa with New Zealand, Canada, Australia, UK and as I said, certain American states, the margins and mark-ups of the furniture are much higher in those areas and the insurance components are lower. In this market, it's the converse situation, the mark-up is much lower on the furniture and the other cost components like the interests rates have been high in years and then the insurance premium and structures there are high. The sum of the whole, if you then do a comparison of those industries per se, the margins that they make are no different in other parts of the world, it's just the component parts of it.”*

² The Panel is indebted to Kim Swan, Executive, International Regulatory Affairs, Lloyd's International Market Access, Lloyd's, London, for assistance in compiling this section. Much of it is drawn from various relevant websites.

commissions can restrict competition and the provision of new insurance products. Although, in the absence of such regulation, there is a risk of excessive rates of commission inflating the price of insurance products, it has been our experience that, in a free market, competitive pressures are sufficient to keep commission rates at reasonable levels. This process may be expedited by requirements on commission disclosure.”

And again: “One would normally expect that, if premium rates are excessive, other insurers will undercut them, thereby bringing about reductions. If insurers are not prepared to do this, this may indicate that the rates are in fact not excessive but correctly price the risk being undergone...Perceptions of what is, and is not, an excessively high premium can vary.”

- 2.4. The degree of disclosure is dependent on the category of insured. Generally speaking it is mandatory for commission to be disclosed by the intermediary to a commercial customer but only if the customer requests it. The disclosure is to be either in cash terms or, if not feasible, of the basis on which the commission is calculated.
- 2.5. It is more or less standard for insurers to remind customers of their right to request information, prior to the conclusion of a contract, about any commission received by intermediaries in the placing of the business. There is, nevertheless, a move towards introducing mandatory disclosure in an effort to minimise conflict of interest issues.
- 2.6. As for market conduct, PPI became a public issue in 2005 when a designated consumer body known as Citizens Advice (CitA) submitted a super-complaint to the Office of Fair Trading (OFT) about PPI. It was based upon the CitA report 'Protection racket: CAB evidence on the cost and effectiveness of payment protection insurance'. CitA stated that the evidence presented in its report suggested that the features of the PPI market seriously harmed the interests of consumers. Three main areas of concern were highlighted:
 - consumers pay excessive prices for PPI;
 - the protection consumers buy is partial, with evidence of high pressure and unfair sales tactics;
 - the administration of PPI claims can be slow and unfair, and can leave consumers facing additional charges or serious debt enforcement action.
- 2.7. The OFT thereupon undertook to carry out its own market study, which was launched on 3 April 2006.

- 2.8. At the same time various trade associations issued their own consumer guides focusing on improving consumer information.
- 2.9. So too, the FSA, as part of its *“Treating Customers Fairly”* (TCF) initiative, conducted its own investigation to improve sales standards in the PPI market.³
- 2.10. The six TCF consumer outcomes on which the FSA required firms to focus were:
- i. Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture;
 - ii. Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly;
 - iii. Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale;
 - iv. Where consumers receive advice, the advice is suitable and takes account of their circumstances;
 - v. Consumers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect;
 - vi. Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.
- 2.11. Thus it was stated, in a press notice of March 2007:

“Improving sales standards in the PPI market remains a key priority for us and we see it as an indicator of whether firms are treating their customers fairly. Customers should come away from the sale having been given the best possible chance of understanding that PPI is almost always optional, what the policy will and will not cover, and how much it costs.”

- 2.12. The investigation was designed to test industry progress on ensuring that customers:
- are told that PPI is optional, where this is the case;
 - receive clear information about the product and what it will cost;

³ The FSA has the right to impose fines on offending credit providers. It is a right which is enforced, as appears from extracts of the relevant and revealing article which appeared in *The Independent* of 17 January 2008 and which is annexed as Appendix 14.

- are given the assistance they need to be clear about what they are eligible for under the policy and what the exclusions are;
- are, where advice is given, recommended a policy that meets their needs; and
- offered a fair refund if they cancel their policy.⁴

2.13. In February 2007 the OFT, liaising closely with the FSA, decided to make a reference to the CC under section 131 of the Enterprise Act 2002 for an investigation into the supply of all PPI services (except store card payment protection insurance services) to non-business customers in the United Kingdom.

2.14. In a press release of February 2007 the decision was explained in the following terms:

“Our examination of the evidence presented to date gives us reasonable grounds to suspect that there are features of this market which restrict competition to the detriment of consumers. Despite some evidence of a degree of consumer satisfaction with aspects of the product, the evidence as a whole suggests consumers get a poor deal. This referral will enable the Competition Commission to undertake a thorough investigation of the market and, if necessary, ensure that appropriate remedies are put in place.”

In reaching this decision OFT has taken account of the work which the Financial Services Authority (FSA) is doing to remedy the problems relating to selling standards and to ensure customers are treated fairly, as well as the various industry initiatives which are underway in response to the FSA’s

⁴ The FSA's new regime for the conduct of investment business - Conduct of Business Sourcebook (COBS) - came into force on 1 November 2007. Following consumer research, the FSA is proposing to build on COBS by introducing a single disclosure document. This would simplify investment disclosure and continue to give firms discretion over how the information is presented while maintaining their responsibility to consumers. The new document aims to provide key information in a more streamlined way to help consumers better understand the services offered by advisers. Firms will be free to develop their own disclosure documents to provide effective and clear disclosure to their clients. Further consumer research is being conducted and will be reflected in a Consultation Paper CP08/3 “Simplifying Disclosure: Information about services and costs” by 19 May 2008.

work. However the OFT and FSA agree that FSA action targeted at selling practices alone cannot remedy the lack of competition the OFT has identified in the PPI sector.”

- 2.15. The OFT, so it stated in the document giving its reasons and “Final Decision” for making the reference to the CC, based its decision on evidence of features of the market that it suspected were preventing, restricting or distorting competition and thereby harming consumers. It said:

“In the view of the OFT the following features of the PPI market are harmful to consumers:

Structural features adversely affecting competition:

- PPI is a secondary purchase, bought only as a result of taking out the primary credit.*
- The point of sale (POS) advantage experienced by distributors means that there is little competitive pressure at the key point at which the consumer buys the insurance.*
- The complex nature of PPI makes comparison between different policies difficult.*
- Lack of product information prior to POS adversely affects competition.*
- Present levels of cancellation or switching by consumers in this market do not exert any serious pressure on the prices of PPI.*

Stand alone providers, who might otherwise be thought to offer a competitive pressure, have difficulty accessing consumers and face substantial start-up and marketing costs to attract custom.

- Vertical integration is a significant feature with around 60% of the market undertaking both the underwriting and the distribution of PPI within the same group.*

Conduct of firms adversely affecting competition:

- Competition is centred on the sale of the credit and not the PPI.*
- PPI is often automatically included in the quote for credit without a customer's knowledge.*
- Consumers in some cases either assume or are told or given the impression by the distributor that taking out the PPI will help the application for credit.*
- Headline APR is used to draw consumers into the credit deal – but the APR for the credit is not necessarily a good indicator of the best deal once the PPI gets factored in.*
- There is poor upfront information, making it difficult for consumers to weigh up whether they will get a good deal.*
- Firms' practices in giving refunds do not reflect cost or consumer.*

Conduct of consumers adversely affecting competition:

- *Consumers do not shop around for the best deal on PPI. A contributing factor to this is the huge POS advantage enjoyed by distributors.*
- *Consumers display poor understanding of PPI, its price and the detail of their cover, with suppliers initially doing little to remedy this situation.*

Performance information indicating competition is adversely affected:

- *PPI has low claims ratios when compared to other insurance products, and with no evidence to suggest costs are high, it seems reasonable to assume that distributor profitability is sizeable with little evidence that this is being competed away.*
- *Commission rates paid by insurers to downstream intermediaries look high compared with other general insurance products.*
- *The pricing of different PPI products cannot always be explained by differences in cover offered.”*

2.16. In a news release of November 2007, accompanying a document entitled “Emerging Thinking”, the CC published “*its current thinking on the nature of competition in the payment protection insurance (PPI) business in the UK*” and invited comment on it from interested parties.

2.17. In the news release the inquiry chairman is quoted as saying:

“After examining a substantial amount of evidence, we think there are some areas that we need to explore further. We are far from making up our minds, but we are focussing on the amount of competition for PPI that distributors face at the retail level. It is clear that the decision of whether or not to take out PPI is an important one and that customers must balance the benefits of insurance against its cost. The evidence we have seen suggests that the cost of PPI is in some instances higher than the interest paid on loans.

At the retail level the initial indications are that consumers buying a distributor’s credit product are relatively price insensitive when they consider buying PPI, and that the competitive constraints from alternative products such as income protection are limited. If that is the case then distributors might face little substantive competition when supplying PPI to those people who buy the distributors’ own credit product. We are currently running a major survey aimed at understanding consumer behaviour and our collection and analysis of evidence from the parties is ongoing. This work will help us understand the extent and nature of competition for PPI at the retail level.

In the course of our inquiry, it has been put to us forcefully that the supply of credit is itself highly competitive and that distributors compete to attract customers, some of whom will go on to buy PPI.

At the moment our evidence base appears to suggest that there are separate markets for PPI and credit, but our survey and ongoing analysis of the parties' data will help us make an informed judgement about this very important and challenging issue."

And again:

"As the industry regulator, the FSA has the lead on consumer protection issues, and continues to take action to address concerns such as mis-selling. Our focus is on the bigger picture, examining whether there is effective competition, delivering value for consumers. The main purpose of publishing today's document is to share our emerging thinking on some of the key issues and invite further evidence to help inform our inquiry."

- 2.18. It is apparent from the above survey that the regulation of intermediary remuneration which is central to our enquiry in South Africa is not an issue of major concern in the UK. Many of the other issues raised in the paragraphs above are, however, relevant to our own enquiry. According to the "Emerging Thinking" document it is the intention of the CC to publish their provisional findings in May 2008. *"In the event that we need to consider remedies, that process will take place in the second half of 2008, with our final report being published in November or December 2008."* Interested parties are accordingly advised to keep themselves informed of the CC's eventual findings on many of the matters discussed in chapters 11 and 12 below.
- 2.19. So too, the FSA published a discussion paper 08/2 in March 2008, entitled *"Transparency, disclosure and conflicts of interest in the commercial insurance market."* Responses are called for by 25 June 2008. The dedicated subcommittee proposed in chapter 12 of this report ⁵ should, if established, pay close attention to the thinking and the recommendations emanating from the FSA's study. What is true for the commercial insurance market generally will be of equal relevance to the CCI market.

3. AUSTRALIA⁶

3.1. *In general*

⁵ Section 3.6.8

⁶ The Panel is indebted to Colin Neave and Philip Field from the Banking and Financial Services Ombudsman Ltd, Ragini Rajadurai from the Insurance Ombudsman Services Ltd, Trevor Slater from the Financial Industry Complaints Service Ltd, Katherine Lane from the Credit Legal Centre (NSW) ("KL"), Carolyn Bond from the Consumer Action Law Centre ("CB") and, in particular, Christian Mikula from ASIC for invaluable information and advice in compiling this section.

- 3.1.1. Consumer credit insurance (CCI), described as easily the most profitable insurance for insurance companies in Australia, has been and remains problematic in that country.
- 3.1.2. CCI as a rule is offered when a consumer takes out a loan, the premium being included in the borrowed amount. It is designed to provide insurance cover should something happen that would affect the consumer's ability to meet the payments due on an underlying loan. CCI usually covers three types of risks: death, sickness or accident, or unemployment.
- 3.1.3. CCI in Australia differs from the UK model in the one respect that intermediary commissions are pegged at 20% of the premium but otherwise many of the market-related problems experienced with CCI in the UK - and, as will become apparent later in this report, South Africa - are also prevalent in Australia.
- 3.1.4. Legislatively CCI is governed in Australia by the Insurance Contracts Act 1984, the Financial Services Reform Act 2001 (FSR) and, more specifically, by Part 8 of the Uniform Consumer Credit Code (UCCC)⁷ which applies to CCI for loans for personal, domestic or household purposes.
- 3.1.5. The Insurance Contracts Act reformed and modernised the law relating to contracts of insurance, including CCI, and aimed to strike a fair balance between the interests of insurers and consumers.
- 3.1.6. FSR aimed to consolidate the regulation of the financial services sector and covers virtually all financial services and products (excluding credit). Most life and general insurance products are specifically designated as "financial products" under FSR. Disclosure lies at the heart of FSR. It is a requirement under FSR to disclose the source of remuneration where this is provided by a financial services licensee. FSR also governs pre-sale marketing practices and places a number of obligations on such licensees and their employees. The Australian Securities and Investment Commission (ASIC), which oversees

⁷ The UCCC came into operation on 1 November 1996. It was developed as "template legislation" following the intergovernmental Uniform Credit Laws Agreement 1993. Under that agreement Queensland was nominated as the State to establish uniform consumer credit laws. All the States and Territories, barring Western Australia, enacted legislation adopting the UCCC while Western Australia introduced legislation that is substantially similar to the UCCC.

the FSR legislation, is empowered to initiate legal proceedings against a company and its employees where there has been a contravention. In addition, consumers are free to raise any such issue with the relevant ombudsman's organizations.⁸

- 3.1.7. The Insurance Contracts Act provides that an insurer must notify a consumer of certain matters within the policy and FSR, in addition, obliges the insurer to advise consumers of significant characteristics of policies, such as exclusions. In addition, the Insurance Contracts Regulations 1985 stipulate minimum coverage provisions with respect to general insurance contracts. Where an insurer offers less than those standard provisions the consumer is to be informed accordingly.

3.2. ***The Uniform Consumer Credit Code (UCCC)***

- 3.2.1. Part 8 of the UCCC is applicable to CCI for loans for personal, domestic or household purposes. CCI is defined in section 132(1) as

“a contract for insurance of any of the following kinds in connection with a credit contract—

(a) insurance over mortgaged property;

(b) consumer credit insurance;

(c) insurance of a nature prescribed for the purposes of this section by the regulations.”

- 3.2.2. Section 132(3) provides:

“This Code does not apply to consumer credit insurance in connection with a credit contract unless the contract for consumer credit insurance insures the obligations of the debtor under the credit contract.”

⁸ “FSR requires those organisations providing financial products to have a dispute resolution system, both internal and external. As members of the Insurance Ombudsman's scheme insurers are bound by the provisions of the Terms of Reference, which govern the conduct of the members in relation to both claim and non-claim disputes. In addition, more than 90% of the general insurance providers are signatories to the General Insurance Code of Conduct which is monitored by the Ombudsman's office. The Code assists consumers in relation to the buying of insurance, making a claim, where there is financial hardship, repairing of property and when disasters strike. The Code also requires insurers to make available to consumers up-to-date, clear and concise information to assist the understanding of how general insurance works to enable consumers to make informed decisions. What is true for insurance in general is of course also true for CCI”.

- 3.2.3. Clause 133 prohibits a credit provider or supplier from requiring a debtor or guarantor to take out insurance or to pay for insurance taken out or arranged by the credit provider or supplier, unless it is compulsory insurance, mortgage indemnity insurance, insurance over mortgaged property or other prescribed insurance; the maximum penalty for a contravention being \$10,000.
- 3.2.4. The clause also prohibits a credit provider or supplier from requiring a debtor or guarantor to take out insurance with a particular insurer, or making any unreasonable requirements about insurance terms, in relation to a credit contract or a sale contract in relation to which there is a tied loan contract or tied continuing credit contract, the maximum penalty again being \$10,000.
- 3.2.5. Clause 134 prohibits a credit provider from knowingly providing credit for a premium for insurance over mortgaged property for more than a one year period, or from knowingly debiting the premium from the debtor's account more than 30 days before the beginning of the period of insurance.
- 3.2.6. Clause 135 limits the amount of commission payable by an insurer to 20% of the premium. It provides:

“135 Commission for consumer credit insurance

(1) This section applies to commission paid by an insurer in connection with consumer credit insurance taken out by the debtor, or for which an amount is paid by the debtor.

(2) The total of any such commission accepted by all or any of the following—

(a) the credit provider;

(b) the supplier under a sale contract in relation to which there is a tied loan contract or a tied continuing credit contract;

(c) the agent of the credit provider or supplier;

must not exceed, in amount or value, 20% of the premium (excluding government charges).

(3) A credit provider or any such supplier or agent must not accept, and an insurer must not pay, a commission exceeding, in amount or value, the maximum allowed under this section.

(4) Civil effect. If a credit provider or supplier contravenes this section, the insured is entitled to recover the whole amount or value of the commission from the credit provider or the supplier, as the case requires.”

- 3.2.7. Clause 136 sets out the requirements for copies of insurance policies and for copies of credit-related insurance contracts financed by credit contracts to be given by insurers to debtors and for prescribed particulars of credit-related insurance contracts entered into by credit providers and so financed to be given to debtors.
- 3.2.8. Clause 137 sets out the procedures to be followed when an insurer rejects a proposal for credit-related insurance to be financed by a credit contract; it will be an offence not to refund or credit in full any amount paid by the debtor.
- 3.2.9. Clauses 138 and 139 provide for the termination of a relevant CCI contract on the termination of a credit contract and for the results of the termination of the insurance contract. It is an offence for a credit provider not to notify a debtor of the debtor's rights on any such termination of a credit contract, the maximum penalty for which is \$5,000.
- 3.2.10. Section 15N of the UCCC requires certain disclosures to be made at the time of contracting, including that where commission is paid by the insurer to the credit provider, details of the insurer and the amount of commission, if ascertainable, is disclosed.

3.3. ***Intermediary remuneration***

- 3.3.1. Circumvention of the commission limitation of clause 135 of UCCC does occur. An example quoted to the Panel reads as follows: *“To illustrate the importance of commissions though (and how far industry is prepared to go to ensure they keep them), shortly after the Code was introduced (thereby limiting the commission) we saw a new credit insurance product emerge called “gap insurance”. This insurance covered the*

*gap between the amount due on the finance contract and the amount paid out by the insurer if the car was stolen or was a write off. Consumers rarely have any idea what this insurance is, and it is overpriced and of questionable value. However, it didn't fit within the "consumer credit insurance" definition of the Code, so the 20% commission didn't apply, and we have seen evidence of commissions on "gap insurance" of over 50%."*⁹

- 3.3.2. Some time in 2004 the Australian Securities and Investment Commission (ASIC), the Commonwealth regulator of financial services in Australia, *"began a review of the remuneration practices of general insurance brokers (brokers) to assess their compliance with legal obligations, particularly in relation to managing conflicts of interest and disclosing remuneration. ASIC also aimed to identify the types of remuneration arrangements that exist between brokers and general insurers (insurers) in Australia."*¹⁰
- 3.3.3. The review was prompted by the investigation of the New York State Attorney General of allegations that *"some insurance brokers in the United States were encouraging their staff to place business with preferred insurers that paid them higher commissions – a practice known as 'steering'. The Attorney General also investigated allegations that brokers were engaged in 'bid rigging' – that is, soliciting fictitious quotes to make the preferred insurer's bid look more competitive. In both cases, insurance brokers were found to have recommended insurance products based on the size of commissions they received from insurers, rather than acting in the best interests of their clients."*¹¹
- 3.3.4. ASIC conducted its review to assess brokers' compliance with their legal obligations, particularly in relation to managing conflicts of interest and disclosing remuneration. ASIC's review also aimed to identify the types of remuneration arrangements that exist between brokers and general insurers in Australia and determine whether there was any evidence of the US practices in the Australian industry.
- 3.3.5. In a news release accompanying the publication of the report it was said:

⁹ CB.

¹⁰ ASIC Report on Insurance Broker Remuneration Arrangements, June 2005, Executive Summary page 4.

¹¹ Ibid.

“Australian law imposes strict requirements on insurance brokers to tell clients about remuneration incentives received from insurers. Where contingent and preferential remuneration arrangements are significant to broker revenue or profit, merely disclosing the conflict and imposing internal controls may not be enough. In such cases, the only way to adequately manage the conflict may be to avoid it. The appropriate arrangements will always depend on the circumstances.”

- 3.3.6. The main types of remuneration paid by insurers to brokers consisted of:
- commissions—including flat rate commission based on premium, contingent remuneration, override commission (extra commission payable on top of the normal rate paid by participating insurers) and extra commission for conducting business electronically etc.;
 - ‘fee for service’—often referred to as administration fees, including fees for performing functions such as claims handling, marketing or risk management services; and
 - non-monetary remuneration—including entertainment, gifts, sponsorship, access to IT and other resources.
- 3.3.7. Brokers are normally paid commission as a percentage of gross written premium (GWP). An increase in GWP therefore increases the commission payable to the broker.¹² According to the report:
- “Insurance brokers are often seen by their clients as professional consultants. The principal function of a broker is to act as agent for the prospective or intending insured to find and arrange appropriate insurance on their behalf. This is so even though a major source of brokers’ remuneration is commissions paid by insurers. A broker may also act as agent of an insurer. Examples include ‘binder’ arrangements and performing administrative functions for an insurer. As a broker can act in dual capacities, it is important for the broker to clearly disclose on whose behalf it is acting when recommending insurance products to clients.”¹³*
- 3.3.8. Conflicts of interest may arise when brokers receive contingent remuneration in two capacities:

¹² The investigation therefore concerned brokers in the conventional sense and not, as in South Africa, credit providers or product suppliers masquerading, as is explained in chapters 3 and 6, as intermediaries because of the extended definition of “intermediaries” in the two South African Insurance Acts.

¹³ Page 7 of the report.

- as agent of the intending insured; and/or
- as agent of the insurer e.g in a binder arrangement.

Where a broker acts as agent of an insured in some situations and as agent of the insurer and not the insured in others e.g. the insurer may arrange one policy for an insured on the open market and another under a binder. If the insured is not made aware of this situation by the insurance broker a conflict of interest may arise.

- 3.3.9. The two types of practice, as it is put in the report:
“raise a question of whether the broker was preferring its own interest over that of its client in order to obtain a higher commission based on the higher premium.”
- 3.3.10. ASIC discovered no instances of bid rigging, and only limited evidence that suggested steering may exist at some level in the Australian insurance broking industry.
- 3.3.11. Intermediaries, so it was found, generally disclosed the receipt of commissions from insurers and of fees for service type remuneration as a percentage range.
- 3.3.12. It is pointed out in the report that disclosure of the composition of the commissions may be necessary for managing potential conflicts of interest if the commission rate included an override component or other incentives for the broker to refer business to particular insurers. ASIC could not ascertain from the information obtained whether *‘fee for service’* type remuneration received by some brokers reflected the economic value of the service to the insurer. If the remuneration significantly exceeded the economic value of the service, clients could be misled about the true nature of the remuneration. There could also be a risk of the broker receiving hidden or secret commissions and a failure to adequately manage a conflict of interest.
- 3.3.13. ASIC found that more than half the brokers reviewed had contingent remuneration arrangements in place and most of those brokers placed a significant proportion of their business with insurers that paid extra commissions based on the volume of business placed with them.
- 3.3.14. In conclusion the review did not find any evidence of the kind of systemic abuses uncovered in the United States. However, ASIC did identify some

deficiencies in relation to Australian brokers' management of conflicts of interest and disclosure of remuneration. The review also highlighted the inherent conflict in the practice of paying volume bonuses or other types of contingent remuneration to brokers.

3.4. *Fee disclosure*

3.4.1. ASIC commenced a project in 2001 to foster better disclosure of fees and charges in product disclosure statements for investment products. A report entitled *Disclosure of Fees and Charges in Managed Funds* (the Ramsay report) was released in September 2002. The ultimate aim was to obtain industry consensus on a standard good practice model for disclosing fees by addressing issues identified in the report such as:

- use of common terms;
- standardised descriptions;
- the purpose of particular fees;
- improved disclosure of adviser remuneration arrangements; and
- transparency of fees.

3.4.2. The model proposed an "at a glance" table for the disclosure of significant fees. The term "fee" included all fees relating to a financial product however charged or described. It included fees, charges, costs and expenses.

3.4.3. Good disclosure principles identified were:

- disclosure should be timely;
- disclosure should be relevant and complete;
- disclosure should promote product understanding;
- disclosure should promote comparability;
- disclosure should highlight important information;
- disclosure should have regard to consumers' needs.

3.4.4. The model comprised three main disclosure items:

- the fee and a brief description of its purpose; the purpose of each fee is stated in the model, especially whether it included a commission component;
- the amount of the fee;
- how and when the fee is paid.

- 3.4.5. In terms of the model more detailed information may have to be furnished about the fees which include an amount for adviser remuneration and a description of the commission arrangements, including the amount or range, where it is not a predetermined amount. This additional information should include how commission can be negotiated (and with whom); any available rebate arrangements and what happens if an adviser is not used (e.g. a statement that commission is still payable, if applicable); a disclosure of maximum fees and the circumstances in which a maximum fee might be charged so that the consumer can ascertain the likely *actual* fee.
- 3.4.6. The fee disclosure model issued with this report in July 2003 was replaced with a revised fee disclosure model in June 2004. This revised model has in turn been superseded by the requirements of the *Corporation Amendment Regulations 2005 (No.1)*.
- 3.4.7. It is a model that can be employed with profit by the South African industry associations in dealing with the disclosure issues that are discussed in greater detail in chapter 12 of this report.
- 3.5. **Market conduct review**
- 3.5.1. Misconduct issues in the field of CCI were reviewed by the Australian Competition and Consumer Commission culminating in a final report in July 1998, entitled “CCI Review”.
- 3.5.2. The report elaborated on previous work undertaken by a Government Working Party and sought, firstly, to identify persisting and new problems for consumers and, secondly, to suggest cost-effective industry-based action to address such problems.
- 3.5.3. It found that despite a general improvement some problems persisted, especially in what was described as “*pockets of less reputable agents and disadvantaged consumers.*” Problems with particular resonance for South Africa included:
- the price and cost of CCI products;
 - competition at the point of sale;
 - training of agents;
 - provision of information to consumers;

- third line forcing;
- content and coverage of policies;
- inappropriate sales.

3.5.4. The price and cost of CCI products

3.5.4.1. The following statistics are of some interest for South Africa:¹⁴

Statistics for year	1992	1993	1994	1995	1996
Loss ratio	41%	46%	38%	42%	34%
Expense ratio	59%	51%	47%	49%	46%
Commission	42%	35%	31%	36%	33%

- 3.5.4.2. CCI, so it was noted in the report, *“has been an extremely expensive class of insurance to administer and distribute, relative to other forms of insurance.”* Underwriting expenses exceeded the cost of claims as a proportion of premiums; conversely, claims expenses exceeded underwriting expenses for most other forms of insurance.
- 3.5.4.3. Commission for agents selling CCI *“increased by ‘reverse competition’ as insurers bid against each other for access to agents.”* An example cited was that of a large multi-product insurance company encountering difficulties in gaining access to motor vehicle distribution outlets. Reverse competition is associated with higher commissions and delivery costs leading to increased prices for the consumer.
- 3.5.4.4. The report noted that commissions had recently been capped to a maximum of 20%. *“However, the effect of capped commissions remained unclear. Although intended to reduce premiums, increased administration and compliance costs may offset, at least in the short term, any reduction in expenses and underwriting result. A distributor may still be able to extract significant margins due to the absence of competition at the level of the ultimate consumer.”* And: *“The cap on commissions has also seen some insurers develop*

¹⁴ See chapter 13.

innovative arrangements which provide alternative forms of remuneration and incentives to agents in addition to commissions.”¹⁵

3.5.4.5. High commissions and delivery costs, together with consumers being relatively insensitive to variations in the price and quality of CCI, has led to very low loss ratios (funds paid out to consumers as a proportion of premiums), compared with other types of insurance, which, so the report concludes, suggests a less competitive market.

3.5.5. Competition at the point of sale

3.5.5.1. The CCI market is highly concentrated, the report says, the top five insurers having 79% of the market and the top ten 96%. Other than at the level of securing agents, there is limited competition at the point of sale.

3.5.5.2. *“Also, it is often difficult for consumers to compare CCI products due to the inherent complexity of the transaction (especially when purchasing CCI in conjunction with a motor vehicle or other consumer durable), consumers’ lack of familiarity with the product, the infrequency of the purchase and consumers’ being relatively insensitive to variations in the price and quality of CCI. Overall, a consumer’s capacity to exercise choice between different CCI products is limited. Consequently, benefits of competition are not always passed on to consumers at the point of sale.”*

3.5.6. Training of agents

3.5.6.1. Individual consumers of CCI dealing with inadequately trained agents may encounter a number of problems such as agents:

- not understanding the policy terms and their own obligations;
- not conveying all the relevant information;
- incorrectly advising consumers.

3.5.6.2. It is recommended in the report that *“industry associations which have coverage of motor vehicles, electrical goods and other consumer durables, should seek to address CCI issues through their own industry regulatory arrangements. More specifically, clauses relating to the sale of CCI contracts should be included in those industry association’s own codes of conduct and other self-regulatory instruments.”*

¹⁵ The following example was quoted: *“Car dealers in one State may become shareholders of a company specializing in marketing motor vehicle insurance products through the purchase of shares on which dividends are paid. This corporate entity wholly owns an insurance company specialising in underwriting CCI products on which commissions are earned independently and in addition to dividends.”* See chapter 9.

3.5.7. Information problems for consumers

- 3.5.7.1. While in most cases insurers and agents do provide consumers with relevant information, not all consumers adequately understand the terms and conditions of the policy and their rights and obligations. That is particularly true for the restrictive nature and interpretation of clauses, especially pre-existing conditions and the different types of policies on offer. *“Consumers are sometimes not even aware that they have been sold a particular policy.”*
- 3.5.7.2. The report continues: *“The multi-dimensional and contingent nature of many insurance products makes understanding and comparability of policies and prices difficult for consumers. These difficulties are compounded by the infrequent purchase of such products, and can be further compounded by other transactions associated with the decision to buy insurance products, as is the case with CCI.”*
- 3.5.7.3. In some instances, so it is reported, consumers do not take the time to read the relevant documentation. *“In the past, problems arose due to consumers not receiving adequate information. Conversely, problems can also occur if a great deal of information is provided in a short timeframe and in conjunction with information relating to other transactions...It can be expected that consumers will not tediously wade through every page and read every word of a large amount of written material. This is especially true with regard to less sophisticated, uneducated consumers but can also be the case for well informed and intelligent consumers.”*
- 3.5.7.4. There are many reasons, so it is suggested in the report, why consumers may not make effective use of substantial disclosure documentation. *“For some consumers, problems with literacy, numeracy and language can present considerable obstacles to understanding even basic and well presented disclosure information. For others, it may be that their lack of sophistication in financial matters constrains the value they can derive from such information.”* So too: *“Even for financially sophisticated consumers, the opportunity, cost of time and competing priorities at the time of purchase may prevent adequate use being made of written information. Reading, analysing and understanding substantial amounts of written product information is not costless – sometimes consumers perceive that these costs are prohibitive when compared to the expected benefits to be gained, and as a consequence the full set of information is not utilised.”*

- 3.5.7.5. *“Put simply, the implications of this for effective consumer protection are not just that in certain circumstances ‘less is more’, but also that the mix of information that consumers receive is important. The more substantial disclosure information that consumers receive, needs to be complemented by shorter and more accessible forms of information to trigger a response by consumers in terms of utilising the more substantial information supplied, seeking independent advice or shopping around further – that is, an ‘optimal mix of information’ for the average consumer.”*
- 3.5.7.6. The causes for these information problems, according to the report, may be linked to:
- inadequate training of agents;
 - policies being completed in the absence of the consumer without consultation;
 - consumers having little time to read and understand the policy;
 - little focus or time spent on explaining the terms of the policy;
 - consumers not being advised of their rights to complain;
 - the inherent complexity of the transaction as a whole;
 - the dealer or credit provider’s influence over the consumer at the time of the primary purchase of the goods or services.
- 3.5.7.7. One suggested corrective is proper training of agents. Another is increasing consumers’ awareness during the transaction process by requiring insurers to insist that consumers complete a simple checklist of questions in the presence of the agent and at the point of sale.
- 3.5.7.8. *“The requirement for particular agents selling proposals to require consumers to use a checklist would help to avoid inappropriate sales by helping consumers to decide whether they needed CCI and what level/form of cover is appropriate for their situation. Basically, it would act as a trigger mechanism with regard to consumer awareness at the point of sale.”*
- 3.5.7.9. Other benefits that would flow from the checklist would include, according to the report:
- ensuring that agents analyse the needs, circumstances and objectives of the consumer with a view to sound advice;

- ensuring that agents obtain all the relevant information (e.g. age, state of health, employment status, other insurance coverage) with a view to sound advice;
- ensuring that agents discuss CCI more thoroughly;
- improved compliance with regulation;
- assistance in monitoring the training of agents by insurers.

3.5.7.10. The checklist should be developed, according to the report, in consultation with the relevant regulators and consumer groups and should form part of the insurance proposal.

3.5.8. Third line forcing

3.5.8.1. Third line forcing involves the supply of goods or services on condition that the consumer acquires them from a particular third party. Although prohibited and decreasing, the practice still occurred.

3.5.8.2. Where it did occur, according to the report, misrepresentations were made to the consumer that the purchase of CCI policies was mandatory in order to be granted the finance to purchase a motor vehicle or other consumer durables. *“This is sometimes taken one step further by including the cost of the policy in the amount borrowed and completing the insurance form without consulting the consumer.”*

3.5.8.3. Sellers of CCI have engaged in this type of conduct, the report says, *“due to incentives arising from high commissions and partly due to inadequate training.”*

3.5.9. Content and coverage of policies

3.5.9.1. The ancillary nature of CCI has meant, the report states, that *“consumers have not been highly sensitive to price and policy content in the past. This is reflected in the content and price of policies not being particularly dynamic.”*

3.5.9.2. A consequence of this *“price/content inertia”* is that many policies continue to have very restrictive conditions and that consumers *“may derive little value from their policies due to the limited applicability of generic policies to their circumstances.”*

3.5.10. Inappropriate sales

3.5.10.1. CCI is sometimes sold to consumers who would not be able to claim on their policies. An example would be the sale of a disability policy to a consumer suffering from a relevant pre-existing condition.

3.5.10.2. Conduct of this nature was once again ascribed to both the incentive to generate a high level of CCI sales, in turn generating high income because of substantial commissions, as well as to inadequate training.

3.5.11. Main recommendations from a South African perspective

3.5.11.1. The report emphasised the importance of consumer awareness in the wider context of consumer education. It was recommended “*that relevant government agencies, industry and consumer advocates adopt a cooperative approach to develop education strategies for consumers...It is not enough simply to make information available to consumers if consumer awareness about CCI is to be raised outside the transaction process. Information must be relevant to consumers’ current needs so that the ‘motivation to know’ is created which is necessary to overcome ‘rational resistance.’*”

3.5.11.2. The suggested “*tailored strategies*” include:

- direct and indirect personal contact;
- written and oral communications;
- different forms of media;
- the use of new technologies;
- the coordination and cooperative involvement of a number of agencies within a flexible framework.

3.5.11.3. An increased general level of consumer awareness would help “*to prompt consumers into actively engaging in comparison shopping in an effort to seek out the best deal.*”

3.6. **General market conduct**

3.6.1. Practices in this part of the market, deprecated as inappropriate, misleading and detrimental to consumers, do occur, so it was mentioned to the Panel by consumer advisers in Australia.

3.6.2. These include:

3.6.2.1. Lack of free choice;¹⁶

¹⁶ CB “Commissions drive the sale of this type of insurance. Commissions can lead to “reverse competition” where the most popular product is that which pays the highest commissions (and therefore usually costs the consumer more). My understanding is that a lender will only offer one CCI product – therefore it’s not really possible for the consumer to look around for a better deal on the insurance.”

KL “There are real conflicts of interest and this often results in forced insurance. A number of finance companies in Australia have a related company insurance arm. The finance company then often just prints the CCI premiums on the loan contract. The consumer often does not even notice the premiums. There is no real consumer choice in these circumstances.”

- 3.6.2.2. Consumers are not always advised or aware that they have committed themselves to CCI in one form or another;¹⁷ disclosure alone, so it is said, is not necessarily the complete answer.¹⁸
- 3.6.2.3. Pre-sale misselling;¹⁹
- 3.6.2.4. Limitations to and exclusions of cover were not always explained to the consumer;²⁰
- 3.6.2.5. Poor value, low claims ratio.²¹
- 3.6.3. In 2004 ASIC compared the cost of life cover of \$50,000 under a CCI policy with cover under a term life policy. It found that CCI policies were two to four times more expensive than term life policies. The difference in price increased even further according to the interest rate charged on the CCI premiums.

KL *"The Consumer Credit Code also prohibits forced insurance but this is very difficult to prove."*

"Unfortunately, my casework experience remains that finance companies continue to "force" insurance onto consumers on a regular basis. In my view the crux of the problem is the financing of the premiums. When the premiums are financed in the loan then they can just be hidden in the loan contract. The consumer literally does not notice the premium. The main reform that I think is needed is to ban the financing of insurance premiums so consumers (and particularly disadvantaged consumers) have a real opportunity to consider whether the insurance is appropriate for them (and they can afford it). It would also encourage shopping around (and competition) as the consumer would need to pay separately for the insurance."

¹⁷ CB *"We suspect that the reason that many of these insurers seem to have low number of claims is that consumers have this insurance but don't know they have it. This indicates bad selling techniques. It has been the practice in the past, for example, for a lender to quote monthly payment that include insurance or to include insurance on the documentation when it is presented to the consumer for signing (before asking the consumer if it is required)."*

KL *"There are real conflicts of interest and this often results in forced insurance. A number of finance companies in Australia have a related company insurance arm. The finance company then often just prints the CCI premiums." on the loan contract. The consumer often does not even notice the premiums."*

¹⁸ KL *"The real problem here is that even with disclosure it is still very difficult for consumers to properly consider their options."*

¹⁹ CB *This type of insurance is also sometimes sold in the situation where it has no financial benefit for the consumer at all. For example, providing the provision of death cover, in the situation where the borrower is a young person without dependents.*

KL *I have been giving education to consumers for many years in financial services. I always support education but I believe that the most important education is actually point-of-time advice. That is, when the consumer is making the decision a number is given that they may wish to ring to get advice on that decision. This is the best possible way to educate consumers so they can understand the decision-making process."*

²⁰ CB *"Because consumers don't understand the product (and it is not in the seller's interest to help them understand) some consumers purchase CCI in the situation where they may be unable to claim (for example because they are a seasonal worker)."*

²¹ KL *"From memory CCI pays out to consumers less than 5% of the time making it an insurance that is very poor value for the consumer."*

KL *"That investigation found inappropriate selling of CCI. Even more disturbing was how many consumers had been sold CCI. My casework would indicate that almost every loan customer had been sold CCI even though it is a very poor value insurance."*

3.7. *In short*

Pre-sale disclosure requirements for CCI as a subset of general insurance is detailed and comprehensive. Yet questionable practices do occur. This is a phenomenon that is replicated in South Africa, as will appear more fully in the chapters that follow.

4. THE UNITED STATES OF AMERICA²²

4.1. *In general*

4.1.1. In the UK, the first model discussed in this section, intermediary remuneration is unregulated. In Australia, the second model, commission is regulated at 20% of the premium. In the USA, the third model, it is primarily the premium rate that, in all the states, is regulated.

4.1.2. Once the premium is regulated the need for regulating the commission payable by the insurer to the intermediary, as a means of protecting the consumer against exploitation, is considerably weakened. That is because premiums represent the insurers income stream and any payment of commission will be at the expense not of the consumer but of the insurer's profit margin. It would only matter if the commission is additionally levied against the consumer either by the insurer or by the intermediary.

4.1.3. Because of the diversity in insurance regulation from state to state in the USA only the broadest of pictures can be painted in this section.

4.1.4. Historically, as well as functionally, a distinction developed between insurance for instalment (or closed-end) credit and insurance for open-end credit. The Fact Book puts it as follows:

"In the 1900s, the concept of extending credit solely on an individual's future earning power was introduced and accepted. Installment credit repaid in monthly installments became the standard. After World War II, the demand for consumer products increased explosively. Consumers began to borrow money routinely to purchase vehicles, modern appliances, and other consumer products. In the 1960s, open-end credit became significant with the introduction of credit cards, which allowed the cardholder to borrow for any

²² The Panel is indebted to Mr William F Burfeind, Executive Vice President of the Consumer Credit Industry Association, for information about credit insurance in the USA. Much of what is stated in the text is directly derived from information furnished by him. In preparing this section copious use has also been made of "The Fact Book of Credit-related Insurance" published in September 2007 by the Consumer Credit Industry Association., to which reference is made in the text as "The Fact Book".

purpose, up to a pre-approved limit. Home equity credit grew in importance in consumer credit after the 1986 Tax Act. For today's consumer, borrowing is easy and convenient."

4.2. ***Credit-related insurance products***

- 4.2.1. Credit-related insurance by definition is insurance sold in conjunction with consumer credit, in which the policy term and the benefits are related to a specific consumer credit transaction.
- 4.2.2. The initiators of credit-related insurance include vehicle dealerships, banks, credit unions, finance companies and retailers.
- 4.2.3. Consumer credit hinges on the premise, as the Fact Book puts it, *"that the borrower can meet the credit obligation from future wages. Earning power serves as the collateral for the credit. When this idea was first introduced, creditors knew that the death, disability, or unemployment of the borrower could place the "collateral" of the credit in jeopardy. Insurance on the borrower's life and ability to work was introduced to protect the creditor and cushion the borrower's loss."*
- 4.2.4. Since the insurance product was geared to a specific credit transaction, so the Fact Book continued, credit-related insurance pioneers developed a unique product and marketing structure while meeting the normal requirements for insurance products. Two speciality insurance products, credit life insurance and credit disability insurance, emerged to meet the specific needs associated with consumer credit.
- 4.2.5. To meet the needs of the instalment borrower, the insurance had to be presented at the time the credit was extended. This led to a marketing approach where the insurance products were offered to the consumer by the credit provider, rather than by a fully licensed insurance agent. So too, policy forms, premium structures, and underwriting conditions had to be simple.
- 4.2.6. The result was a product that could easily be explained and presented to the consumer, whose only decision was to either accept or reject the insurance. If the insurance was accepted, the coverage took effect immediately, along with the credit obligation.

4.2.7. *Closed-end credit insurance*

Several common characteristics of instalment credit insurance, as identified by the Fact Book, emerged to meet these conditions, which still apply to most such credit-related insurance written today:

- credit life, disability, and involuntary unemployment insurance are offered separately or as a package as a voluntary option on the part of the consumer;
- coverage matches the credit, subject to policy maximums. Life insurance in force during the term of insurance equals the sum of the remaining payments due on the credit (gross coverage) or the outstanding balance (net payoff coverage). The monthly disability and involuntary unemployment benefit is equal to the required monthly payment;
- the first beneficiary of the policy is the creditor, who uses the proceeds to extinguish the credit. Any additional proceeds are paid to the second beneficiary or the insured's estate;
- for consumer credit, the premium charged was typically a single premium paid at the inception of the insurance. The premium was included in the amount advanced and was financed along with the principal. The same premium rate applies to all ages and both genders. The initial policy size was generally under \$25,000, and the term of insurance was short, generally 60 months or less;
- during the last 5-7 years, however, there has been a trend towards collecting a monthly premium on closed-end loans. Regulation is generally unsympathetic towards financed single premium and it is being prohibited or restricted in connection with real estate secured (mortgage) loans. Because of "reputational concerns" some mortgage lenders ceased to offer single premium. Large long-term loans generate large premium amounts which, together with the finance charge, are faulted as being "equity stripping." Industry's first response (15-20 years ago) was to offer truncated single premium coverage. A truncated policy would insure the long term loan for a

limited period, usually 5 years. This would reduce the premium amount but not the amount of coverage, just the term of coverage.

Most real estate loans tend to be refinanced anyway within 5 years;

- policy forms contain few exclusions;
- insurance terminates when the credit ceases. If the credit is repaid prior to the scheduled maturity date, a refund of the unearned premium is paid or credited to the consumer.

4.2.8. *Open-end credit insurance*

4.2.8.1. Open-end credit, according to the Fact Book, did not take off until the widespread introduction of bank credit cards in the 1960s. Credit property insurance on open-end credit is monthly premium, monthly renewable property insurance, purchased in conjunction with open-end credit, insuring consumer products that are bought (or pledged as collateral) against specified loss occurrences causing damage to, or disappearance of, the property. The benefit is repair or replacement of the property.

4.2.8.2. Insurers began to offer credit life and disability insurance with monthly premiums based on the outstanding card balance each month. Credit life insurance paid the outstanding balance on the date of death. If the insured became disabled, credit disability insurance paid the minimum monthly payment during the period of disability.

4.2.8.3. Since card balances were generally under \$4,000, these two insurance products did not generate sufficient premium dollars to support the fixed expenses of processing the insurance products. Credit insurers chose to add a new product, involuntary unemployment insurance (IUI). If the insured became involuntarily unemployed, IUI paid the minimum monthly payment during the period of unemployment. The insured events included layoff, firing, lockout, and strike. In most other policy provisions, IUI was similar to credit disability insurance.

4.2.8.4. From 1985 to 2001, these programs were a common option for open-end credit cardholders. Insurers offered the three insurance products as a package. An offer was made initially, and additional solicitations were made periodically with billing inserts and by telemarketing. Since 2001 virtually all

new solicitations in this market have been for non-insurance debt protection products.²³ According to the Fact Book *“debt protection products have arrived. They dominate new solicitations for general-purpose credit cards and retailer revolving charge cards.”*

4.2.8.5. Common characteristics of open-ended credit-related insurance, to quote the Fact Book once again, are:

- the consumer with a bank’s credit card or a retailer’s revolving charge card is solicited when the card is issued and later by mail or telemarketing;
- the consumer is offered a package programme containing life insurance, disability insurance, and involuntary unemployment insurance;
- life insurance pays the outstanding balance on the date of death. Disability and involuntary unemployment insurance pay a level monthly benefit while a claim is in progress. The benefit equals the minimum monthly payment on the date of disability or involuntary unemployment;
- the first beneficiary of the policy proceeds is the creditor. Benefits reduce the outstanding balance on the card;
- insurance is provided on a month-to-month basis. Premiums are paid monthly based on the card’s outstanding balance on the billing date;
- the same premium rate is charged to every borrower of a producer in a state for the package of products. There is just one rate for all ages and both sexes;
- the average insured balance is about \$4,000 on general-purpose credit cards;
- policy forms contain few exclusions;

²³ Debt protection, a form of debt cancellation, consists of a two party contractual agreement between the credit provider and the consumer to cancel or suspend payment upon specified occurrences. Credit insurance, on the other hand, is a three party arrangement (credit provider, consumer and insurer) whereby indemnification is paid upon specified occurrences. Creditor interest in debt cancellation is driven in large measure by credit insurance regulations which the creditor seeks to avoid: forms approval, rate regulation, agent licensing and a desire for uniformity by creditors doing business in multiple states (state regulation subjects creditors to varied compliance requirements). See, in particular, “Debt Protection Products, a practical guide for lenders” by Gary Fagg and Keith Nelson, (2008), published by CreditRe Corporation.

- insurance terminates at age 65 (or higher in some states) or when the card is terminated.

4.2.9. **GAP**

GAP, according to the FACT Book, *“is now the second slot in most vehicle dealerships’ F&I office product menus, following vehicle service contracts... In most states, GAP is sold as a non-insurance debt protection product called GAP waiver.”*

And again:

“GAP can be written on a variety of assets that are used as collateral to secure credit, however, it is most commonly written for vehicles...”

And again:

The letters G-A-P may stand for Guaranteed Vehicle Protection, or possibly Guaranteed Asset Protection, but those words do not have significant meaning. Several of the early developers called the product TLP, for Total Loss Protection. Many people just consider the letters to stand for the gap that occurs between the indebtedness and the value of the primary property insurance benefits. When an insured loss results in a total loss to the property, the primary property insurance policy usually provides a benefit equal to the ACV. In consumer credit, the outstanding indebtedness often exceeds the ACV (actual cash value) of the collateral asset at the time of a total loss. Typically, the outstanding indebtedness and the collateral’s value decline at different rates. Colloquially, the borrower has “negative equity,” is “under water,” or is “upside down.”

The difference between the indebtedness and the collateral’s ACV is the borrower’s unprotected exposure—the GAP. If a total loss occurs, the borrower has a contractual obligation to pay the creditor the excess of the indebtedness over the actual cash value.”

4.3. **Commission Regulation**

- 4.3.1. There is no uniformity about commission regulation amongst the various states. Only fourteen states currently have limitations on commission or compensation for intermediaries. "Commission" as a percentage of premium is easy to define and limit; "compensation" is not. Commission regulation is a key point in regulatory discussion. Some regulators believe that commission needs to be regulated.

4.3.2. Insurers are generally not opposed to the concept of commission limitation provided it serves as a sufficient incentive for the credit provider to promote the product and is consistently enforced. But experience has shown that competitors are always trying, sometimes successfully, to find a way around such limitations in order to gain marketing advantage.

4.4. *Premium regulation*

4.4.1. All of the states regulate the premium rate; most publish a "prima facie rate" which is a "safe harbour" rate for insurers. The prima facie rate is presumed to be reasonable without any further proof required of the insurer. An insurer may use any rate up to the prima facie rate. To use a higher rate the insurer must file for a "deviation" and demonstrate that the rate they want to use satisfies the reasonableness standard - a minimum loss ratio test. A few states require insurers to annually file and adjust the premium rate schedules to reflect the prospective attainment of the loss ratio standard predicated on recent loss experience (usually three years).

4.4.2. The regulation does spell out a minimum level of benefits that must be provided to enable the insurer to use the prima facie rate. If the insurer wants to restrict these benefits, it must file for approval of a lower actuarial equivalent premium rate. If an insurer wants to expand the benefits, it may file for approval of a higher actuarially equivalent premium rate.

4.4.3. The loss ratio standard (incurred claims to earned premium) varies from 50% to 70% depending on the state concerned. Most states still use 50%, a few use 60%, and two (New York and Maine) use 70%. A state may have different loss ratio standards for life, disability (accident and health) or unemployment coverage though they will still be within these ranges.

4.4.4. Regulators have come to the realisation that loss ratio alone may not be a reliable standard for rate reasonableness. A premium rate must not be excessive to the consumer; and it must not be inadequate to the insurer. Strict application of a designated loss ratio would produce a premium rate with an inadequate margin for insurer expenses, profit, etc. So, in many states the actual experience is less than the stated loss ratio standard. Indeed, the National Association of Insurance Commissioners (NAIC) model

regulation offers States an option for a reasonableness standard: (1) a 60% loss ratio; (2) a 60% loss ratio or such lower loss ratio as may be necessary to provide an adequate margin for insurer administrative expenses, premium taxes, creditor compensation, etc.

4.4.5. The NAIC model is just that, a model. States are not required to use it though most use some parts or some earlier versions of it.

4.5. *Improper incentives*

The following three provisions in the NAIC model regulation defining prohibited transactions are generally part of state regulation:

- the offer or grant by an insurer to a credit provider of any special advantage or any service not set out in either the group insurance contract or in the agency contract, other than the payment of agent's commissions;
- an agreement by an insurer to deposit with a bank or financial institution money or securities of the insurer with the design or intent that the same shall affect or take the place of a deposit of money or securities which otherwise would be required of the creditor by the bank or financial institution as a compensation balance or offsetting deposit for a loan or other advancement; and
- a deposit by an insurer of money or securities without interest or at a lesser rate of interest than is currently being paid by the creditor, bank, or financial institution to other depositors of like amounts for similar durations.

4.6. *Objectionable Practices*

4.6.1. Coercion, misrepresentation and failure to refund unearned premium upon early termination of the insured loan or credit transaction are some of the questionable practices that do occur in this part of the market.

4.6.2. They are addressed through federal and state disclosure in two ways:

4.6.2.1. Loan documents must disclose:

- that the insurance is optional and not a condition of credit;
- the amount of the premium charge; and
- the signature of the consumer that these disclosures were made.

4.6.2.2. The consumer must receive a policy or group certificate of insurance that explains:

- the terms, conditions and exclusions;
- the right to cancel coverage at any time;
- the right to a premium refund in the event of cancellation or early termination of the indebtedness; and
- with increasing frequency, instructions as to how to recover the refund.

4.7. *To sum up*

4.7.1. CCI, it is probably fair to say, originated and was fully developed in the USA. As such the American experience is pertinent to South Africa where, as is discussed elsewhere in this report, CCI manifested some idiosyncrasies of its own. Nonetheless, the two jurisdictions have far more in common than not and many of the issues that were and are being debated in the USA continue to echo in South Africa.

4.7.2. One aspect that has not, however, been received in South Africa was premium regulation. It will be necessary for the Panel to look at the American model as a possible correction to the perception that insurance companies and credit providers, often accommodated within the same group of companies, are raking in excessive profits due to immodest premiums being charged for CCI at the expense, so it has been suggested, of financially illiterate and unsophisticated consumers.²⁴

²⁴ See chapter 8 sections 1 and 4 and, on the issue of the value proposition, chapter 13.

CHAPTER 6

INTERMEDIARY REMUNERATION REGULATION

1. SOME INTRODUCTORY REMARKS

- 1.1. This enquiry was prompted, as was mentioned in the opening chapter of this report, by reports in the financial press that a prominent LOA member had contravened not only the commission regulations issued under the LTIA but also the LOA's own Code of Conduct, by rewarding intermediaries in excess of the permitted maximums. All members of the LOA were canvassed, as were those of SAIA who joined in this voluntary enquiry, to respond to a questionnaire, referred to hereinafter as "the initial questionnaire". From the submissions received and the evidence given during several days of public hearings it became manifest that there was a lack of clarity and consistency in the manner in which individual insurers understood and applied the commission regulations issued in terms of the two insurance Acts.
- 1.2. The Terms of Reference require the Panel to investigate, consider and make recommendations relating to, *inter alia*:
 - current and recent practices in the CCI market;
 - the appropriateness of current commission levels;
 - incentive payments;
 - administration and other fees paid.
- 1.3. Before the submissions made and the evidence given are analysed in greater detail it becomes necessary to examine the state of the current legislation on CCI.

2. THE STIA

- 2.1. Section 44 prohibits "...any valuable consideration as an inducement to a person to enter into, continue, vary or cancel a short-term policy..." In the context of the section the "person" can only be the insured. The section, as it stands, does not, therefore, purport to prevent an insurer from paying an inducement to an intermediary to promote its products above those of its competitors.
- 2.2. The crucial section relating to intermediary remuneration is section 48(1). It reads as follows:

“Intermediary remuneration and binder agreements –

(1) No consideration shall be offered or provided by a short-term insurer or a Lloyd’s broker or a representative of such insurer or broker or any person on behalf of such insurer or broker or accepted by any independent intermediary other than someone who has entered into an agreement contemplated in subsection (2), for rendering services as intermediary, and otherwise than in accordance with the regulations.”

- 2.3. Subsections (2) (3) and (4), dealing with underwriting managers and binder agreements will be dealt with elsewhere in this report as a separate topic.¹
- 2.4. The prohibition is directed against insurers (or their representatives) offering or providing, and against independent intermediaries accepting, any consideration
- (i) in excess of what is regulated in the regulations to the Act
 - (ii) for rendering services as intermediary.
- 2.5. An intermediary is independent, according to the relevant definitions, if he or she is not employed by or working for an insurer in rendering services as an intermediary.
- 2.6. “Services as intermediary” is defined to mean
- “any act performed by a person –*
- (a) the result of which is that another person will or does or offers to enter into, vary or renew a short-term policy; or*
 - (b) with a view to-*
 - (i) maintaining, servicing or otherwise dealing with;*
 - (ii) collecting or accounting for premiums payable under; or*
 - (iii) receiving, submitting or processing claims under, a short-term policy.”*
- 2.7. There are two kinds of “services as intermediary” for which the remuneration is regulated:
- (a) pre-contractual persuasion or motivation of a potential insured to enter into a policy with the insurer i.e. being instrumental in having the business placed with the insurer concerned; and
 - (b) post- contractual administrative services that include:
 - (i) maintaining, servicing, dealing with the policy;
 - (ii) collecting and accounting for premiums;

¹ Chapter 9 section 8.

- (iii) receiving, submitting or processing claims.
- 2.8. To the first kind, which refers to the reward paid by a principal to an intermediary for procuring business for the principal, reference will henceforth be made as an “introduction fee” or commission proper.
- 2.9. To the second kind, which in essence covers duties which the insurer is contractually obliged to perform itself, reference will henceforth be made as a “servicing fee”. The terminology used in these two paragraphs is that of the Panel. It is clear from Part 5 of the regulations that the legislature uses the word “commission” more loosely to cover the fees for both types of service.
- 2.10. Since “an independent intermediary” is defined as a person who renders “*services as an intermediary*” (other than a representative who in turn is defined as someone employed by the insurer “*for the purpose of rendering services as intermediary*”) and since such services can be rendered by a dealer or retailer, a sales person, a broker, a credit provider or anyone to whom the whole or part of the service is outsourced, it follows that any such person qualifies as an intermediary.
- 2.11. To this one should, however, add the following gloss. Following the decision of the High Court in the matter between *Liberty Life Association of Africa Ltd and The Financial Services Board* in case 10600/98 and the apparent uncertainty in the industry on who and what an independent intermediary was, the FSB in December 1998 circulated an interpretative note, entitled “Limitation on Remuneration for Services rendered by an Intermediary.”
- 2.12. Par 2.4 of the note reads:
- “The term ‘intermediary’ must be clearly defined. The interpretation of ‘services as intermediary’ revolves around what an intermediary is. When considering what an intermediary is, the ordinary meaning of the word should be assigned to it and the ordinary functions normally associated with it in practice will be taken into consideration. In this case it clearly relates to the type of person, natural or juristic, which performs the activities foreseen in the 1943 Insurance Act, as expanded in the new Act.”*
- 2.13. The examples quoted in the note of instances falling outside “*the ordinary meaning of the word ‘intermediary’*” are claims handling bureaus or “*the submission by an attorney of his client’s claim.*” But the bureau or attorney would not, in the examples given, be acting on the instruction of or by agreement with the insurer in doing the work described; if

they were, they would indeed, it is suggested, qualify as intermediaries for purposes of the Act.

- 2.14. While an insurer may pay any consideration to an intermediary (as ordinarily understood) for work falling outside the definition of “*rendering service as intermediary*”, the moment the work falls inside the definition the person to whom the consideration is paid becomes an intermediary, regardless of whether such a person would ordinarily be understood to be an intermediary. An intermediary as ordinarily understood is someone who liaises and acts as a facilitator between principals, in this case between the consumer and the product supplier or the credit provider, like a broker or a financial adviser. An intermediary would not ordinarily act as the financier of the transaction, or as the motor vehicle dealership or as the furniture retailer and credit providers would not “ordinarily” be understood to be intermediaries. Yet there can be no doubt that on the wording of the regulations they are correctly treated as such in the industry for the purpose of being paid an introduction or servicing fee when they do work falling within the definition of “rendering service as intermediary.” It is the type of work and not the type of person, contrary to what the interpretative note suggests, that determines whether someone doing the work is an intermediary for purposes of the Act or not.
- 2.15. Once an intermediary is circuitously defined, as it is, with reference to “services as an intermediary” and such services are in turn defined, it follows
- that work falling within the definition can never be non-intermediary work, the payment for which is not regulated;
 - that someone doing such work will by definition be an intermediary;
 - that someone doing work for the insurer *not* falling within the definition, such as IT or publicity work, is not for that purpose an intermediary so that the payment for such work is not regulated.
- 2.16. An interpretation given by some insurers to the FSB’s interpretative note is that, in the words of one of the insurers, it “*acknowledges that insurers are permitted to outsource administrative functions to independent intermediaries whose income does not derive from commission.*”
- 2.17. This interpretation is reputed to be based on paragraph 2.6(b) of the note which, together with (a), reads:

“(a) An insurer may pay any remuneration to an intermediary for services rendered in relation to anything other than:

- (i) maintaining, servicing or otherwise dealing with;*
 - (ii) collecting or accounting for premiums payable under;*
 - (iii) receiving, submitting or processing claims under;*
- a short-term policy.”*

(b) Conversely, an insurer may pay any consideration to any person, other than an intermediary, as remuneration for services rendered as referred to in (a) above.”

2.18. Sub-paragraph (b) does not say, at least not in express terms, what is attributed to it and in the Panel’s view it would require an extreme interpretation to reach that conclusion, such as, for instance:

- (i) in terms of the regulations intermediary remuneration is payable to an independent intermediary for (a) introducing the business and (b) servicing the policy;
- (ii) the remuneration is only capped if the independent intermediary derives its income from both (a) and (b);
- (iii) hence, if the intermediary derives its income from (b) alone, its remuneration is not restricted.

2.19. In the Panel’s view the wording of the regulations, especially the regulations issued under the LTIA discussed in the next section,² does not support the middle proposition.

2.20. In any event the interpretative note cannot alter the meaning of the regulations. At best it could be argued that it would be a mitigating factor if the intermediary structured its business on the strength of what it was advised the note means and the intermediary is afterwards challenged or prosecuted for contravening the regulations.

2.21. The interpretative note did not bring the requisite clarity and may in fact have added to the uncertainty as to what was and what was not permitted payment. Thus it was stated in evidence:³

² See section 3 below. An intermediary who introduces the business but renders no administrative work in regard to the policy is thus entitled to only 7.5% commission in terms of the LTIA.

³ By Ms **Thurling**.

“So as a result of the interpretative note then, some clarity was received in regard to this wide definition of intermediary services but it also allowed for certain structures to be put in place in terms of which an intermediary would get the commission. A non-intermediary, for instance, an administrator or an outsourced arm of the insurer would be paid administration fees which were not regulated the same way that commission was; and likewise, claims management bureaus, those sort of things, could also be paid fees which were unregulated. That allowed then various structures to be put in place where the insurer would have these various outsourced agents, administrators, the like, that they would pay fees and not commissions.”

- 2.22. On a proper interpretation of “services as intermediary” and “independent intermediary” any outsourcing by the insurer to an outsider of any of the functions falling within the description of such services would be subject, as far as the payment of consideration for it is concerned, to intermediary remuneration regulation.
- 2.23. It matters not that the outsider is wholly independent of the insurer or forms part of the same group of companies. Separate legal entities are involved which are separately remunerated for such services. But what is true is that in the case of internal administrators there is no prejudice to consumers, in like manner that there is no prejudice to consumers if the intermediary services are rendered by employees of the insurer, instead of by a separate company within the group.
- 2.24. The actual regulation is to be found in Part 5 of the regulations of which 5.1(1) provides:
- “No consideration shall, in respect of short-term insurance business carried on in the Republic, directly or indirectly, be provided to, or accepted by or on behalf of, an independent intermediary for rendering services as intermediary, otherwise than by way of commission in monetary form.”*
- 2.25. In terms of regulation 5.1(3) the total remuneration payable (to one or more intermediaries) is restricted to the maximum payable in terms of regulation 5.3.
- 2.26. In terms of regulation 5.3 the remuneration shall not exceed 12.5% of the premium in the case of a motor policy and 20% under any other short-term policy.
- 2.27. An intermediary who is entitled to both an introduction and a servicing fee (as defined above) is entitled to only one fee at the prescribed percentage.
- 2.28. Where an intermediary is paid a single fee for administrative work exceeding the regulated limit, part of which work falls within the definition and part outside, only the part falling within the definition is subject to regulation. The fee will notionally

have to be apportioned between the two parts. To the extent of the excess there is no contravention. This may be more easily said than done and illustrates another problem with the manner in which the regulations are formulated.

- 2.29. So too, where different intermediaries do different aspects of the administrative work qualifying them for different fees, only one fee is payable in total. The stipulated remuneration will either have to be apportioned between them or the overpayment will constitute a contravention of the regulations.
- 2.30. Finally, any contravention of section 48 is a criminal offence.

3. THE LTIA

- 3.1. The LTIA, notwithstanding differences in wording, follows largely the same pattern as the STIA.
- 3.2. Section 48 corresponds to section 44 of the STIA in prohibiting inducements by insurers to potential insured to enter into policies with them. Inducements to intermediaries are thus not expressly prohibited. However, to the extent that the level of consideration to intermediaries is regulated, on pain of criminal prosecution if excess remuneration is charged, paid or received, and to the extent that any inducement is likely to consist of a payment or reward in excess of the regulated sum, such inducement is by implication prohibited.
- 3.3. The main provision relating to intermediary remuneration is section 49. It reads:
“Limitation of remuneration to intermediaries – No consideration shall be offered or provided by a long-term insurer or a person on behalf of the long-term insurer or accepted by any independent intermediary for rendering services as intermediary as referred to in the regulations, other than commission contemplated in the regulations and otherwise than in accordance with the regulations.”
- 3.4. The regulations pertaining to section 49 are in Part 3 thereof, more particularly regulation 3.2 which, inter alia, provides;
“General limitations – (1) No consideration shall, directly or indirectly, be provided to or accepted by or on behalf of an independent intermediary for rendering services as intermediary, otherwise than by way of the payment of commission in monetary form.
(1) No commission shall be paid or accepted otherwise than in accordance generally with this Part and more particularly as specified in the Table.

(2) *Irrespective of how many persons render services as intermediary in relation to a policy, the total commission payable in respect of that policy shall not exceed the maximum commission payable in terms of regulation 3.4.”*

3.5. Regulation 3.4 in turn provides:

“Maximum commission payable – (1) *No primary commission shall exceed in respect of each kind of policy and benefit component specified in column 2 of the Table, an amount arrived at by applying...*” and then follows different permutations for determining the appropriate rate for different long-term products.

3.6. The table differentiates, inter alia, for the purpose of fixing different maximum rates of intermediary remuneration, between:

- a *life policy* providing term cover only (as defined) which is incorporated in a group scheme which is a credit scheme *with* administrative work (as defined), as opposed to

- the same but *without* administrative work

as opposed to

- an *individual life policy* providing term cover only

as opposed to

- a *health and disability policy* providing term cover only which is incorporated in a group scheme which is a credit scheme *with* administrative work

as opposed to

- the same but *without* administrative work

as opposed to

- an *individual health and disability policy*.

3.7. These regulations must be interpreted in conjunction with regulation 3.1, the definitions clause. The important definitions for present purpose are –

“administrative work means *work in connection with the handling of enquiries, maintaining administrative records and the receipt and processing of claims under a group scheme;*”

“credit scheme means *a group scheme under which every life insured is indebted to or a surety of the policyholder whose insurable interest as policyholder arises solely from that indebtedness or suretyship;*”

“group scheme means a scheme or arrangement which provides for the entering into of one or more policies, other than an individual policy, in terms of which two or more persons without an insurable interest in each other, for the purposes of the scheme, are the lives insured;”

“independent intermediary” means a person, other than a representative, rendering services as intermediary;”

“individual policy” is in turn defined as “a policy under which a particular person is the life insured, or two or more particular persons having an insurable interest in each other are the lives insured jointly;”

“rendering services as intermediary means the performance by a person other than a long-term insurer or a policyholder, on behalf of a long-term insurer or a policyholder, of any act directed towards entering into, maintaining or servicing a policy or collecting, accounting for or paying premiums or providing administrative services in relation to a policy, and includes the performance of such an act in relation to a fund, a member of a fund and the agreement between the member and the fund;”

“representative” means someone employed on certain conditions by the insurer for the purpose of rendering services as intermediary in relation to policies issued by the insurer or another insurer with which it is associated;

“term cover means a policy under which a long-term insurer undertakes to provide policy benefits only upon –

(a) the life of a life insured having ended;

(b) the life of a life insured having begun;

(c) a health event occurring;

(d) a disability event occurring, during a specified period only.”

- 3.8. The comments made in paragraph 2.4 and following of the preceding section on the STIA apply in large measure to the LTIA, in particular to the distinction that is drawn in the definition of “rendering services as intermediary” between the pre-sale introduction and the post-sale servicing fees.
- 3.9. As stated earlier, a scheme can only be a “credit scheme” if it is a “group scheme”. The exact meaning of “group scheme”, as defined, is not easy to grasp. The word “scheme” can strictly speaking refer to a plan or concept by a single party whereas the word “arrangement” implies some or other form of understanding or interaction, perhaps short of a formal agreement, between more than one party, in this instance between

the policyholder and one or more interested parties, which would be the insurer and/or the lives insured. In the context of the regulations as a whole the latter meaning is the most likely one.

- 3.10. The elements of a group scheme are:
- (i) an insurer
 - (ii) a policyholder of policies that are not individual policies (as defined)
 - (iii) an arrangement between the insurer and the policyholder
 - (iv) more than one life insured
 - (v) all of whom belong to a group
 - (vi) the common feature of which is *not* that they have an insurable interest in each other, but
 - (vii) that they *are* all subject to the same basic contractual relationship with a common denominator (e.g. that they are all employees of the same employer or are all indebted to the same credit provider)
 - (viii) who collects the premiums and pays them to the insurer and
 - (ix) to all of whom the same basic policy provisions apply across the board.
- 3.11. “*Individual policy*” is exempted. A policy would be an “*individual policy*” if it lacks the features described in the paragraph above.
- 3.12. The common denominator or common feature in the case of a *credit scheme*, as a sub-category of a *group scheme* is, so it is suggested, that all the lives insured are indebted to the same credit provider who by the definition of “*credit scheme*” is to be the policyholder.
- 3.13. The parties involved in a credit scheme (leaving aside the special case of suretyship) are
- (i) the insurer
 - (ii) the policyholder
 - (iii) more than one life insured
 - (iv) all of whom are indebted to the policyholder as the credit provider.
- 3.14. An arrangement can accordingly not be a credit scheme for purposes of the LTIA regulations if the debtor is the policyholder. But when the policy is issued to the debtor as the nominal policyholder and is accompanied, as part of the policy, by an automatic cession in favour of the credit provider, as sometimes happens, it would be

- unrealistic not to regard the credit provider as the policyholder in all but name, at least for the purpose of determining the applicable intermediary remuneration tariff.
- 3.15. The STIA differs from the LTIA in providing for a composite fee (12% or 20%, depending on the nature of the business), whereas the LTIA provides for a split fee, 7.5% as an introduction fee and 15% for administrative work.
- 3.16. The intermediary under the STIA would be entitled to the composite fee irrespective of whether he, she or it introduced the business and did the administrative work or only the one or the other.⁴
- 3.17. Under the LTIA the intermediary is entitled to a primary commission of 7.5%. The secondary additional remuneration of 15%, but no more, is only payable in the case of administrative work being done and that only in the case of a group scheme which is a credit scheme.⁵ In effect this means that it is only in the case of credit life insurance issued under the LTIA that specific provision is made for a regulated servicing fee.⁶
- 3.18. Finally, sections 66 and 67 of the LTIA introduce criminal sanctions for contraventions of section 49.

4. CREDIT LIFE INSURANCE AS AN “ASSISTANCE POLICY”

- 4.1. In terms of the LTIA “*assistance policy*” means
“a life policy in respect of which the aggregate of –
(a) the value of the policy benefits, other than an annuity, to be provided (not taking into account any bonuses to be determined in the discretion of the long-term insurer); and
(b) the amount of the premium in return for which an annuity is to be provided,
does not exceed R10,000, or another maximum amount prescribed by the Minister; and includes a re-assurance policy in respect of such a policy;”.
- 4.2. The obvious example of an assistance policy is a funeral policy with a benefit not exceeding R10,000.
- 4.3. The significance of the categorisation is that the commission chargeable by an intermediary is exempt from regulation.⁷

⁴ See sections 2.26-29 above.

⁵ See section 3.6 above.

⁶ See too chapter 8 section 3.11.

⁷ Item 7 of the Table to Part 3 of the regulations issued under the LTIA. One can only speculate as to the rationale behind the exemption. One reason may be that there is so little “fat” in such policies for

- 4.4. If regard is had to the definition of “assistance policy”, a credit life policy which yields benefits only on the occurrence of “a life event” and which do not exceed R10,000 would qualify as an “assistance policy.”
- 4.5. Should the event triggering the payment of the benefit be something other or more than a “life event”, e.g. disability or retrenchment, the policy would not so qualify.
- 4.6. So too, if the policy is issued under a short-term licence it would not qualify as such.
- 4.7. In short, only in its simplest form, namely an unadorned credit life policy for less than R10,000 issued under a long-term licence, will the commission be uncapped. Inasmuch as credit life policies in practice covers more than merely the insured’s life and is more often than not taken out under the STIA, credit insurance will not as a rule be assistance business.

5. COMMISSION ARBITRAGE BETWEEN THE LTIA AND THE STIA

- 5.1. A CCI policy can be issued by an insurer under either a long-term or a short-term licence. The difference is that the LTIA regulates the intermediary remuneration specifically in the case of a “credit scheme” whereas the STIA has no corresponding provision. The general rates payable under the STIA also differ from the differential rates payable under the LTIA which in turn are dependent on various permutations as explained in section 3 above. This difference in the rating regimes creates a potential for commission arbitrage.
- 5.2. A short-term policy usually runs for a relatively short term, say a year, whereas a long-term policy generally runs for considerably longer periods. This difference in policy term would reflect in the remuneration payable to the intermediary concerned. On the other hand, there are short-term policies that could run for longer periods, such as a guarantee policy (the term of the contract guaranteed) or a liability policy (the term of the debtor’s indebtedness to a credit provider). As such the overlap remains.
- 5.3. The maximum commission scales in the two Acts, while possibly geared to ensure parity in the case of typical policies under the respective Act, thus result in anomalies when applied to non-typical cover which can be provided under both Acts, each as credit insurance.

intermediaries that commissions are naturally low and that it would stultify this sector of the market if commission were regulated. See further chapter 8 section 4.7.

- 5.4. This problem can only be resolved if the regulations under the two Acts are properly aligned.

6. THE FAIS ACT

- 6.1. The FAIS Act (FAIS), unlike the STIA and the LTIA, does not purport to regulate intermediary remuneration. Its primary objective is to regulate market conduct in the financial services industry rather than intermediary remuneration.
- 6.2. The definition of “intermediary service” in FAIS resembles “services as intermediary” in the STIA and the “rendering services as intermediary” in the regulations to the LTIA but the definition is not related to maximising commission payable to intermediaries.
- 6.3. FAIS in fact does not have a meaningful impact on the relationship between product supplier and intermediary (such as a broker or, in the context of CCI, a retailer, dealer or credit provider rendering intermediary services, as defined) or between insurer and intermediary.
- 6.4. What FAIS does require of a person rendering a financial service is to observe “*all applicable statutory or common law requirements applicable to the conduct of business*” (section 16(1)(e)). Due compliance with the provisions of other laws and proper disclosures to prospective policyholders, as is further explained in chapter 11, are the imperatives.

7. THE FAIS CODES

- 7.1. FAIS, as is further explained in chapter 11, makes provision for the publication of different codes of conduct depending on the sector which it serves (section 15(2)(a)).
- 7.2. Intermediary remuneration falls under the General Code since there are no specific codes applicable to particular categories of insurance such as CCI. The General Code does not, however, take the matter of intermediary remuneration much beyond what is provided for in the STIA and the LTIA, save to require full disclosure of the due remuneration and other monetary aspects of the transaction between the parties.
- 7.3. Where maximum amounts or rates are prescribed by a law, the financial service provider may elect to disclose either the actual amount or the prescribed maximum amount or rate.
- 7.4. These matters are further discussed in chapter 11.

8. **THE POLICYHOLDER PROTECTION RULES (PPR)**

The PPR, promulgated under sections 62 and 63 of the LTIA and the STIA respectively and discussed in greater detail in chapter 11 below, are not directly relevant to the capping of intermediary remuneration.

9. **PAYMENTS MADE BY CONSUMERS TO INTERMEDIARIES**

- 9.1. Sections 48 and 49 of the STIA and LTIA deal respectively with the capping of remuneration payable to an independent intermediary for rendering services as such. The prohibition relates to the maximum remuneration permitted to be paid to an intermediary by an insurer. Both provisions proceed to add “*or accepted by any independent intermediary*”. Does the prohibition of acceptance of remuneration extend to remuneration paid by the consumer as the client or by any other third party? Or to rephrase the question: should any such payment have to be taken into account in determining the maximum remuneration to which the intermediary is entitled?
- 9.2. The FSB in its directive 132.A ii (LT) of 30 January 2004 expressed the view that section 49 of the LTIA was not intended to regulate or restrict the freedom of an intermediary and a consumer to agree separately on a fee in relation to services rendered by the intermediary for the consumer, such as, for instance, post-contractual advice. The object of section 49, so it was concluded, was merely the regulation and limitation of remuneration paid by long-term insurers to independent intermediaries. The matter was once again raised by the FSB in its Aide Memoire of November 2005, in which it was concluded: “*Nothing prohibits an individual to agree to an additional payment to the intermediary.*”
- 9.3. The FSB’s interpretation that section 49 does not exclude a separate fee arrangement between the intermediary and the consumer is to be supported. The STIA in section 8(5) expressly permits a fee payment by a policyholder to an intermediary, for instance a policy fee, provided only that the amount is expressly and separately disclosed to the policyholder. The LTIA admittedly does not contain a similar provision but the context of the remuneration provisions in the LTIA clearly does not imply the prohibition of any such agreement between policyholder and intermediary, for instance to recommend an appropriate policy at an appropriate price, nor that any payment to the intermediary in terms thereof should be taken into account in order to

determine the remuneration cap. The LTIA should not be understood to penalise an intermediary for rendering a service to the consumer at the latter's request and in his interest. A clear distinction exists between services rendered by an intermediary for and in the interest of the insured, for which the consumer as the life insured is liable,⁸ and services rendered on behalf of the insurer and which the insurer is contractually obliged to render to the life insured, such as administering the policy or processing a claim made in terms thereof. For such services the life insured should as a matter of principle not be held liable.

10. THE NCA

- 10.1. The provisions of the NCA relating to credit insurance have been discussed in chapter 3. The more pertinent issue in this context is whether the NCA purports to regulate and restrict the remuneration payable to intermediaries for introducing and servicing credit insurance.
- 10.2. The short answer is that it does not. The NCA does not presume to override the provisions of the STIA and the LTIA, which, in so far as they relate to insurance in general, also relate to CCI in particular.
- 10.3. There are, however, provisions in the NCA, more particularly section 163, dealing with the situation where “*a person who is not an employee or agent of a credit provider, solicits, completes or concludes a credit agreement for and on behalf of a credit provider or a consumer*”. The provision is confusing since a person who acts in this fashion will as a matter of law be a credit provider's agent. Such a person must be identified as such in the credit agreement and must disclose to the consumer the amount of any fee or commission due to him or her which “*must not exceed the prescribed amount.*”.
- 10.4. As with the STIA and the LTIA there is a conceptual distinction between an initiation and a service fee. The maximum *initiation* fee is prescribed in regulation 42 and Table B as R150 plus 10% of the amount of the credit facility, short term credit transaction or other credit agreement in excess of R1,000 but never to exceed R1,000. The maximum monthly *service* fee is prescribed in regulation 44 as R50. These provisions

⁸ Examples from the FAIS Ombud's determination in the *Gumede* matter, discussed in chapter 12 section 2, are delivery and licensing charges and a contract fee. There may be other grounds for opposing the recovery of such fees, such as their non-disclosure, as is discussed elsewhere in this report.

refer specifically to “*credit agreements*”, from which, as is discussed in chapter 3, insurance contracts are expressly excluded. They accordingly do not apply to credit and credit life insurance contracts since section 106 makes no mention of these matters. Regulations 42 and 44 are accordingly not relevant to credit insurance.

- 10.5. The NCA contains no prohibition against the payment of incentives to solicit CCI business.

11. THE COMPETITION ACT, NO 89 OF 1998

- 11.1. This Act has no direct bearing on the issue of intermediary remuneration as such. Even in an indirect sense, if the thinking should be that premiums should be regulated in order to protect consumers, particularly those at the lower income end of the market, against exploitation (in which event there would be no need to regulate the remuneration of any intermediaries involved in the transaction), such regulation can hardly be said to be anti-competitive.

- 11.2. The Competition Act, speaking generally, contemplates agreements or concerted practices between firms or associations of firms which are in competition with one another, of manipulating prices or markets to the detriment of consumers. Its purpose is to prevent not the stabilisation of low prices in the interests of consumers but the fixing of high prices in their own interests. Any regulation of the premium by legislation will accordingly not fall foul of the Competition Act. For present purposes this Act requires no further consideration. It is primarily concerned with market forces whereas market forces in the CCI industry are only of secondary significance.

12. THE LOA CODE ON COMMISSION CONTROL

- 12.1. The Code refers specifically to section 49 of the LTIA and to regulation 3.2(1) and is conceived as a series of interpretative notes on the practical application and implications of these provisions. It mentions in particular “*that the distinction between general promotional activity, which is obviously permitted, and the reward of a specific broker or broker organisation by what could be regarded as ‘a consideration’ for the placement of business is a fine line.*”

- 12.2. Clauses 2.1 and 2.2 of the Code emphasise the potential conflict of interest that may exist when a broker is “*in a position where the decision to place business with a particular life*

office is influenced by any abnormal service or any subsidy or reward of any kind other than commission as laid down in the Regulations.”

- 12.3. Clause 2.3 recognises, perhaps even more clearly than the LTIA itself or its regulations, that insurers “*may not do anything which could be construed as an inducement, consideration or reward for the placing of business which is over and above that provided for in the regulations.*”
- 12.4. The remainder of the Code consists of guidelines to insurers about conduct that may be seen as collusive or as an improper incentive for the placing of business.
- 12.5. Clause 9, finally, requires each member office “*to submit an annual certificate of compliance to the LOA Secretariat which shall state the extent to which the Code was complied with during the year under review as well as the specific instances (and reasons) where non-compliance with the Code took place.*”

13. THE SAIA CODE OF GOOD BUSINESS PRACTICE

The Code deals generally with ethical and other standards within the short-term insurance industry. It contains only one provision that is directly relevant to intermediary remuneration, namely that members are required to “*comply with all applicable legislation.*”

14. RECAPITULATION

- 14.1. The only aspect of the premium that is specifically regulated by law, both in terms of the LTIA and the STIA, is the remuneration payable by insurers to intermediaries.
- 14.2. For the purpose of the capping provisions “intermediaries” are not confined to entities traditionally considered to be intermediaries or middlemen, such as brokers, who intercede, mediate or liaise between different principals in order to facilitate a transaction between them. As it was said in evidence by Ms **Dewey**:

“...the regulatory framework we've got is designed with your traditional genuine middleman in mind, you know, the broker guy who sits between the product supplier and the consumer, whereas here the boundaries are not so clear as to who's the product supplier. In the consumer's mind, the examples I found quite interesting around vehicle finance, and in the consumer's mind the product is the car, not the pieces that come with it...”

Mr Napier: *But your intermediary here, is the intermediary acting as the agent of the insured, which in this case is the scheme?*

Ms Dewey: *No. These are FSPs. The contracts are FSPs but they either seem to have alliances with or are wearing a double hat as being the credit provider as well.”*

- 14.3. This passage from the evidence illustrates another problem: is the “intermediary” as defined a true representative, and if so, whose agent is he: the agent of the consumer, the credit provider, the product supplier or the insurer? The answer, it is suggested, is that it would be a mistake to see the intermediary, as defined, as an “all-purpose” single agent. The man in the store completing the documentation for the consumer fulfils a multi-purpose function. He sells the asset, settles the terms for credit and arranges insurance cover for both the product and the indebtedness. His status will depend on the capacity in which he operates and the function he fulfils at the time. In promoting an insurer’s product he may be acting as the insurer’s agent, but not otherwise.
- 14.4. Traditional brokers, according to the evidence, are not ordinarily involved in CCI business.⁹
- 14.5. Intermediaries are characterized, as the legislative provisions are currently framed, not by their liaising functions but by the particular activities that are defined in those provisions and for which maximum fees are prescribed. Those activities and the fees are specific. It follows that an entity may qualify as an intermediary even if he or she or it also happens to be a principal, such as a dealership or a retailer or a credit provider, provided only that any of the activities performed by the entity fall within the description thereof in the legislation.
- 14.6. The activities mentioned are two of a kind: introducing new business for the insurer for which the intermediary is entitled, under the LTIA, to a maximum stipulated “introduction fee” (commission proper), on the one hand, and performing certain administrative functions in relation to the contract for which the intermediary is entitled to a maximum stipulated “servicing fee” (also, albeit inaccurately, referred to as commission), on the other. Under the STIA there is a composite fee for both kinds of activities.¹⁰
- 14.7. When a fee is paid to an intermediary the insurer is obliged to disclose it to the consumer as a percentage of the premium.

⁹ See chapter 3 section 3.2, chapter 4 section 12.8.

¹⁰ See, in particular, section 3.15 and following above.

- 14.8. An intermediary proper, in the sense mentioned in the second paragraph above, would sometimes be required to do administrative work as well – but such work would be incidental and not essential to the function of a broker. What is problematical about the extended meaning ascribed to “intermediary” in the definitions sections of the two Acts, at least in so far as it relates to the servicing fee, is that it emphasises not the core attribute of a middleman between two principals but the incidental aspect of doing administrative work. In turn this leads to the erroneous impression that the so-called intermediary is doing true intermediary work for and on behalf of the consumer, for which the latter is liable; consequently, because the consumer is liable, the remuneration payable to the intermediary should in the interest of the consumer be capped.
- 14.9. In fact, the administrative work for which a maximum servicing fee is chargeable (such as collecting premiums, servicing the consumer and processing claims) corresponds broadly to the work the insurer is obliged to do itself in terms of the express and tacit terms of its contract with the insured, and for which it is remunerated by the receipt of the premium. If it does that work itself no fee is chargeable and no disclosure is required in respect of such services. Any expenses incurred in doing the work will have been taken into account in costing the premium.
- 14.10. The insurer may, however, choose to outsource such administrative work to a third party, who may or may not be the intermediary who introduced the business to the insurer. The insurer must of course pay the third party for such work. In that event the insurer would equally have taken such anticipated expenses into account in costing the premium. It follows that the payment for such work should come from the insurer’s income from the premium and not additionally from the consumer. There is no harm in disclosing that amount to the consumer since the consumer is not required to pay for it over and above the premium. And because the consumer is not liable for such payment, there is no logical reason why the “servicing fee” should be capped at all. The level of remuneration should remain a matter for negotiation between the insurer and the third party in which the consumer has no real interest. Any confusion that may arise in that regard is entirely due to the fact that the third party is artificially depicted as an intermediary in the definitions referred to above.

- 14.11. Commission regulation in the form of restricting the introduction fee was initially conceived as a means of containing the premium in the interests of the consumer who is required to pay it. To pre-empt an anticipated circumvention of the restriction by insurers disguising the introduction fee as so-called administrative work, the legislature, instead of expressly outlawing incentives exceeding the maximum tariff, sought to regulate “administrative work” as well. That meant defining “administrative work” narrowly, thereby creating new opportunities for commission circumvention. To compound the problem “intermediaries” were also defined with reference to administrative work which was an incidental activity and not a core attribute of an intermediary proper. The unintended consequence was not only to distort the meaning of “intermediary” but to create uncertainties in the industry as to whether the payment for legitimate functions performed by the now defined intermediaries, such as pre-sale repair work,¹¹ was regulated or not.¹²
- 14.12. On a different point, the actual fee, be it an introduction or a servicing fee, will differ, notwithstanding that the nature and extent of the work the intermediary performs may be of the same nature, duration and extent, depending on whether it is done under a short-term or a long-term licence.
- 14.13. Incentive payments to intermediaries or their sales personnel to encourage them to, or reward them for, bringing in new business are not expressly prohibited in the legislation. But to the extent that the maximum remuneration that may be charged is fixed, any excess paid is by implication a contravention that is subject to criminal sanction. The LOA Code does contain an express prohibition against incentives being distributed.
- 14.14. Prior to the 1998 Insurance Acts, regulation 30 of the STIA interestingly did contain an express prohibition which read:
- “No registered insurer...shall pass or offer, as remuneration for services rendered towards effecting, maintaining or servicing a short-term insurance policy, or as an inducement to obtain business, to any*

¹¹ See chapter 10 section 9.

¹² The point was made in evidence in slightly different terms by Ms Dewey: *“Well, I think that's what was probably attempted to be achieved by having this additional 15% concession by understanding the different roles fulfilled in this space and your type of intermediary and what they do is probably different in this space to the guy who is going to get 3.5% up front on a life policy sort of thing. But in doing that, I think you've created precisely this confusion by lumping admin and every other form of intermediary services into one definition. So maybe, you know, separating out the activities and then deciding do we or do we not need to regulate the remuneration for pieces of that activity.”*

independent intermediary, or to any person associated in business with or related within the second degree of consanguinity or affinity to an independent intermediary who has rendered or is to render such services, any consideration other than commission in monetary form...”.

- 14.15. The remuneration must be in monetary form. Incentives by way of holiday trips and gifts such as TV sets and gift vouchers to intermediaries or their staff are thus outlawed.
- 14.16. The questions whether cell captives, underwriting management and profit share arrangements may result in the contravention of the commission regulations are discussed in chapter 9.

CHAPTER 7

THE EVIDENCE ON INTERMEDIARY REMUNERATION

1. THE INITIAL QUESTIONNAIRE

- 1.1. The first question in the initial questionnaire sent to all LOA and SAIA members active in the credit and credit life insurance field was:

“1(a) Do you believe the current commission levels for this product [to be identified by the respondent] is appropriate?”

The response can be summarised as follows:

Long- term insurers:

Yes: 10; no: 0; it depends: 4; decline: 2.

Short-term insurers: yes: 2; no: 5.

- 1.2. The follow-up questions of the questionnaire read:

“1(b) Do you provide/Have you provided incentives (over and above commission) to the intermediary, which can include an individual or an entity and on what basis was it calculated? Please provide details of calculations thereof and on what basis was it calculated? Please provide details of calculations thereof and format of payment. Explain why these incentives are justified in terms of the law and, if applicable, the LOA Code on Commission Control.

1(d) It is understood that various types of fees may be paid to the intermediary by the insurer (directly or indirectly, or by any other entity related to the insurer, in addition to commission, being fees paid to the intermediary for rendering services other than advice or intermediary services.

1(i) Do you outsource broker consulting or other administrative services in relation to the products and if so, what controls are in place to regulate any incentive payments made by them to intermediaries. What financial relationship exists between the broker consultants and the intermediaries and what remuneration is payable.

1(j) Are there any other forms of remuneration not mentioned above?”

- 1.3. Of the 22 insurers, short-term and long term, who responded to this series of questions, seven answered all of the questions in the negative.
- 1.4. Those insurers who responded positively referred to a range of payments in excess of the regulated commission, including:
- outsourcing administrative work;
 - outsourcing broker consulting and advice functions;

- outsourcing information and advice functions to call centres in particular;
 - paying for client data bases;
 - paying royalties for the use of brand names;
 - contributing to intermediaries' marketing or infrastructure expenses;
 - distributing incentive vouchers and fees;
 - paying for pre-delivery inspection and repair work on motor vehicles;
 - sponsoring an intermediary's group magazine.
- 1.5. Most insurers stated that incentive payments had been discontinued.
- 1.6. Details of some of these additional payments are mentioned in the section that follows immediately.

2. **A SUMMARY OF THE EVIDENCE OF INSURERS ON INTERMEDIARY REMUNERATION** (in the sequence in which the evidence was presented)

- 2.1. Mr **Shaw** who did a presentation on behalf of **SAIA** told the Panel that on the short-term side the administration fee that is generally paid to retailers, dealerships and credit providers in respect of CCI is additional to the "commission" of 20% of the premium. It was, as he put it, "*an additional reimbursement for filling in the functions of the totality of the insurance process.*" In effect the intermediary in the extended sense referred to above could earn up to 67% of the premium. "*The biggest element of the cost is in fact the monthly collection of the premium and the follow-up.*"
- 2.2. The evidence of Mr **Hoosen**, the CEO of **Regent Life**, was also to the effect that the 22.5% maximum of the premium that could be charged under the long-term licence for credit life policies would be adequate "excluding administrative services". The administration work, including the collection of premiums, is sometimes split between the insurers and the motor dealership. The intermediary might handle the collection of premiums and the insurer the processing of claims. A further "policy administration fee" of 1-2% of the premium was paid to "sales agents". Additional payments were made, again as a percentage of the premium, at least at the outset, for what was believed to be additional value received, such as payments for the purchase of the dealership's data base.

"What we felt was that with regards to the regulations imposed on us in our industry, we cannot pay them more than the 25% commission [22.5% plus VAT] that they're entitled to if they did serve the

administration function for us, that we're allowed to in terms of the Act. So in order to make it reasonable for them to continue this practice of selling insurance products, which was beneficial to us and to the consumer, in our opinion, we had to find other ways of them generating income.

“And what we felt was that one way we could do it, where we could have a value generation for ourselves as a company and stay within the commission regulations, was to get something else out of this from the dealership. And the dealership, now not in the sense of it being an intermediary but a dealership, as being the motor dealer itself. And in that respect what we did, we said well, Mr Dealership, we can only pay you so much which is commission but we can give you more money if you provide us with additional services that would add value to us as an organisation and these services were then providing us with their customer data.”

In the past gift vouchers were given to intermediaries. These practices which he believed to be widespread throughout the industry, have been discontinued by his company, at least pending the Panel's eventual findings.¹

- 2.3. Mr **Lombaard**, the Managing Director of **Pinnafrica**, explained that his company operated under both a long-term and short-term licence. In the past some clients were paid administration fees in addition to regulated commission. The company has entered into several intellectual property licensing agreements with different companies in terms of which, in return for royalties as a factor of turnover or profits, it utilized such companies' brand names, also termed “white labelling”. Each such agreement was separately structured.

“So we wholesale the product to finance houses, motor dealerships, anywhere where we can establish a business relationship that the people enjoy, we wholesale the products and they then go and retail that out.”

And again: *“I have two agreements with my intermediary clients, one is the agency agreement ...and another one is the intellectual property agreement ...in terms of which, because I don't have a brand name and I don't advertise at all,...I rent the intellectual property of my clients.”*

The royalties paid are in addition to the regulated commission. The company outsources its administrative functions and on occasion in the past handed out vouchers to sales agents, based on the achievement of sales targets, not, to use his

¹ See further chapter 10 section 2.5.

words, as “a perverse incentive” but to encourage sales enthusiasm. He conceded that *“it’s a fine line between what are healthy sales activities and what are perverse incentives.”*²

- 2.4. Mr **Blumeris**, its chief operating officer, spoke for the **Nedgroup Life** Assurance Co Ltd. Reference was made in the response to the initial questionnaire that Nedgroup Life had *“inadvertently breached the commission regulations”* during the period 2005-2007 by making payments to Nedbank as the credit provider. The payment was made out of profits and did not disadvantage policyholders. Administrative services are not outsourced but remains in the group although *“administrative handling is quite a lot more burdensome because of smaller sum assured, shorter periods, the way premiums are collected.”* Its sole source of business is Nedbank clients. What is paid by way of commission is the 7.5% of the premium for all the work, including the introduction, that goes into effecting the actual transaction. In addition a payment is made to Nedbank *“for the sourcing of client data”*. Nedgroup does not regard that as “administrative work” but as a separate arms length transaction for which payment is made after the event; administrative work would be the work required to implement the transaction, such as the collection of the premiums, servicing the client, the processing and paying of claims, and the like. He readily conceded that the distinction is *“blurred”* and not *“cut and dried.”*
- 2.5. The presentation on behalf of **Relyant Life** (long-term), **Relyant Insurance** and **Customer Protection Insurance** (both short-term) was given by Mr **Shaw** who previously made a presentation on behalf of SAIA. These companies all operate within the same group. The insurance companies in the group are all what was described as *“virtual insurance companies”* with the actual work being performed (except for advice which is routinely redirected to dedicated call centres) at branches throughout the country, described as *“quasi-insurance companies”*. The branches doing the work are paid the maximum permissible commission, so called, being 22.5% in the case of long-term insurance and 20% in the case of short-term insurance. In addition they are paid 42% and 45% “administration fees” for long-term and short-term work respectively. Mr Shaw referred to it as *“a blurring in the functionality”* and *“a blurring in the activity”* and conceded that a strict interpretation of the legislative provisions may not justify these additional payments.³

² See further chapter 10 section 2.6.

³ See too chapter 10 sections 2.9 and 2.10.

- 2.6. Mr **Shaw** also made a presentation on behalf of **Monarch Insurance**, a short-term insurer, of which he is a director. This company, as appears from its response to the initial Questionnaire, reimburses the store from which it sources its business and which it regards as the intermediary for this purpose, 13% of the premium for the collection and accounting of premiums, 12% for administration and management services and 3.67% for claims administration. There may also be fees paid by the customer to the intermediary in respect of administration and other services. Advice functions are outsourced to a call centre. The insurer also contributes towards the costs of producing the store's Club Magazine in which customers of the store are advised of the insurer's products.⁴
- 2.7. **Absa Life**, a wholly-owned subsidiary within the Absa group, was represented by Mr **Lategan**, Executive Director, Absa Financial Services and Mr **De Jager**, Managing Director, Absa Life and Absa Insurance Company. The major portion of its business is sourced from the banking operations within the group. Intermediary remuneration remains within the group and is structured in conformity with regulated commission limits.
- 2.8. **Hollard Life Assurance Co Ltd** and **The Hollard Insurance Co Ltd** were represented by Ms **Thurling**, Head of Compliance, and Ms **Walters**, Head of Corporate Affairs. The Hollard group has a *"life licence and a short-term licence,...it's managed collectively as a company which sometimes means we mix and match in terms of how we ... provide ...the services we do provide..."* Speaking generally, it was said: *"Unfortunately in here I think insurers have themselves to blame. We pay the maximum commission regardless of the services that are brought to bear by the intermediary ... So guys got the 22,5 or the 12,5 or the 20% regardless of what service they were particularly performing and now we are sitting with the problem where ... intermediaries went beyond those particular services, how do we actually compensate them for that, and therefore ... some of the other structures which I think are correctly there but obviously there may be abuses in terms of how those particular structures play out."* They expressed the following view, apropos the differences in the commission rates for long-term and short-term business: *"So I think the regulations and the Act in that particular respect needs to be tidied up. I think a lot of the problems are around the fairly ambiguous drafting and the lack of clarity in regard to what those particular provisions mean ..."*

⁴ See too chapter 10 section 2.8.

Turning to their own business models, the details of which are to be found in Hollard's response to the initial questionnaire in respect to different product types, Hollard pays royalties of between 1% and 10% of the premium to the holders of registered trademarks where the non-insurance brand is used in marketing material, application forms and policy wordings. An instance was discovered of one unauthorised promise of additional commission being made by a sales representative acting on his own initiative to a motor dealer. This was never paid.

Broker consulting services are outsourced. Customers may pay policy fees to intermediaries at the instance of the intermediary. The small area repair technology product is managed by an underwriting manager, which historically provided vouchers to the individuals who were instrumental in selling the product; intermediaries/dealers are paid a pre-sale inspection fee which is not regarded as an intermediary service and commission is paid to the individual selling the product.⁵

The motor warranty product is administered by another underwriting manager, which has its own fee structures in place, including advance repair payments to motor dealers and a no claims bonus of 4% to 5% of the gross premium on the expiry of the policy concerned. These latter practices have been discontinued. The extended warranty product is offered at the time of sale. The customer may pay a disclosed fee to the intermediary for services performed by the intermediary for the customer.

- 2.9. **Wesbank**, not an insurer but a credit provider, gave evidence generally about undesirable practices in the industry seen from the perspective of a credit provider and, as such, an intermediary. The evidence was given by Ms **Myburgh**, Head of Insurance, and Mr **Litton**, Head of Risk. On the issue of non-cash incentives and vouchers, Ms Myburgh said: *"Feedback that I've heard in the industry is it's not happening at all. All the investigations and press, etc, has certainly put a stop to it. People are saying I'm not prepared to pay you anything, you get remunerated from your company. So it has to a very, very large extent literally been stamped out I would think."* On the issue of administration fees it was said in their response to the initial questionnaire:

"On any products, legislation confirms that an administration fee may be charged, but it must be disclosed to the consumer. However, since these administration fees are not set at an agreed amount, the consumer may therefore not know what "fee" is acceptable. The result is that consumers may be

⁵ See too chapter 10 section 2.7.

charged anything from 10-50% of the risk premium. Credit providers have requested that this fee is not added to the risk premium and we are reliant on our dealer network to comply with this request. Unreasonable fees being levied to consumers are undesirable and should be legislated as this practice affects the consumer and insurers...We recommend that such fees are capped at a % of the risk and full disclosure must always be provided to consumers. We would suggest that these fees are pre-printed on all policy schedules provided by the insurance company.”

- 2.10. Mr **Jooste**, Head of Legal, assisted by other officials in the **Momentum Group**, Mr **Nagel**, CEO of FNB Life, Mr **Richardson**, CEO of Momentum Ability, Mr **Atkinson**, CEO of Momentum Aspire, Mr **Naidu**, CEO Momentum Joint Ventures and Ms **Terblanche**, Momentum Group Compliance Officer, did a presentation on behalf of the Group. Incentives are paid by Aspire to external call centres to whom work is outsourced, but these payments would in any event fall within the legislated limits. In one instance a relatively small incentive was paid to a sales person to encourage the sale of a new product, which will be recovered from future commissions owing.
- 2.11. Ms **Dewey**, Legal Group Executive, Ms **Mothupi**, Group Executive, Corporate Affairs and Ms **Marshall**, Corporate Affairs, represented **Liberty Life**, **Liberty Active** and **Capital Alliance**. All intermediary payments fall within the prescribed limits. The further discussion centred mostly on whether profit share arrangements between insurers and intermediaries may result in commission regulation limitations being contravened. In its response to the initial questionnaire the following comments were added:
- “The commission regulations in terms of the Long-term Insurance Act contain a definition of “group scheme” (of which credit schemes are treated as a subset) which we believe to be vague. We recommend that this definition be reviewed to provide certainty as to the legal status of these schemes. Currently we believe that there is uncertainty in the industry as to which types of structures are included in this definition, resulting in inconsistent commission practices.*
- “It is also not clear from the commission regulations what activities fall within the scope of ‘administrative work’ for credit life scheme commission purposes, again leading to inconsistent practices. It is also not clear whether such ‘work’ falls within the definition of ‘rendering services as intermediary’ for purposes of the regulations. We recommend that these definitions be reviewed with a*

view to creating a consistent framework which will allow reasonable remuneration for legitimate administrative services, while limiting the scope for conflicts of interest.”

- 2.12. **Guardrisk** Holdings Ltd, operating via different companies under both long-term and short-term licences, was represented by Mr **Goedhart**, Director of Marketing, Mr **Vikisi**, Compliance Manager and Mr **Sibanda**, Chief Operations Officer. Administration services are outsourced to cell owners or independent administration service providers. *“We claim to be the first cell captive insurance company in the world.”* The prescribed commission is paid to the dealership as the intermediary. In addition an administration fee may be paid *“to the motor manufacturer financial services arm to do administration on our behalf because Guardrisk is purely a wholesale operation. We don’t have the ability to issue policies and pay claims. That is all outsourced to another intermediary, not the dealer but the financial services.”* In some instances dealers are paid by the administrators for repairs to be carried out by the dealership to a vehicle before the vehicle is sold. The work thus done by a dealership in inspecting and repairing the vehicle before sale is not regarded by Guardrisk as “services as an intermediary” for the purpose of restricting the fee paid for the work done.
- 2.13. The spokespersons for **Centriq** Insurance Co Ltd were Mr **Penny**, Head of Special Projects, and Mr **Whisgary**, Head of Risk Management, Technical and Legal. According to the response to the questionnaire and the evidence tendered, the commissions paid to intermediaries for different products under the short-term licence are within the prescribed limits. Claims administration functions are outsourced in the case of motor warranties to motor warranty administrators. An additional risk management fee of 27.5% of the GWP is paid in the case of motor warranties but this is not seen by Centriq as a payment to the motor dealers in their capacities as the providers of intermediary services but as repairers and servicers of motor vehicles.⁶
- 2.14. **Regent Insurance**, operating under a short-term licence, was represented by **Mr Dickenson**, Managing Director. Motor dealers are paid the maximum permissible commission and, until it was recently stopped, a pre-delivery inspection fee. Some intermediaries enjoyed a profit share incentive until 1 June 2007 in terms of separate profit share arrangements. Administrator services are outsourced in one case, for

⁶ See too chapter 10 section 2.11.

which an underwriter's fee is paid, with commission payments by the outsource broker being within the prescribed limits. There was one instance in the past when they joined with a credit provider in paying a dealership an incentive by means of vouchers for a period of three months.

- 2.15. **Mutual & Federal**, represented by **Mr Kemp**, responsible for the cell captive within the Group and **Ms Pedra**, Compliance Officer, is a cell captive insurer operating on the short-term side. In the case of motor vehicle warranty cover the maximum commission is paid to intermediaries "*who sell the business to the customer*" while the claims and policy administration fee is paid to the underwriting manager owning the cell and to whom administrative work is outsourced. In addition a pre-delivery inspection fee, equivalent to 20% of the premium is paid to the dealership. The insured is also required to pay, in addition to the premium, an administration fee to the dealer in respect of the paperwork done by the dealer and which is fully disclosed.
- 2.16. The evidence on behalf of **Real People Assurance Co. Ltd.** was given by Mr **Grobbelaar**, Managing Director and Mr **Mouton**, General Manager. The bulk of the group's business is unsecured personal loans. The maximum regulated remuneration is paid to the credit provider within the group who is also responsible for all administrative work.
- 2.17. Mr **Kotze** acted as the spokesperson for **Old Mutual Life Assurance Company's** Group Assurance division, operating as a group provider of credit life insurance. Where the administrative work is done by Old Mutual itself, it pays commission to the credit provider at the maximum rate of 7.5% of the premium; when the administrative work or part thereof is done by the financial institution, the remuneration varies between 7.5% and 22%.
- 2.18. **Metropolitan Life** was represented by a delegation consisting of **Mr Duggan**, Head of Distribution, **Ms Moodley**, Executive: Legal and Compliance and Mr **Arpesella**, Executive. Metropolitan pays the regulated maximum remuneration to credit providers covering the cost of administration borne by intermediaries. The main point of discussion centred on the competitive advantages of offering credit life insurance within a cell captive structure.
- 2.19. **Channel Life** was represented by Mr **Husteld**, Chief Operating Officer and **Ms Rickson**, Head, Group Benefits. It provides credit life insurance to the debtors of a

credit provider within the group and pays commission of 7.5% of the premium to the credit provider and a further 7.5% servicing fee to another company administering the assessing and paying of claims. That would be within the permitted limit for intermediary remuneration if the administrative work was done under a group scheme.

3. SOME COMMENTS ON THE EVIDENCE

- 3.1. Most of the long-term insurers believe that the statutory levels of intermediary remuneration, embracing both the introduction and the servicing fees, are adequate whereas the majority of short-term insurers appear to hold the opposite view.
- 3.2. In the LTIA the two kinds of fees are separated out at 7.5% of the premium as a maximum introduction fee and 15% as a servicing fee, whereas the STIA, while differentiating between the two kinds of fees in the regulations, lump them together when the levels are fixed as a composite 12.5% for motor business and 20% for other business. This can become a potential problem if one intermediary introduced the business and another looked after the policy.⁷
- 3.3. No criticism was levelled in the responses or the evidence of insurers at the introduction fee. The problems related to the “servicing fee”, both on the short-term and the long-term side. It is a two-fold problem: first, the description of the activities for which a servicing fee is chargeable is not sufficiently precise, leaving room for different interpretations of what conduct is and what is not regulated; and secondly, depending on whether a broad or a narrow interpretation is given to those activities, the servicing fee is seen by many as inadequate remuneration for the work required to be done.
- 3.4. This prompted one of the Panel members to remark:

“There appears to be a tendency – I just make this as a remark – for product suppliers in your business to push beyond the limits of the commission. Am I right in that statement? And now they are trying to find ways and means of justifying that extra bit and they call it administration... But the regulation is not limited to the actual sales. It goes far beyond that. The intention, it seems to me, was to put in all Acts that are now called ‘administration’ into the definition of commission. And now the industry is using very ingenious schemes, really, to get outside of the prohibition. Is that fair? Is that an unfair statement?”

⁷ See chapter 6 section 2.26-28.

- 3.5. Two questions must be posed in that regard: one, is it truly necessary to regulate the outsourcing of administrative work to the intermediary or any one else for that matter, and, two, if it is, where is the line to be drawn between work that should and work that should not be regulated?
- 3.6. The first issue is discussed in greater detail in chapter 8 below. To the second the simple answer is that it is not possible to compile a comprehensive and watertight list of specific activities. There will always be unforeseen activities falling outside the prescribed net. If it is to be described in terms of principle rather than as a list of specific activities, it is suggested that the point of departure should be the obligations, express, implied and tacit, to which the insurer is contractually committed in implementing the policy.⁸
- 3.7. When a fee is paid to an intermediary the insurer is obliged to disclose it.⁹ The purpose is no doubt to inform the insured of how much of the premium is allocated to intermediaries. But what will be disclosed will sometimes only be that portion of the remuneration paid to an intermediary the insurer believes to be regulated but not any of the other payments made to the intermediary. To that extent the disclosed information will of course not be accurate and will not serve its ostensible purpose.

4. THE FOLLOW-UP QUESTIONNAIRE

- 4.1. Having considered the initial submissions and the evidence, member offices of the LOA and SAIA “*whose business included credit insurance*” were asked to complete a further questionnaire¹⁰ on “*aspects on which the panel is in need of supplementary information in order to write its report and make recommendations for the benefit of the credit insurance industry as a whole, both short- and long-term...which may obviate the need for additional oral evidence. It is also intended to serve as a survey.*”
- 4.2. Some 20 responses were received. The responses were mostly of a high standard and evidenced a genuine and thoughtful attempt by respondents to be of assistance to the Panel.

⁸ See too chapter 10 section 1.8 and following.

⁹ See chapters 11 and 12.

¹⁰ Appendix 8.

- 4.3. On some issues all the respondents were in broad agreement; on others there were significant differences of opinion not always prompted by differences between the short- and long-term regulatory regimes.
- 4.4. We propose, in the paragraphs that follow, to list and report on the responses received from respondents to the more important questions relating to intermediary remuneration and to select a representative sample of the reasons given by respondents for their respective views. We do so for two reasons in the main. Firstly, because many people in the industry spent many valuable man-hours compiling their replies and they deserve due recognition from the Panel for their efforts in doing so. Secondly, and perhaps more importantly, because the views of the industry, conforming and diverging, are not only interesting in themselves but are also of interest to, and deserving of the attention of, the authorities in deciding whether to act on the recommendations in this report. The views of insurers, having been canvassed by the Panel at some cost to the industry, should be recorded for that purpose.
- 4.5. The numbering that follows corresponds to the numbering in the follow-up questionnaire.

4. REGULATION

“4.1 Do you or do you not believe, and why, that the current levels of regulation in respect of intermediary remuneration should be:

(a) scrapped entirely;

(b) reduced;

(c) increased?”

Summary:¹¹

In favour of (a): (with improved disclosure)

Long-term insurers associated with major banks: 0/4;

¹¹ For the purpose of this exercise Guardrisk, Hollard and Pinnafrica were treated as short-term insurers.

Other long-term insurers: 4/6;

Short term insurers: 7/7;

Credit provider: 0/1.

Responses

Absa Life:

We believe that the levels of regulation of intermediary remuneration in the short term market should be retained, as these are fairly straightforward, and easy to apply.

We believe that the levels of regulation in the long-term market should be reduced, as these are complex to apply and are unnecessarily cumbersome. The principle of regulated remuneration should be retained, but the regulations themselves should be simplified. This should include tightening up on the definition of the various services that intermediaries are able to offer.

Liberty:

Improved regulation and disclosure would benefit consumers in that they would understand the services being rendered to them, as well as the cost of such service.

Momentum:

In our opinion best practice suggest that over the longer-term it would be better to do away with the current levels of regulation in respect of intermediary remuneration, but that should be accompanied by full, transparent and enforced disclosure to consumers.

However, given the current level of consumer education and consumer awareness this would not be in the best interest of the consumer. In the long term intermediary remuneration should be deregulated, but in the short term the regulations should be kept in place.

Therefore we would suggest that the current regulations be kept in place, but optimised, not increased.

Nedlife:

(a) No. Nedgroup Life believes there should always be basic levels of regulation to protect the consumer, particularly around disclosure of remuneration earned by intermediaries. Clients should be aware of the financial benefits that intermediaries earn while selling to be able to question, compare and negotiate.

(b) Yes, the level of regulation could be reduced. Total remuneration should be set at a specific maximum rate to ensure consistent disclosure to policyholders between product providers.

(c) No. Nedgroup Life believes that increased regulation generally results in increased costs and complexity that, despite the regulations best intentions, inevitably get passed on to the client.

Alexander Forbes:

In general we believe that regulated commission should be scrapped. A combination of market forces, proper disclosure, service levels required by clients, industry costs and oversight by regulators will ensure that the correct remuneration levels are reached. That said we are concerned that in a deregulated environment commission levels could reach very high levels.

The current regulations do not properly cater for outsourcing of bona-fide services to intermediaries and other service providers and this needs to be rectified.

Clientèle:

Should be scrapped entirely as it is well known locally and internationally that they cannot be effectively enforced. Moreover, standardised remuneration does not necessarily reflect the correct market price for the service at the time, in the place and under the circumstances. Hence, like all administered prices, it causes severe market perversions and unintended consequences. This is largely why commission regulation does not apply in most other leading insurance jurisdictions.

Hollard:

We believe that commissions should be de-capped entirely. The current limits are not policed and are difficult to enforce. Allowing insurers to pay a market related rate that adequately remunerates the intermediary for its services and which is disclosed in a manner that is transparent and allows the consumer to understand what he is being charged for each service, creates an environment that encourages compliance. Ideally, once the consumer understands the remuneration components of the price which are set out fully, he will be in a better position to question and challenge what he is buying. In reality, for most consumers, the bottom line is all they look at and if this is acceptable to them then it is irrelevant how the price is arrived at.

Pinnafrica;

Remuneration must be deregulated, but accompanied by with proper disclosure requirements. It is impossible to regulate remuneration in practice due to the availability of various legal structured mechanisms, e.g. cell captive arrangements, captive insurers, third party service payments, joint ventures, re-insurance structures etc. which effectively eliminates remuneration regulations. In addition, different distribution models have widely differing costs. Commercial considerations must be the primary determinant of remuneration in an open market system. The consumer must be provided with choice through competition, accompanied by full disclosure.

Relyant:

As a consequence of the very strict compliance requirements which relate to insurance practices in South Africa at present, as well as the reporting and co-inciding and conflicting, around the globe, we hold the view that brokerage (commission levels payable to brokers) – generically referred to as commissions to

intermediaries – could be scrapped entirely. We do not believe that the commission levels should be reduced and they have been in existence for around 20 years at the statutory levels. In many smaller policies very often the commission is insufficient to cater for the administrative functionality required by a broker which has led to the introduction of various forms of additional remuneration – properly and effectively disclosed – such as broker fees, policy fees and IT service fees which are then added to the premium.

Wesbank:

Whilst we are of the view that commissions and fees should eventually be deregulated, we are of the view that regulation is required to ensure that consumers are protected against unscrupulous market practices. We would therefore like regulation of intermediary remuneration to remain the same.

“4.3 Do you or do you not believe, and why, that premiums as such should be regulated?”

Summary

In favour:

Long-term insurers associated with major banks: 0/4;

Other long-terms insurers: 0/6;

Short-term insurers: 0/7;

Credit provider: 0/1.

Responses

Liberty

Premium rates should not be regulated, as that would be anti-competitive, and would potentially risk the viability of credit insurance business if underlying mortality trends would vary significantly from pricing assumptions. If the regulated premium rate were quite conservative to allow for such risk, then many insurers would charge the maximum regulated premium immediately, which would not be in the interest of customers.

While Liberty would be supportive of a CAT standard product in terms of FSC compliance, this would need to be positioned quite carefully as a product available on particular types of credit. Arbitrary differentiation by sum assured or premium would be problematic from a customer expectation as well as implementation perspective.

Momentum:

We do not believe that premiums should be regulated at all, the free market is the most efficient regulator. This will maintain and help promote competition in the market. We submit that the issues that have been alluded to in the press in relation to this kind of business emanate from poor market conduct, by some market participants, when the products are sold. One particular aspect is the asymmetry in knowledge and bargaining power between the consumer and intermediary. This has long been recognised as a driver of appropriate regulation and has given rise to a number of regulatory measures. These measures are aimed at promoting appropriate selling practices including full and appropriate disclosures to consumers. This is intended to empower and enable consumers to make an informed decision. We believe that these regulations have been largely successful. Added to this, industry associations play a role, the current enquiry is an example thereof. Premium regulation is price control and fundamentally anti-competitive. It places a strategically important dimension of the business under the public sector and hence political control. The public sector is not by design equipped to deal with such a responsibility and any public sector failure will of necessity be foisted onto the industry. A more significant issue is probably that of market conduct of the participants in the industry, particularly the way in which the products are sold and the disclosures that are made to consumers.

The existing regulations on market conduct, such as the Long-term Insurance Act, 1998, the Policyholder Protection Rules in terms of the Long-term Insurance Act, the FAIS legislation, the Competition Act and to some extent the National Credit Act, Consumer Protection Bill and Protection of Personal Information Bill already establish or will establish a clear and unambiguous basis for appropriate conduct for all concerned when selling the products, particularly as far as disclosure is concerned.

It must also be accepted that there is a point beyond which the regulatory framework cannot and should not protect the consumer, and where the consumer must follow the consequences of their decisions.

A fundamental consideration must therefore be whether or not further regulation is required and whether the current framework, properly applied with minor alterations will not be adequate to deal with the issue in hand, in that it affords the consumer sufficient rights and choice.

Nedlife

No, premiums should not be regulated as this will reduce innovation, competition and product development. This will be detrimental to policyholders. Nedgroup Life is committed to consumer protection but believes that healthy competition is also in the consumers best interest.

There are also a number of additional issues that come with this sort of regulation:

- (a) premiums could be regulated to unprofitable levels thereby forcing a number of players out of certain markets*

- (b) *regulation would need to be dynamic to reflect changes in risk, administrative, compliance and distribution costs and financial metrics such as cost of capital and required returns on equity: this would be incredibly difficult for regulators to continually assess*
- (c) *fixing premiums could be seen as anti-competitive and effectively promoting cartel-type behaviour.*

Metropolitan:

Although some consumers may benefit from premium regulation because of their premium having been placed in a structure where the interests of the intermediary and consumer are not aligned, consumers in general will be negatively affected. The cost of regulation will be passed onto the consumers, and the regulated premium may often be higher than would otherwise have been charged within a competitive market. Consumer groups are priced according to their group risk profile, and for this reason premium rates can differ vastly between schemes. A regulated premium may mean that certain groups are unable to get credit insurance, which is clearly to the consumers detriment.

Hollard

It will inhibit product development, stifle innovation and reduce competition. A price cap will lead to a reduction in the amount and type of cover to accommodate distribution costs. No new benefits will be added to products. Less innovation in distribution and product design (especially with respect to risk management) leads to less opportunity to buy the cover which means less access. Benefits such as retrenchment cover are likely to be lost at the expense of those consumers whose needs are greatest for this type of product.

We do not think it will be helpful. It will result in less choice, less access, standard products and a worse deal for the consumer. Price is regulated by market forces. It is unlikely that one would price oneself out of contention and consequently lose business by not falling within the general parameters imposed by our competitive landscape.

Pinnafrica

Premiums must not be regulated. Insurers must retain the commercial prerogative as a central skill to underwrite efficiently, which includes the determination of pricing policy. The market must be the determinant of relative value. Regulation does not create an efficient market system.

Relyant

We do not believe that premiums should be regulated. We hold the view that regulation of premiums removes the competitive element of insurers in the market in general. All regulation leads to increased costs for the consumer worldwide. Furthermore, in the event of market downturns and unprofitable results, the impact on insurers could be quite dramatic. It also places a substantial and undue onus on the Insurance

Regulator and ultimately the Government to ensure that there is no failure in the marketplace. It also flies in the face of competition which is ultimately beneficial to the consumer.

Wesbank:

We believe that market forces, actuarial modelling and claims experience should dictate the level of premium charged. We therefore, would not like to see premiums as such, being regulated.

We would no longer have a competitive edge and the consumer's freedom of choice would be adversely affected.

“4.6 Do you or do you not believe, and why, that as far as the regulation of credit insurance is concerned, it is necessary to differentiate between

- (a) LSM 1-5 and*
- (b) others?”*

Summary:

In favour:

Long-term insurers associated with major banks: 2/4;

Other long-term insurers: 3/6;

Short-term insurers: 3/7;

Credit provider: 0/1.

Responses:

Absa Life:

Given that credit insurance is marketed across a wide range of income groups in South Africa, we believe that for the LSM 1-5 a range of simplified products should be developed which are “pre-packaged” and contain a known level of cover for a known premium, as well as possibly other standard features. A policyholder acquiring such a product would know, through consumer education, that such product meets certain requirements, and he would not need to carry out enquiries on a range of other products to compare benefits, features and premium levels. This would be similar in concept to the Mzansi bank account, the recently-launched Fundisa collective investment scheme, or the Zimele product.

Momentum

No, differentiated regulation based on income in this area would be extremely difficult to implement and manage, both for regulators and practitioners. Any potential benefit to be derived from doing so would be lost in the associated increased costs that will ultimately be carried by those it is intended to protect.

There is no immediately apparent basis on which regulation can be based to protect a part of the consumer body. More clarity is required as to the definition of those that need the protection and the rationale for the protection before the matter can be considered.

Nedlife

Nedgroup Life believes that regulations appropriately dealing with effective and proper disclosures, relevant language requirements and levels of commission would be welcomed for this market segment.

Nedgroup Life believes that current regulation is sufficient for LSM's above 5 although any measures implemented in a. above could be of benefits to all consumers.

Channel Life:

LSM 1-5. It is important to protect this market as it is less educated and the clients are usually not even aware that credit insurance forms part of purchasing certain goods; disclosures to this group should be in simple language, upfront and sufficient to limit enquiries to a minimum. However, differentiation based on LSM level will be impractical. Differentiation based on size of cover will be more practical and may have the desired effect.

Clientèle

Not necessary to differentiate as poorer people should not be insulted by the assumption that they are naturally stupid. They are often more careful and wiser with their purchases than wealthier persons.

Hollard:

Yes, we support the access standards which have gone a long way towards improving product value and protecting the more vulnerable lower Relyant consumers. We believe that minimum standards are appropriate and successful when initiated and supported by an innovative industry, as opposed to being imposed by the regulator. These standards are not, however, necessarily appropriate for the more sophisticated market, and would inhibit innovation in this market. All consumers need transparency and want a fair deal. Everyone should have a policy that fulfils their needs in a manner they clearly understand and at a reasonable price.

Guidelines and standards should apply to the LSM 1 to 5 market segment. Apart from relevant, meaningful disclosure, these standards should not necessarily apply to the rest of the consumer market.

Mutual & Federal

No, as this could be construed as a discriminatory practice.

Relyant:

We do not believe that there should be any differentiation in the market place insofar as the regulation of credit insurance is concerned. In our particular instance, there are no additional policy fees, broker fees or any other fees added to the gross premium charged to the client for the very wide cover provided for the protection of the client and simultaneously that of the retailer whilst having an insurable interest in the goods sold. Regulation of premiums and/or other charges (which are to some extent presently controlled by the NCA) could ultimately lead to an increase in the costs of the actual furniture and appliances sold in order that the acceptable levels of returns on shareholders funds, assets managed etc, are maintained. This 'sum of the whole' model has been in existence in the retailing industry (furniture and appliances) for more than 25 years and has not adversely affected the consumer.

The very stringent requirements of the NCA have, in our view, taken care of what might have been considered in the industry.

“4.9 Do you or do you not believe, and why, that it is necessary to differentiate broadly between credit insurance for:

- (a) personal and home loans;*
- (b) indebtedness in the furniture retail market;*
- (c) indebtedness in the motor vehicle market?”*

Summary:

In favour of:

Long-term insurers associated with major banks: 2/4;

Other long-term insurers: 2/6;

Short-term insurers: 3/7;

Credit provider: 1/1.

Responses:**Absa Life:**

We believe that there should be differentiation in credit insurance between these various types of credit markets. Each constitutes a potentially different market segment, with its own needs and level of insurance literacy. The consumer goods and furniture market, for instance, should cater for more consumer education on the features and nature of credit insurance, and how it provides a benefit to the consumer acquiring it. The home loan and vehicle finance market would tend to attract a more financially sophisticated consumer, who would require less education in this regard, and who would likely be able to carry out his own research on comparative products. The economic cost of insurance at this level would also justify this activity.

Liberty:

In Liberty's view, differentiation across broad product lines would be sensible, as it would protect the customer against an inappropriate product offering. Home loan products are typically held for a medium to long term (anecdotally 7-8 years). The level of commission, profit margin and admin fees charged over such a period and on a large sum assured could accumulate to a value that would not be defensible.

Shorter term debt, where the value proposition is very much around the convenience of the embedded credit insurance will be less open to such criticism.

Momentum:

The principles applying to the various lines of business do not differ from one another, although the products may differ as far as the kind of cover and the contractual conditions of cover are concerned. Again the issues can be addressed in appropriate market conduct of the product provider and the intermediary concerned, for which adequate regulation and distinction already exists.

Real People: *Yes, it is necessary to differentiate, as many things, from risk profiles, payment patterns, client education levels to average sums assured will differ.*

Regent Life:

Rather differentiate on categories such as LSM and as such, the value of transaction should be a determining factor.

Mutual & Federal:

Yes – Due to the differentiation in the product type, periods of cover and quantum of the debt.

Relyant:

We are of the view that the present infrastructural insurance components operating in the South African Short-Term insurance industry, very clearly differentiate between the types of covers provided in points 4.9 (a) to (c) above. Over years, very definite types of insurance policies have been devised and made available to consumers in the three categories mentioned with the various policies considering the exigencies of each consumer base.

Various aspects of the NCA cater for the nuances of the various types of arrangements which are required for consumers and we hold the view that no change is needed or required.

Wesbank

In the event of a total loss to the asset [motor vehicle], without credit insurance, the credit provider will suffer major losses and the consumer will be forced to continue paying for an asset that they no longer have the use of.

“4.10 Do you or do you not believe, and why, that as far as the regulation of credit insurance is concerned, it is necessary to differentiate between:

- (a) product lines where brokers are involved as intermediaries in the credit insurance transactions;*
- (b) where brokers are not involved in the credit insurance transactions?”*

Summary:

In favour of:

All respondents: 2/19.

Responses:**Relyant:**

We see no need to change the present infrastructural modus operandi.

We hold the view that the evolution of the credit insurance market in South Africa has brought about differing modus operandi which cater for the various sectors. Insurance legislation does however complicate the matter where credit providers are required to register in a similar manner to an independent insurance broker, whilst the manner in which credit insurance is sold, handled and administrated is very different.

The large banking and financial institutions all have their own insurance broking departments or subsidiaries, which handle insurances when credit for assets and/or finance is provided. Generally speaking,

the other independent brokers are not aligned to financial institutions and therefore do not play much of a part in credit insurance transactions.

“4.11 Do you or do you not agree, and why, with evidence that has been given that the current levels of intermediary regulation under both the Long-term and Short-term Insurance Acts are outmoded to the extent that the legislation is broker-related while much of the current credit and credit life business does not involve a broker relationship at all?”

Summary:

Agree:

Long-term insurers associated with major banks: 4/4;

Other long-term insurers: 3/4 (two inconclusive);

Short-term insurers: 4/7 (one inconclusive);

Credit provider: 1/1.

Responses:

Liberty

We agree that anomalies arise from the application of the current commission regulations to some credit life distribution models. The regulatory framework has been designed to cater for the “traditional” intermediation model, where the intermediary acts as an independent third party “go-between” between the policyholder and the insurer. Where credit life group schemes are concerned, where the policyholder is generally the credit provider, the intermediary often has a closer legal relationship with the policyholder than the norm. In practice, the intermediary is often an associated company or subsidiary of the credit provider and is in fact only legally regarded as an “intermediary” because the services rendered by this entity fall within the rather broad relevant definitions in the LTLA commission regulations and / or the FAIS Act. To the extent that these entities provide intermediary services in relation to an insurance transaction, these are often only incidental to a broader range of services (including the provision of credit for the purchase of retail goods and administrative services in relation to the credit transaction) offered by the credit provider to its ultimate clients.

Arguably, these entities are not really “intermediaries” at all, but actually part and parcel of the credit provider’s own infrastructure. Bearing in mind that the credit provider is generally the policyholder in respect of credit insurance group scheme policies, it is therefore arguable whether, in these cases, fees payable in respect of the services provided by the “intermediary” entity should fall within the current commission model at all, or

whether it would not be more appropriate to regard them as a form of cost (and, in some cases, profit) sharing between an insurer and its policyholder.

The regulation of credit life commissions should be flexible enough to recognise the true nature of the legal relationships between the parties concerned, instead of imposing the current “one size fits all” model onto all distribution arrangements. Where, for example, administrative services in relation to the credit insurance policy concerned are not being conducted by a “true intermediary” but in effect by the credit provider itself, then it should be possible for the costs (and cost savings) of those services to be apportioned appropriately between the parties without having to impose current commission limits. It will however be vital for the regulation to ensure that all potential conflicts of interests are adequately disclosed to the end consumer, and that the consumer will understand what proportion of the total consideration they pay to the credit provider is allocated to what services.

Momentum

The question concerns regulatory policy. Historically it was only intended to regulate brokers’ commission, in our opinion this does not need to be amended. No case has been made to extend commission regulation to include other areas previously not regulated, such as insurance agents or profit share structures, and such a case cannot be assumed to exist. If such an enquiry is to be made it must of necessity commence by firstly considering the case in favour of broker commission regulation, before it can be extended to other areas.

Nedlife:

Agree that the Long Term Insurance and Short Term Insurance Act does not sufficiently address the sale of credit life insurance. However, the FAIS and NCA legislations supplement the Long Term Insurance Act and adequately protect the consumer. Further differentiation between traditional life insurance products and credit life both in the LOA Codes as well as legislation could be useful. This should take place with consultation between all member offices and consumer bodies that are active in the credit life market. However, it is critical that these additions arrive as over-arching guidelines that do not add cost, complexity and reduce competition.

Metropolitan:

Yes its true that much of the regulation is geared towards brokers being involved, but we cannot see how changing this will make any difference as far as remuneration is concerned. All our credit providers are seen as independent intermediaries and for purposes of remuneration get remunerated according to the commission regulations. If one wants to change the levels of regulation, one should change the definition of independent intermediary in the LTIA and the definitions of intermediary services in the FAIS Act.

Clientèle:

Fully agree with this statement, whether or not brokers are involved. Enforcement of commission regulation has always been problematic. Several insurance registrars have admitted as much in years past. It is also anti-competitive and economically unsound.

Regent Life:

Distribution models have evolved beyond traditional broker channels only and legislation needs to be amended.

Centriq:

Yes we at Centriq agree with this statement in this context as there are different interpretations of what is an independent intermediary and what services as intermediary are as contemplated in the Short-term Insurance Act. A distinction ought to be drawn between an independent intermediary who provides intermediary services in the normal course of their business eg an insurance broker and any person other than an independent intermediary who provides services as intermediary eg an insurance administrator. The Financial Services Board produced an Interpretative Note: Limitation on Remuneration for Services Rendered by an Intermediary at the time that the new Short-term Insurance Act was promulgated which provides a useful guideline as to the distinction between these two type of activities.

Hollard:

Yes, we agree. Insurance is being sold in an entirely different way and the cost-drivers are different to that of a traditional broker giving financial advice.

Commission should be de-capped to take account of these realities. Alternatively, it should be regulated so as to take account of them by recognising selling that takes place in a “tick box” environment and providing clarity on “advice giving” requirements in these circumstances. Where the consumer need is clear then the same obligations regarding “advice giving” should not be applicable as with those products requiring extensive advice. We need a simpler “advice giving” regime to be applicable in these circumstances.

Regent Insurance

The levels of intermediary regulation are outmoded in view of the fact that the extent of intermediary services can vary considerably. Do not agree with the statement that much of the current credit business does not involve a broker relationship.

Relyant:

We agree that there is an anomaly insofar as intermediary regulation is concerned, in particular as it relates to the furniture retailing industry. We comment further below.

The reality is that a furniture retailer sells goods and provides credit to a consumer, simultaneously desiring to ensure that, for both its sake and of the consumer, the assets so sold and the debt incurred are adequately insured.

We believe that a furniture retailer should be entitled to sell, administer, underwrite and manage claims directly as though it was a branch of a registered insurer. This is particularly relevant in such instances where the retailing group has gone through the regulatory process of setting up its own in-house insurer for such third party transactions. We strongly believe that commission legislation should not be applicable in such instances, but for disclosure to the client and the appropriate regulatory authorities to be provided regarding any fees paid by the registered insurer to the retailer.

Wesbank:

Yes, where the credit provider or motor dealer is involved in offering credit life insurance and credit insurance, there is no broker involvement.

The credit provider or motor dealer acts as an intermediary. Where the consumer takes motor comprehensive insurance, this is done by a broker and not by ourselves at all.

5. INCENTIVES

“Do you or do you not believe, and why, that there should be an express prohibition in both the Short-term and Long-term Insurance Acts against incentives being provided by insurers or their associates to independent intermediaries for the placing of their credit insurance products?”

Summary:

Agree:

Long-term insurers associated with major banks: 1/4;

Other long-term insurers: 2/6;

Short-term insurers: 4/7;

Credit provider: 1/1.

Responses:**Absa Life:**

Incentives ultimately impact the bottom line of the insurer, in the same way that the advertising of products and services would. Whilst incentives do have the potential to be used to circumvent commission regulations, not all incentives offered should be viewed in a negative light, or seen as a way to simply pay more remuneration to the intermediary. For example, incentivising the intermediary to place more business with a particular company may ultimately benefit the client, if that company has superior administrative and process systems, and the client is able to have an overall better experience with that company. Furthermore, incentivising could also take the positive form of providing intermediaries with education and training programmes by companies, on current market issues or regulatory matters.

Liberty

Liberty agrees that incentives payable outside of regulated commission structures should be prohibited. The above comments however relate to the situation where the intermediary is indeed acting as an independent go-between between the insurer and the policyholder / credit provider. As commented in the responses to questions 4.11 and 4.12 above, greater flexibility should be allowed with regard to commercially sensible arrangements to share risks and reward between insurers and credit providers (even where, for business reasons, the credit provider may use another designated entity within its group to render administrative services relating to credit insurance).

Nedlife

Nedgroup Life believes that the current LOA code on commission control and current legislation is sufficient to regulate incentives. It is important that the consumer is protected to ensure that relevant and appropriate incentivisation is in place. Incentivisation is also part of all sales based activities in other markets and is crucial in ensuring that consumers are not deprived product choice.

Regent Life:

No, this restriction does not apply to other financial institutions (such as banks) and creates competitive disadvantage for insurers considering that credit insurance is closely linked to banking.

Guardrisk:

Generally we believe that for independent intermediaries there should be no prohibition of any type of incentives other than the regulated commission.

However, such prohibition should not apply in instances where the intermediary is “not independent” e.g. for any motor dealership staff acting as agent or intermediary, there should be no prohibition of incentives subject to full disclosure.”

Pinnafrica:

Commission payments are incentives. Commission incentives are central to the sale of insurance products through intermediaries. In a deregulated commission environment, the nature of the incentive becomes irrelevant. In a regulated environment, incentives always have the potential for abuse and circumvention.

Relyant:

We do believe that there should be express prohibition in both the Short-Term and Long-Term Insurance Acts against incentives being provided by insurers or their associates to independent intermediaries for the placing of their credit insurance products. Insofar as it concerns the Short-Term Insurance Act, we hold the view that Section 44 (part VII) and Section 45 of the Long-Term Insurance Act should be amended to cater for this proposal.

Credit providers and their aligned insurers (own insurers and cell captive insurers only) have no need to incentivise independent intermediaries. It is this incentivisation and perhaps a level of greed which has led to abuse in the marketplace. Regulated insurance companies, as part of a furniture retailing group, are subject to all the legislative requirements presently forming part of our statutes, and have acted ethically at all times. Such companies have added motivation with the intention to settle claims promptly to avoid any unhappy consumers who may wish to purchase further household goods.

Wesbank

Yes. This will help to ensure that consumers have the freedom to elect a product of their own choosing, after weighing up various options. In addition to this, playing fields will be levelled and consumers will not be coerced into selecting an inferior and more expensive policy.

6. INTERMEDIARY REMUNERATION

“6.1 Do you or do you not believe, and why, that the current regulation of intermediary remuneration in respect of particular credit insurance products is adequate?”

Summary:

Agree:

Long-term insurers associated with major banks: 3/4;

Other long-terms insurers: 3/6;

Short-term insurers: 1/5 (two inconclusive);

Credit provider: 1/1.

Responses:

Liberty:

Liberty is of the view that the current regulated commission structures are appropriate, as its intermediaries are able to run their businesses at a reasonable profit margin based on the current scales. The current scales are also defensible from a customer perspective.

Alexander Forbes:

There are two issues. The first issue is that insurers need to be able to remunerate various third parties (including brokers) for a variety of administration services that are more efficiently conducted by the third party or broker. Insurers should be able to freely outsource bona-fide services on an arms length basis.

The second issue relates to remuneration to intermediaries for services rendered as part of the selling/ advice process. Please refer to the comment in 4.1 above.

Real People:

No. Some credit insurance premiums are very low, thus making it very difficult to entice intermediaries to market these products as their commissions are premium related.

A flexible model is required, allowing insurers to increase commission where required, subject to adequate disclosure to clients.

Hollard:

We believe that there should not be a maximum per product line.. The same amount of work/ services is performed for policies where currently different limits apply, and different average premiums result in vastly different incentives. These need to be aligned. The playing field is not level and sellers are more likely to sell those products with higher premium and consequently higher commission regardless of any other factors. An incentive based on a percentage of premium is not a measure of the service provided, but rather the measure of the business introduced. Remuneration should be related to work and services performed and advice given, rather than being calculated on the basis of a flat scale.

Pinnafrica:

Remuneration regulations are effectively circumvented through various legal mechanisms, which creates an anti competitive market environment, which is not in the best interest of the consumer.

Relyant:

We believe that commissions paid for the services of a broker is adequate. Given the relatively low monthly individual premiums involved, we further believe that aspects of intermediary remuneration need to be considered particularly where the quasi insurance branch of a furniture retailer should be entitled to receive full remuneration for all services rendered where it ‘stands in the stead’ of the insurance company and is aligned with, and to, the insurer by being part of the same group.

Wesbank:

Whilst we agree that the legislated percentages are adequate, there is a need in the industry to pay term commissions on monthly policies. With the introduction of the NCA, insurers are factoring commission to intermediaries, with the result that the credit provider is unable to operate on an equal footing. The credit provider is no longer competitive and consumers may be prejudiced.

“6.3 Do you or do you not believe, and why, that if commission regulation is to be retained there should be a differentiation between the remuneration paid to intermediaries in respect of credit insurance for:

- (a) personal and home loan debts;*
- (b) financing debts for the sale of furniture and similar goods by retailers;*
- (c) financing debts for the sale of motor vehicles by motor dealers.”*

Summary:

Agree:

Long-term insurers associated with major banks: 1/3 (one inconclusive);

Other long-term insurers: 1/6;

Short-term insurers: 3/6 (one inconclusive);

Credit provider: 1/1.

Responses:**Liberty:**

Typically the longer the expected term of the product, the lower the commission levels should be. Products with an expected term of less than 24 months (say) could allow for higher commission terms to allow for the acquisition costs incurred by the intermediary.

Channel Life:

There should be no differentiation – all treated equally. Differentiation will inevitably lead to arbitrage, and will make enforcement even more difficult, as it will be more complicated. Again, differentiation based on the size of cover amount may be more appropriate.

“6.4 Do you or do you not believe, and why, that the commission should be the same in respect of the same credit insurance products regardless of whether the insurance was issued under a long-term or short-term licence?”

Summary:

Agree:

Long-term insurers associated with major banks: 4/4;

Other long-term insurers: 4/4 (two inconclusive);

Short-term insurers: 4/4 (three inconclusive);

Credit provider: 1/1.

Responses:**Guardrisk:**

Yes, we believe it should be the same, otherwise regulatory arbitrage will be created e.g. the VAT discrepancies that arise depending on which licence is used with this business.

Hollard:

We believe that both Insurance Acts should have the same requirements. This would stop confusion and regulatory arbitrage, as well as structures being set up to optimise the amount of commission payable.

6.5(a) Do you or do you not believe, and why, that the commission should be expressed:

(a) *as a proportion of the value of cover rather than of the premium;*

Summary:

Agree:

Long-term insurers associated with major banks: 0/4;

Other long-term insurers: 2/4;

Short-term insurers: 0/7;

Credit provider: 0/1.

Responses:

Momentum:

That depends on whether this way of expression is to enable regulation of the maximum, or to protect consumers. As a measure to regulate the maximum it could work, but it would not offer any benefit over the current approach. Expressing commission as a percentage of cover in order to protect consumers is not recommended as it may not be the best measure for comparison and decision making. The products are often decreasing term assurance based, which makes the comparison difficult.

Centriq:

It is convenient from the perspective of the service provider to express commissions as a function of premiums which is a proxy measure of the exposure and out of which premiums the commissions must be paid. We also do not see how such a practice would prejudice the consumer.

Hollard:

(a) The premium is based on the sum insured so the commission is indirectly based on the value of cover as it stands. Less expensive policies may require more work than higher value ones. Fees for services rendered may be a better measure.

Relyant:

We believe that the present manner of calculating and disclosure of commission as a percentage of the premium and rand value should not change. Under present legislative requirements, what is actually earned is declared in Rand terms to the consumer. To change the basis to a value of the cover could lead to interpretation problems particularly when the cover is reducing as is required in certain instances by the NCA. It could also lead to innumerable administration problems.

*“6.5(b) Do you or do you not believe, and why, that the commission should be expressed:
(b) to the consumer as a fixed rate in Rand terms rather than as a proportion of the premium?”*

Summary:

Agree:

Long-term insurers associated with major banks: 1/4;

Other long-term insurers: 3/5 (one inconclusive);

Short-term insurers: 2/5 (one inconclusive);

Credit provider: 1/1.

Responses:

Absa Life:

Ideally, it should be expressed in Rand terms, as this is more transparent to the client, and more easily understood. However, this should be subject to administrative constraints brought about by premiums that fluctuate due to varying levels of cover from time to time, where the Rand amount of commission payable could also vary.

Alexander Forbes:

This would be good in principle. May not work as cover/premium is variable depending on outstanding debt.

6.6 Do you or do you not believe, and why, that the credit insurance industry is:

(a) price sensitive?

Summary:

Agree:

Long-term insurers associated with major banks: 1/4;

Other long-term insurers: 2/4 (two inconclusive);

Short-term insurers: 1/5 (one inconclusive);

Credit provider: 1/1.

Responses:**Liberty:**

Credit insurance is driven largely by convenience to client at the point of sale, and is therefore not very price or cost sensitive. However, the industry cannot use this as an excuse to charge exorbitant fees or premium rates. When the fees or margins are brought under public scrutiny (as they have recently been), they need to be defensible from a fairness and moral perspective.

Momentum:

In general, consumers are not price aware, therefore we recommend that the FSB assists the consumer by ensuring proper disclosure and price comparisons. Our experience is that the upper end of the market is more aware of the cost and is more price sensitive.

Hollard:

The credit insurance industry is not as price sensitive as standard commodity products. Convenience is a more important factor, within reason. Consumers very seldom shop around and compare prices. Credit insurance does, however, have price thresholds which are determined by the market.

6.6(b) Do you or do you not believe, and why, that the credit insurance industry is:
(b) cost sensitive?

Summary:

Agree:

Long-term insurers associated with major banks: 3/4;

Other long-term insurers: 3/3 (three inconclusive);

Short-term insurers: 4/5 (two inconclusive);

Credit provider: 1/1.

Responses:**Centriq:**

We believe that the credit insurance industry is both price and cost sensitive in the sense that a price increase would result in a significant reduction in business volumes and a consequent increase in cost and an increase in cost would result in pressure being put on margins and a consequent increase in price.

Hollard:

Yes, as the costs of distribution and covering the risk are the main drivers of price.

6.7 Do you or do you not believe, and why, that the profit margin for retailers and dealers operating successively as sellers, credit providers and intermediaries for credit insurance is too high?

Summary:

Agree:

Long-term insurers associated with major banks: 0/0 (four inconclusive);

Other long-term insurers: 1/2 (four inconclusive);

Short-term insurers: 0/5 (two inconclusive);

Credit provider: 0/1.

Responses:**Liberty:**

While Liberty cannot comment specifically on margins experienced by the industry, we do believe that it is reasonable and commercially sensible that the benefits of aggregation of the various components of a value chain should accrue to either customers (by way of a cheaper price) and to the aggregator of the value chain. It is not appropriate that regulation should provide for structurally different fee structures or profit margins, dependent on whether these services are provided by single or multiple providers.

Momentum:

We take this question to relate to the dealers' and retailers' share in credit life profits. As a starting point, there is no upper limit on profits in a free market economy. One never regulates "profits" explicitly. This principle is subject to the proper functioning of the market mechanism in the underlying transactions.

The real question is therefore what the insurance regulations on commission are intended to achieve. Is the object to promote competition and enhance the functioning of the market mechanism in credit insurance transactions, or is it merely to cap the amount that may be paid to a particular intermediary in a transaction, with the intention of implicitly protecting the consumer against this cost component by so doing? If it is the latter, and the profits are made after complying with the regulations, then the profits can never be too high.

If there is such a problem as “too high” profits, we do not believe that the correction of that problem is best (or at all) achieved by capping commission levels in the insurance regulations and believe it should be addressed differently, for instance through proper disclosure.

Any policy decision in this area requires the careful assessment and application of economic principles in the light of the prevailing practices. It is in this context that we believe that the market conduct of the participants could be a bigger issue than the level of commission.

In the South African institutional landscape the responsibility to oversee the functioning of the market mechanism resides with the Competition Commission, which is in a position to employ existing measures to deal with the matter if anything is amiss. Generally speaking the Competition Commission functions so as to enable the market mechanism to function efficiently.

Centriq:

Motor dealers operate in a highly competitive market and any windfall profits would immediately attract new entrants into the market.

Guardrisk:

Based on the input received from one of our major clients, they are of the opinion that profit margins are not excessive in relation to all the other value added products that they offer their clients.

Pinnafrica:

There are frequent examples of retailer and dealer insolvencies. Also, there are many examples of very successful retailers and dealers. Profitability is affected by many factors. Generally, credit insurance is profitable. Profitability will remain high in the absence of normal market forces and competition.

Relyant:

We do not believe that the profit margin for retailers, in particular, operating in the white and brown goods sector, is too high. Regrettably, insufficient cognisance is taken of the cost structures insofar as it relates to insurance products sold to buyers of furniture and household items of this nature. Generally speaking, the premium is collected monthly on a manual basis. Very often the premium is not paid on time and in time. This leads to additional administrative costs of following up the payment from the consumer. The Rand value of such costs is, in itself, very high. There is generally no ‘first world’ collection of monthly premiums by debit order. The premium often so collected is lower than many costs levied by banks for financial services provided. Certain of these have been commented upon below. The cost component of the premium for administration, premium collection, claims handling and other ancillary expenses of policy wordings, statutory compliance costs etc consume around 43 – 47% of the monthly premium.

“6.8 Do or do you not believe, and why, that premiums for credit insurance are on average too costly considering insurers’ risk experience for this type of cover?”

Summary:

Agree:

Long-term insurers associated with major banks: 0/1 (three inconclusive);

Other long-term insurers: 1/3 (three inconclusive);

Short-term insurers: 2/5 (two inconclusive);

Credit provider: 0/1.

Responses:

Absa Life:

We believe it is difficult and even unfair to draw comparisons on the costliness or otherwise of premiums between a low-premium-high-volume environment (such as most credit life product lines) and other products with higher premiums. Certain actions (selling, administration, claims handling, policyholder services, etc) demand the same input (time, costs, etc), whether the premium is big or small. In the low premium environment, expenses will therefore be a far greater portion of premium. The risk in certain product areas is also higher (more uncertain claims and lapse patterns), which demands a bigger profit margin to compensate. Finally, market forces should ultimately force premiums down if they are unacceptably high. We would argue that there is plenty of evidence that there is price competition between suppliers. For example, in packaged / composite solutions the total price matters very much.

Centriq:

Our experience is that losses on motor warranties tend to run off at around 85% of risk premiums. The deductions on motor warranties also appears to be unusually high because the cost of the pre-delivery service and repair charge is factored into the deductions. Also, administration fees are consistent with other sectors in the insurance market.

Guardrisk:

Claims ratios on credit insurance are generally lower when compared to other types of personal insurance, which means that this business tends to be more profitable for insurers.

Hollard:

There are instances where the customer is clearly paying too much but on the whole credit insurance premiums are affordable. The monthly premium is a relatively low amount in monetary terms, and generally more affordable than stand-alone insurance products. It may be worth promoting consumer awareness by publishing product and commission comparisons.

Pinnafrica:

It is commonly known that credit insurance products are profitable.

“6.9 Do you or do you not believe, and why, that it creates a potential conflict of interest vis-à-vis consumers when retailers and dealers operate successively as sellers and/or credit providers and intermediaries?”

Summary:

Agree:

Long-term insurers associated with major banks: 1/4;

Other long-term insurers: 3/6;

Short-term insurers: 2/7;

Credit provider: 0/1.

Responses:**Absa Life:**

We do not believe that a conflict of interest is created, as the client is still entitled to seek cover elsewhere, and is not obliged to acquire it through the vendor. For the lower end of the market, where premiums are generally low, it does not become economical to shop around for alternative sources of cover, and hence the ability of the retailer/ dealer to provide a one-stop-shop for the client is in fact beneficial.

Centriq:

It is a one stop shop type practice which is not unusual in commerce and industry. Consumers have an option to purchase their credit insurance elsewhere if the cost of such insurance on the dealer shop floor is not perceived to be providing value.

Relyant:

We do not believe that there is a conflict of interest in the situation stated above. Generally speaking, lower LSM customers of furniture retailers, are not able to obtain insurance in the standard commercial insurance market, nor could independent insurers provide an acceptable product at a reasonable price, considering the huge administrative burden with which they would be faced.

Wesbank:

No, provided that incentives are prohibited and full disclosure provided.

“6.10 Do you or do you not believe, and why, that for the purpose of the regulation of intermediary remuneration credit insurance should be treated as a category separate from other forms of insurance?”

Summary:

Agree:

Long-term insurers associated with major banks: 4/4;

Other long-term insurers: 3/6;

Short-term insurers: 2/5 (two inconclusive);

Credit provider: 1/1.

Responses:**Absa Life:**

Yes-the unique characteristics of credit insurance do justify it being treated as a separate category from other types of long-term and short-term cover.

Clientèle:

No, credit life is merely decreasing term assurance which has been sold for at least the past 200 years.

Centriq:

Credit insurance is mandatory in an instalment credit transaction as security against the debt and should therefore be treated differently to other forms of voluntary insurance transactions. The distinction should however be restricted to the degree of disclosure required in each such insurance transaction.

“7.10 Do you differentiate, for the purpose of making payment or the passing of consideration in respect of credit insurance, between:

- (a) intermediaries and non-intermediaries;*
- (b) different kinds of administrative work;*
- (c) work done for the benefit of the insurer and work done for the benefit of the insured (such as post-contractual advice?)”*

Summary:

Yes:

Long-term insurers associated with major banks: 2/4;

Other long-term insurers: 1½/6 (one inconclusive and another said yes to (a) and no to (b) and (c);

Short-term insurers: 5½/7 (one insurer said no to (a), yes to (b) and no to (c) and another said yes to (a) and no to (b)).

Responses:**Absa Life:**

(a) Yes. Intermediaries are remunerated in terms of the regulated commission, while non-intermediaries are paid for any services that they might render related to the provision of credit insurance.

(b) Yes, depending on the type of service being provided, e.g. the bank provides premium collection services and policy maintenance, while call centres are also involved in capturing business and fulfilment.

Centriq:

We pay the dealer a commission in return for the provision of services as intermediary. We pay the administrator an administration fee and risk management fee for intermediary services and for risk management services part or all of which risk management fee is passed on to the dealer in exchange for the provision of pre delivery service and repair services so as to ensure that the vehicle is in good working order as a prerequisite for the granting of motor vehicle warranty insurance cover. We pay the administrator a profit

share on the surplus on run off of the claims, part of which we understand is passed on to the motor dealer for good risk management.

Guardrisk:

(a) Between intermediaries and administrators who are different entities with different mind, management and functions. The administrator is usually the cell owner whereas the intermediary is usually the dealership.

(b) Depending on the type of administration and marketing services provided to the insurer, there is a differentiation in the fee structure and the value.

Hollard:

Non-intermediaries are paid fees rather than regulated commission. For products other than credit life, administrative work is paid on a fee basis, the fee being dependent on the nature of the work provided. A policy fee is paid by the client for the services rendered by the intermediary for his benefit. All other fees and commissions are paid by us.

The commission limitations are for those intermediaries performing intermediary services as defined in the Act. Non-intermediaries and non-intermediary services are in our view entitled to remuneration which is not subject to commission regulations

Pinnafrica:

Requirements and contracts differ widely. We may make use of call centres, sales consultants etc. In other instance, we may make use of the intellectual property of agents and/or intermediaries. Other services, for example legal, actuarial services, accounting etc are also used externally. In some instances, agents may self-administrate certain of the insurance functions.

Relyant:

Commission at the standard legislative requirement of 20% is paid and post sale administrative work is reimbursed up to the level of not exceeding 45% of the gross premium.

5. SOME COMMENTS ON THE RESPONSES TO THE FOLLOW-UP QUESTIONNAIRE

5.1. On certain issues of principle all or at least a significant majority of respondents appear to agree that:

- (i) premiums as such should not be regulated;
- (ii) the STIA and the LTIA and in particular the regulations relating to intermediary regulation issued in terms of the LTIA, are unclear and in need of revision;

- (iii) the level of remuneration payable for intermediary services, if it is to be regulated at all, should be the same regardless of whether the work is done under a short- or a long-term licence;
 - (iv) the levels of such remuneration should take account of the nature and extent of different categories of work done by intermediaries;
 - (v) there should be greater emphasis on proper disclosure to applicants for CCI and policyholders;
 - (vi) it is not desirable that insurers' claims ratio per product line or their ratio of rejection of claims per number of claims be disclosed to applicants for insurance or policyholders;
 - (vii) CCI is cost-sensitive.
- 5.2. On other issues there were differences not only amongst insurers generally but amongst sub-categories of insurers, especially on whether:
- (i) CCI deserves, because of its ancillary nature, separate treatment from other forms of insurance;
 - (ii) the time is ripe for the elimination of all forms of regulation of intermediary remuneration;
 - (iii) the current levels of intermediary regulation are adequate;
 - (iv) if regulation is to be retained, whether a distinction should be drawn, for the purpose of the regulation of intermediary remuneration, between
 - (a) the upper and lower income ends of the market and, if so, on what basis;
 - (b) different product lines;
 - (v) conflicts of interests arise vis-à-vis consumers when retailers and dealers operate successively as sellers and/or credit providers and intermediaries;
 - (v) there should be an express prohibition against the payment of incentives to intermediaries;
 - (vi) CCI is price sensitive;
 - (vii) whether intermediary remuneration should be disclosed as a proportion of cover or in Rand terms rather than as a percentage of the premium.
- 5.3. On certain issues insurers were ambivalent or non-committal, for instance, on whether premiums or intermediaries' profit margins in the CCI market are exorbitant.

CHAPTER 8
THE PANEL'S RECOMMENDATIONS ON INTERMEDIARY
REMUNERATION REGULATION

1. SOME INTRODUCTORY REMARKS

- 1.1. The principal purpose of regulating intermediary remuneration is doubtless the protection of consumers against exploitation by insurers and intermediaries. The protection can be direct by restricting intermediary remuneration as an item of cost that is passed on to the consumer by way of increased premiums or it can be indirect by prohibiting improper incentives that in the long run would likewise tend to increase premiums across the board.
- 1.2. Any proposed regulation of intermediary remuneration should aim to strike a balance that would be fair to the consumer (not overpaying for the insurance), the insurer (not being underpaid for assuming the risk) and the intermediary (not being underpaid for introducing the business). The amount of a premium should ideally be market-related, economically viable and not excessive.
- 1.3. Premiums are comprised of different elements:
 - risk premium;
 - fixed costs;
 - introduction fee (commission);
 - policy administration costs e.g. policy costs and premium collection (if incurred by the insurer itself);
 - servicing fee (if the policy administration is additionally outsourced);
 - profit.
- 1.4. The range of possible approaches to regulating intermediary remuneration for CCI is:
 - no regulation at all of the premium or of any of its elements (but with comprehensive disclosure requirements);
 - regulation of only the introduction fee;
 - regulation, in addition, of the servicing fee;
 - regulation of the premium.
- 1.5. The two extremes are complete deregulation or regulation of the premium across the board.

- 1.6. Regulation of the premium as such is not, the Panel believes, a realistic option for South Africa. Admittedly, if the emphasis is to be solely on the interests of consumers, that may be the logical approach. It is the approach adopted in certain states in the United States¹ and certain continental countries. To the extent that the LOA's Zimele product standards for low income consumers provide for a maximum premium, it may be seen to be analogous². But the Zimele product standards are not compulsory and the recommended maximum premium is thus not enforceable. It is, moreover, a different issue whether a product along similar lines would be appropriate for the entire CCI market.
- 1.7. Indeed, the one issue on which all the insurers in their responses to the follow-up questionnaire were in agreement was that premiums as such should not be regulated.³ The arguments raised by insurers against regulating premiums are compelling. A balanced approach requires that the emphasis should be on market forces and that the interests of parties in the distribution chain other than the consumer should also be taken into account. Regulation of the premium, in the view of the Panel, is not the answer.
- 1.8. The other extreme of complete deregulation of intermediary remuneration, may be more in line with modern trends elsewhere in the world.⁴ That, too, was the position provisionally adopted by the Policy Board in 1999-2000 with the proviso that due provision be made for comprehensive disclosure to the consumer. Regulations to that effect were prepared and actually signed by the Minister but, due to the widely publicised investigations of the Attorney-General of New York,⁵ never published.⁶
- 1.9. On the issue of complete deregulation of intermediary remuneration, the responses to the follow-up questionnaire show that the insurers themselves are fairly equally divided.⁷
- 1.10. All the Panel members favour the approach that market forces, rather than regulation, should ultimately determine not only the course and level of different premiums for

¹ See chapter 5 section 4.

² See section 4.4 below.

³ Chapter 7 section 4.5 item 4.3.

⁴ But see chapter 5.

⁵ See chapter 5 section 3.3.3.

⁶ FSB Aide Memoire November 2005 page 9.

⁷ Chapter 7 section 4.5 item 4.1.

different products serving different objectives but also any remuneration payable to intermediaries for introducing new CCI business and for doing administrative work for and on behalf of insurers. But for one aspect discussed below, all the Panel members, in considering whether intermediary remuneration regulation should be retained, increased or reduced, are in principle in favour of deregulation in the CCI space.

- 1.11. This approach is in line with trends elsewhere in the world but as is apparent from the discussion in chapter 5 this is not a universal approach and there are conflicting views on whether deregulation tends to lower or increase premiums in the short or long run.
- 1.12. Regulation or deregulation of intermediary remuneration raises the following subsidiary issues of principle, discussed in the paragraphs that follow:
 - 1.12.1. Should the introduction fee be regulated?
 - 1.12.2. Should the servicing fee be regulated?
 - 1.12.3. Should there be a special dispensation for the lower income end of the market?

2. **REGULATION OF THE INTRODUCTION FEE?**

- 2.1. The one aspect the Panel members are not in complete agreement is the deregulation of the introduction fee. Although all the members of the Panel favour deregulation in principle, some are of the view that in the South African context the time for immediate and complete deregulation may not yet have arrived. This concern echoes similar reservations expressed by several witnesses and respondents to the follow-up questionnaire referred to above.⁸
- 2.2. The one view is there should be complete deregulation, on condition that there is full intermediary disclosure, and consequently that the capping of the introduction fee should likewise be discarded.
- 2.3. That view has the merit of simplicity. Market forces, combined with proper disclosure, would ensure fairness, according to this view, to both consumer and insurer. Moreover, it would dispose of the perennial problems of administering and enforcing the system. Intermediary remuneration regulation is notoriously difficult to police, as the South African experience has proved. Deregulation, by admitting defeat, defeats

⁸ Chapter 7 section 4.5 item 4.1.

the problem. As Mr **Casserly** put it in evidence: “*I concur with disclosure coupled with deregulation as going a long way to resolving [the problem]. Because all of these structures are artificial and all the connivance is artificial and designed to overcome whatever caps exist*”. On that approach capping is not the solution to the problem but its cause.

- 2.4. But that view does have implications. In the short term premiums may escalate, until market forces have settled their appropriate levels. Uncapping commissions, even with ostensible disclosure⁹, would, moreover, attenuate the entire concept of improper incentives. If there is no regulated commission, there is no effective objective standard against which improper incentives are measurable. Commission is a form of incentive payment and the regulated maximum defines the limit of what is deemed by the legislature to be both a proper reward for a past service and a proper incentive for a future one; any additional consideration passing from the insurer to the intermediary, especially if it is not in monetary form, may or may not be an improper incentive, depending on the motive accompanying its giving. But if there is no commission capping, all incentives, regardless of motive, by implication become proper. Any incentive, whatever the form or amount, can simply be explained away as being an unregulated commission.
- 2.5. A further argument advanced in favour of discarding the regulation of the introduction fee *in toto*, is that the CCI market in South Africa is essentially a captive one. The credit provider, be it a finance house or the dealership or the furniture retailer, on the one hand, and the insurer, on the other, are almost invariably linked as members of the same inter-company group. In the evidence it was referred to as “vertical integration”. The payment of the commission or the giving of consideration will thus invariably gravitate towards and remain within the group. Absent the competitive consideration, so the argument goes, there is no call to regulate the commission.
- 2.6. The counter-argument on this point is that this linkage is not always present. So, for instance, there was evidence that a particular insurer could still be favoured by credit providers who are not in a group context with it. Furthermore, there can still be competition between different groups for the business of a credit provider not belonging to any one of them.

⁹ Where the incentive is improper it is unlikely that the disclosure will be full and complete.

- 2.7. The view of other members of the Panel is accordingly that the principle of the capping of the introduction fee should be retained, for the reasons that follow.
- 2.8. Without capping the introduction fee the mischief of improper incentives cannot be contained.
- 2.9. The introduction fee, or commission proper, is a true form of intermediary remuneration. In introducing the insurer's product to the consumer the broker, if there is one, or the credit provider or the dealership or the furniture retailer, is functioning as an intermediary properly so called between two principals, the insurer and the consumer.
- 2.10. The intermediary would normally act on the mandate of both the insurer and the consumer to both of whom the intermediary as a representative would owe a fiduciary duty. For that service the intermediary is fully justified in negotiating a fee from either the insurer or the consumer or both. As matters stand at present the fee payable by the insurer is regulated and should be disclosed to the consumer whereas any fee recoverable from the consumer although not regulated should nevertheless be disclosed to the consumer.
- 2.11. The commission paid to the intermediary by the insurer serves not only as a reward for an introductory service performed in the past but also as an incentive for such services to be performed in future. Incentives can be proper or improper. An incentive would be proper, speaking generally, if its aim is to prompt or encourage the intermediary to greater effort and efficiency in performing the intermediary mandate in future to the best of the intermediary's ability. The incentive would be improper if it seeks to motivate the intermediary, in breach of its fiduciary duties toward the insurer and the consumer, to earn more commission, regardless of the quality of the service that is being rendered.
- 2.12. Introduction fees and incentives go hand in hand. Improper (or what was also called in evidence "perverse") incentives are the downside of the introduction fee. As a general proposition improper incentives are condemned worldwide. They are sought to be contained by regulating the introduction fee. The mischief the "capping" provisions are designed to meet is two-fold in nature. First, improper incentives create conflicts of interest for intermediaries in tempting them to favour the products of principals who are prepared to pay them most generous commissions regardless of

whether the recommended product best suits the consumers. This, secondly, redounds to the disadvantage of consumers in two respects. One, since the cost of incentives is inevitably passed on to the consumer it would have a ripple effect in eventually increasing premiums and, two, it would tend to skew the advice given to consumers as to which product to choose.

- 2.13. The capping of the introduction fee was introduced to meet and contain a recognised mischief, namely reward-driven incentives for placing business regardless of the merits or demerits of the recommended product. As it was stated in an FSB Aide Memoire of November 2005:¹⁰

“The commission payable in both the insurance industries was not regulated until 1977. Previously the intermediary and the insurer agreed a commission, which was unknown to the policyholder but which was paid by the policyholder, implicitly or explicitly. The Minister then issued regulations that regulated maximum commissions in terms of the Insurance Act, 1943. Interestingly the regulation of maximum commission was initially introduced to protect the solvency of smaller insurers. It was found then that particularly because of the operation of production bonus systems, broking firms were influenced by extra material rewards that they could have gained by recommending to a client the product of an insurer with whom business has previously been placed, regardless of the suitability of that company’s policy for that client. In offering production bonuses insurers were tempted to outbid each other in order to attract the business, thus forcing up commission rates. Increases in production bonuses (profit sharing) offered them by insurers appeared to be more common than increases in basic commission rates. This all took place in an era where very little or no disclosure was required or done. It was also argued that by “capping” the maximum commission, the cost to the policyholder was limited and thereby the policyholder was protected.”

- 2.14. There were mixed responses to the question in the follow-up questionnaire¹¹ of whether incentives should be expressly prohibited. Those who favoured complete deregulation also believed that there was no need to limit incentives.
- 2.15. The essence of the mischief is that insurers are compelled, in order to remain in business, to promise and give intermediaries additional incentives by way of additional remuneration so as to induce them to place the insurers’ business with their customers. There was no evidence before the Panel that this mischief has abated or

¹⁰ Pages 10-11.

¹¹ Chapter 7 section 4.5 item 5.

has been eradicated or that it would do so within the foreseeable future and accordingly that there is no longer a need to counter it. The evidence, on the contrary, is that insurers, especially on the short-term side, are astute in finding new channels of payment to intermediaries. The reason may be to incentivise intermediaries to favour their products thereby improving their competitive edge vis-à-vis their competitors. But it could also be that the present levels of remuneration of intermediaries are inadequate and that they need the insurers' additional support in order to survive. This latter aspect is dealt with separately later in this report.¹²

- 2.16. The mischief can best be combated in two ways. First, by clearly defining the activities for which the introduction fee is payable and by fixing the permissible level of remuneration, taking account of the degree of difficulty and effort required on the part of the intermediary to effect the introduction for which a fee is charged. By limiting remuneration for defined activities to a monetary reward up to a certain level, any reward in excess of the limit, or in non-monetary form or for activities not mentioned, would by implication be outlawed. On that approach the emphasis would be solely on the limit of the permissible reward for specific activities, irrespective of the intention of the parties concerned in giving and accepting it.
- 2.17. Secondly, by expressly outlawing incentives or rewards promised or given by insurers to intermediaries for placing insurance business, otherwise than by way of the permissible levels of remuneration. The emphasis would be on the intention of both the giver and the recipient of the incentive or reward. This is the approach adopted by the LOA in clause 2.3 of its Code on Commission Control providing that insurers who are members of the LOA *“may not do anything which could be construed as an inducement, consideration or reward for the placing of business which is over and above that provided for in the regulations.”*
- 2.18. These two measures, defining the activity and fixing the amount, on the one side, and expressly prohibiting improper incentives, on the other, complement each other. The first measure is essentially objective and rigid. The second, in emphasising the true intention of the parties, imports a subjective element and as such is more flexible. The second builds on the first. Without the first, the second, standing alone, would be so imprecise to be incapable of practical enforcement.

¹² Section 5 below.

- 2.19. The legislature opted for the first measure, not in conjunction with the second but in isolation. This can be identified as a weakness in the system, first, by diverting attention from the true intention of the parties concerned and thereby creating opportunities for insurers and intermediaries to escape the restrictive net by inventing new activities not covered by the specific definitions and for which consideration is thus given; and secondly, by ignoring the most direct and effective means of enabling the regulating authority to distinguish between proper and improper incentives.
- 2.20. Those members of the Panel favouring the retention of the regulation of the introduction fee as a means of combating improper incentives would recommend that a system be put in place, comprising both the objective and subjective approaches described above, so as to ensure a more effective policing of impermissible incentive payments or other inducements.
- 2.21. The suggestion can readily be achieved by appropriate amendments to s 44 of the STIA and s 45 of the LTIA by adding the intermediary as an entity to which the payment of any form of consideration as an incentive for procuring policies of insurance, otherwise than by means of the permitted remuneration, is prohibited. The sanction is criminal prosecution or an administrative penalty. In addition, if the suggestion discussed below is accepted that, in the long term, the NCA is the appropriate vehicle for scrutinising CCI market conduct including intermediary activities,¹³ the NCA can cross-reference to the STIA and the LTIA, as amended, or it can contain its own integrated set of provisions in lieu of that of the two Insurance Acts.
- 2.22. How, then, is the matter to be approached if an insurer paid an intermediary a fee which is in excess of the permitted introduction fee and is alleged to be an improper incentive?
- 2.23. One approach would be to regard the stipulated remuneration as the absolute maximum of any consideration of whatsoever nature that may pass from the insurer (or any associate of the insurer) to the intermediary (or any associate of the intermediary). In effect it would amount to an irrebuttable presumption that the payment was intended as an incentive paid by the insurer to the intermediary as a

¹³ Section 6.

reward for bringing in business and that it was, as such, a contravention to which a criminal or administrative sanction attached.

- 2.24. Such an extreme approach would be unrealistic and cannot be supported. It would remove the subjective element (testing the true nature of the transaction against the intention of the insurer and the intermediary) from any assessment of the situation. Nevertheless there may be merit, worth considering, in a scaled-down approach i.e. by reversing the onus when any payment is made or other form of consideration is given which is proved to exceed the permissible maximum and is alleged to be an improper incentive. It would then be for the insurer and the intermediary concerned to persuade the regulator, court, ombudsman or other tribunal charged with investigating the matter that the payment or consideration was *not* intended as an incentive but was prompted by some other legitimate reason.
- 2.25. In terms of this approach:
- (i) the insurer is entitled to pay and the intermediary is entitled to receive a fee payable in cash up to the limit specified for the particular activity described;
 - (ii) any other payment made or consideration given by the insurer to the intermediary and received by the latter, if challenged, is deemed to be a contravention of the relevant regulation unless the insurer and/or the intermediary can show that it was *not* intended as an incentive to procure new business.
- 2.26. This approach, being in essence an objective test tempered by a subjective test, is less formulaic than a test emphasising only the nature of the specified activity without relating it to the intention of the insurer and the insured. It will entitle the entity tasked to assess the situation to see through the smoke and disregard the mirrors. It will subject any transaction involving additional payment or consideration more readily than at present to scrutiny and challenge by the regulating authority and by the parties' own peers.
- 2.27. To sum up: on this particular issue the Panel is not unanimous in making a recommendation. Some members would recommend that regulation of the introduction fee be scrapped in its entirety. Other members would recommend that the regulation of the introduction fee should be retained, at least for the upper income

end of the market,¹⁴ and that a distinction should be drawn between proper and improper incentives; to that end it would be helpful to legislate for the imposition of a reverse onus.

- 2.28. The introduction fee under the LTIA is 7.5% of the premium. Under the STIA it is either 12.5% or 20% depending on the nature of the business that was introduced. The further recommendation of those members of the panel who are in favour of retaining the cap is that the regulations under both Acts should be reviewed to align the levels of the commission to the nature of the product, regardless of the licence under which an intermediary operated when the introduction was effected. There is strong support for this recommendation from respondents to the follow-up questionnaire.¹⁵
- 2.29. Such levels, in the view of the Panel, should be determined collectively by the LOA, SAIA, the FSB, National Treasury and the NCR.¹⁶

3. **REGULATION OF THE SERVICING FEE?**

- 3.1. As was discussed earlier in chapter 6, the so-called servicing fee is a product of the definitions clauses of the STIA and of the regulations to the LTIA. Even if the regulation of the servicing fee may be apposite for insurance generally - on which the Panel is not called upon to express a view - it is less so for CCI where true broker involvement, if it exists at all, is, according to the evidence, rare.¹⁷ As it was put by Mr **Casserly**, who gave evidence in his personal capacity but from an intermediary perspective, “*there are no intermediaries per se who practise credit life insurance*”.
- 3.2. Because of the cross-referencing between the definitions of “rendering services as an intermediary” and “independent intermediary”¹⁸
- (i) credit providers, dealerships and furniture retailers are deemed to be intermediaries when in fact they are, as far as the administration work is

¹⁴ See section 4 below.

¹⁵ Chapter 7 section 4.5 items 4.9, 4.10, 6.3 and 6.4.

¹⁶ See chapter 12 section 3.6.6 – 3.6.8.

¹⁷ See chapter 7 section 4.5, items 4.10, 4.11 and 6.9.

¹⁸ The issue is discussed in greater detail in chapter 6 sections 2, 3, 14, chapter 7 section 3 and chapter 10 sections 1 and 2.

concerned for which they receive a servicing fee, principals and not traditional intermediaries functioning as middlemen between insurer and insured;

- (ii) the administrative work they do for insurers is not essential for or even typical of the work a true intermediary would do for a principal. In rendering services as intermediaries the credit providers, dealerships and furniture retailers are functioning not as intermediaries proper but as sub-contractors to the insurers they serve.
- 3.3. It follows that the servicing fee, in the view of the Panel, is structured on a wholly artificial basis.
 - 3.4. Both the STIA and the LTIA expressly limit the consideration that may be paid to or received by an intermediary (as defined) for intermediary services (as defined).¹⁹
 - 3.5. Such a prohibition is perfectly sensible when it refers to the introduction fee. It is a means of guarding against the danger of inflating premiums in order to accommodate intermediaries, as that term is ordinarily understood. The introduction fee, as stated earlier, is both a reward and an incentive and the cap is the legislative divide between a reasonable and an unreasonable reward and proper and improper incentives.
 - 3.6. The limitation, however, is expressed in broad and general terms relating to all forms of consideration passing from the insurer to the intermediary without restricting it, as it should have been, to the introduction fee.
 - 3.7. The problem arose because it suited some insurers to come to an arrangement with credit providers, motor dealerships and furniture retailers for the latter to do all or much of the subsequent work that was required from the insurer concerned itself to implement its side of the contract.
 - 3.8. If the commission cap also applied to such additional work the stated remuneration, at least on the long-term side, would be perceived to be inadequate.²⁰ Insurers thereupon prevailed on the legislature to allow a further 15% and to specify the additional work for which additional payment by way of a servicing fee could be paid and recovered.

¹⁹ See chapter 6 section 2 in respect of the STIA and section 3 for the LTIA.

²⁰ See the responses to the follow-up questionnaire, items 6.1, 6.7 and 7.10.

- 3.9. In the LTIA the distinction between the introduction fee and the additional work is reflected in the legislation and in the prescribed fees; in the STIA a flat fee is prescribed for both the introduction and the servicing fee although the distinction is recognised in the Act and the regulations issued in terms thereof.
- 3.10. In the result the legislature conflated two functions that are inherently disparate and by doing so distorted the meaning of “intermediary.”
- 3.11. It is not without significance that of all forms of insurance it is only in the case of credit life insurance issued under the LTIA that provision is specifically made for a regulated servicing fee.²¹ The Panel, moreover, is unaware of any other jurisdiction where the servicing fee, in addition to the introduction fee, is regulated.²²
- 3.12. The servicing fee is payable to the credit provider, dealership or furniture retailer:
- (i) under the STIA for -
 - “(iv) maintaining, servicing or otherwise dealing with;*
 - (iv) collecting or accounting for premiums payable under; or*
 - (v) receiving, submitting or processing claims under, a short-term policy;”*
 - (ii) under the LTIA for *“maintaining or servicing a policy or collecting, accounting for or paying premiums or providing administrative services in relation to a policy.”* In addition “administrative work” is defined as *“work in connection with the handling of enquiries, maintaining administrative records and the receipt and processing of claims under a group scheme.”*
- 3.13. These are all functions an insurer is obliged to perform itself in terms of the express, implied or tacit terms of its contract with the policyholder. They cover the entire spectrum of post- sale matters the insurer should attend to, including
- preparing and processing the application form;
 - preparing and issuing the policy;
 - dealing with enquiries;
 - sending out notices;
 - collecting or receiving premiums;
 - processing non-payments and lapsing of policies;

²¹ See chapter 6 section 13.5 and following.

²² See chapter 5.

- receiving and evaluating claims;
 - paying claims;
 - repudiating claims;
 - dealing with ombudsman's queries.
- 3.14. These activities will all be factored in when the premium is actuarially determined. The insured accordingly pays for these services by paying the premium.
- 3.15. When the insurer outsources such work to a third party the cost for such work should likewise come from the insurer's premium income and not from the insured. If the insured is required to pay it would constitute double payment.
- 3.16. The same is true if, for the sake of convenience, the third party happens to be the credit provider, the dealership or the furniture retailer.
- 3.17. When the payment for the outsourced administrative work comes from the insurer's premium income, as it should, it would have no detrimental effect on the premium.
- 3.18. Deregulation of the servicing fee should not in the long term add to the level of premiums. That is because premiums are broadly market-related. So, for example consumers are required to pay, in addition to the premiums, policy fees and sometimes administration fees, payable to intermediaries. These are not regulated.²³ Nevertheless, even though there is regulatory *carte blanche*, these items remain within the same broad band throughout the industry.
- 3.19. That being so, there is no reason in either logic or as a matter of social policy imperatives why the servicing fee should be subject to any regulation. Such work remains a matter for negotiation between the insurer and the third party to whom the administration work is outsourced. It does not affect the consumer as the life insured.
- 3.20. The only reason why there could be a reason to regulate the servicing fee is if the servicing fee is in truth a disguised improper incentive – when the payment is a mere pretence and no administrative work is in fact done. That situation is addressed in the previous section of this chapter, i.e capping the introduction fee as a means of inhibiting improper incentives. Then it is not a case of regulating the servicing fee; it is a case of regulating the introduction fee.
- 3.21. The recommendation of the Panel is accordingly that the entire concept of the servicing fee and in particular its capping, be deleted in both Acts.

²³ See chapter 6 section 8.

3.22. The justification for the recommendation is two-fold. One, because the Panel is in principle, and subject to what was said above about improper incentives, opposed to the regulation of intermediary remuneration and, two, because the regulation of the servicing fee is misconceived and fulfils no function other than to cause confusion in the industry; in particular, having once been costed when the premium was initially priced, it can have no further negative effect on the premium, irrespective of what the insurer pays the credit provider, the dealership or the furniture retailer for doing the administration work for which the insurer is responsible itself in terms of its contract with the insured.

4. **A SPECIAL DISPENSATION FOR THE LOWER INCOME END OF THE CONSUMER CREDIT INSURANCE MARKET?**

4.1. Several questions engaged the attention of the Panel. These are discussed in the paragraphs that follow.

4.2. Should there be a special regulatory dispensation for the lower end of the CCI market?

4.2.1. One view, also expressed by some respondents to the follow-up questionnaire,²⁴ is that such an approach smacks of paternalism and would tend to be divisive. This sentiment accords with the approach of the NCR who does not favour “segmenting” consumers, the effect of which may be to marginalise the very segment of society to which protection is intended to be extended. The evidence, moreover, is by no means consistent that consumers at the LSM 1-5 levels are necessarily more gullible, when it comes to purchasing merchandise, than more affluent consumers.

4.2.2. A relevant consideration is that credit life, according to the evidence, functions largely at the lower end of the market. The results of a survey conducted by RGA Reinsurance Company, on which Mr **Ross** spoke, show that credit life insurance in 2005 was extended to cover micro-loans averaging R5,025 (this insurance market growing by 219%), vehicle financing at an average sum of R82,769 (growing by 73%), mortgaging at an average of

²⁴ Chapter 7 section 4.5 item 4.6.

R197,945 (growing by 31%), credit cards averaging R8,232 (with a growth rate of 88%) and personal loans of R10,301 (growing at a formidable 315%).

- 4.2.3. The other side of the picture is that consumers at the upper income end of the market, according to some evidence, tend not to avail themselves of the CCI facilities offered to them as part of a credit package but make their own arrangements to secure their indebtedness. So, for instance Mr **Casserly** testified:

“...customer sophistication is the indeterminate element in the debate. The sophisticated customer I guarantee you is not paying credit life premiums to anybody. Even though he may finance the vehicle, he would finance that vehicle outside of dealerships or directly with his contact at a financial institution or would be sufficiently alert to the typical add-ons that are prevalent in the retail space, so he'd be alert to that. So I don't think that your sophisticated customer is affected one way or the other. It's your relatively less sophisticated customer that would be subject to it. And there I argue I guess with education about what his rights are and all of that sort of stuff he would or could then, be in a position to make comparative type judgements”.

- 4.2.4. If that is so, regulating or deregulating the lower income end of the CCI market would in a sense mean regulating or deregulating CCI as a whole.

- 4.2.5. Having made the statement that consumers at the lower income end of the market are not necessarily artless customers, the Panel nevertheless accepts that when it comes to relatively more sophisticated financial products, of which CCI is a prime example, lower income consumers, especially in rural areas, are by and large more vulnerable to exploitation than others.²⁵ A pragmatic differentiation benefiting, without in any way disadvantaging that category of consumer, is thus deserving of support.

- 4.2.6. Special treatment of this nature is apparent from the LOA's Zimele product standards as well as from the special provisions in the LTIA relating to “assistance policies” which are defined in the LTIA as meaning

*“a life policy in respect of which the aggregate of –
(a) the value of the policy benefits...*

²⁵ See for instance the facts found in the *Gumede* determination discussed in chapter 12 section 2.

*(b) the amount of the premium in return for which an annuity is to be provided, does not exceed R10,000 or another maximum amount prescribed by the Minister...*²⁶

- 4.2.7. Against that background the Panel was prepared to consider the further questions posed below.
- 4.3. If there is to be a special dispensation, at what level should the line be drawn?
- 4.3.1. Should it be at LSM 1-5 or at a predetermined amount of cover for separate CCI product lines? The Panel would recommend the latter. This would be in line with the majority opinion of insurers in response to the follow-up questionnaire.²⁷
- 4.3.2. In the view of the Panel the appropriate levels should be determined collectively by the LOA, SAIA, the FSB, National Treasury and the NCR at a mean amount per product line, such as for instance an amount in the region of the R15,000 referred to in the NCA for credit life rather than to the proposed R50,000 mentioned in National Treasury's Discussion Paper for micro-insurance.²⁸
- 4.4. Should the LOA's Zimele product standards for credit life be extended to other forms of CCI and in particular should separate models be devised for different CCI products subject to the predetermined amount of cover?
- 4.4.1. The essence of the Zimele product standards for credit life is described in paragraph 6.2 of National Treasury's Discussion Paper²⁹ in the following terms:
- "However, in reaction to the Financial Sector Charter, the insurance industry has set about developing common industry standards to ensure fair charges, easy access and decent terms (CAT standards) for all member products. The long-term insurance industry has adopted these CAT standards as the basis for the Zimele product accreditation launched earlier this year. These voluntary standards (which however enable insurers to obtain Charter-points) already define appropriate and simplified terms, limited exclusions and simplified "plain-*

²⁶ See too chapter 6 section 4.

²⁷ Chapter 7 section 4.5 item 4.6.

²⁸ The Future of Micro-insurance Regulation in South Africa, Discussion Paper of 11 February 2008. Micro-insurance, of course, includes credit insurance.

²⁹ Ibid.

language” disclosure standards, as well as maximum rates to the policy holder³⁰. As these standards become entrenched in the market, they could be used as the basis for the development of micro-insurance product requirements in terms of simplicity, flexibility and affordability. The fact that the market is already familiar with the voluntary requirements could simplify the task of implementing such requirements.”

4.4.2. The LOA in an explanatory note elaborated as follows. The emphasis is on maximum premiums and cover and clear language and disclosures.

“Credit Life

- *Minimum cover and benefits available:*
 - *Death benefit only; or*
 - *Death and permanent total physical impairment.*
 - *If temporary physical impairment or retrenchment benefits are included as compulsory benefits, they must be provided without exceeding the maximum premium set out below. If they are voluntary options, the premium must be disclosed separately.*
 - *Cover may not exceed the outstanding debt amount*
- *This product may not be used to provide cover on a mortgage loan.*
- *No temporary exclusions (waiting period) for any cause of death: Death cover must commence on receipt of the first premium.*
- *Standardised exclusion wording: Standardised exclusion wording must be used.*
- *Limitations on allowable exclusions: Only the following exclusions will be allowed:*
 - *For Life and Physical impairment*
 - *Pre-existing conditions: All conditions that were known to have existed up to a maximum of 12 months prior to the inception of the policy will be excluded for a maximum of 12 months after inception.*

³⁰ Footnote 56 reads: “It is required that customers must be able to buy the policy, pay a premium or amend a policy at least once a month within 40km of their residence or place of work. It is envisaged that Zimele-accreditation will send a signal to consumers that products are trustworthy and reasonable in terms of pricing and terms. Amongst others, the CAT standards require all products wishing to gain accreditation to fulfil various criteria, with the main goal being the provision of a product that is easily accessible, flexible, simple and easy to understand. Criteria include that policy documents must use standardised policy terms, simple product descriptions must be provided and that a summary of the policy terms must be available in all 11 official languages. No HIV/AIDS exclusions are allowed. Interrupted contributions must be allowed for with grace periods to make up lost payments. Standardised exclusion wording is required and there are limits on allowable exclusions. Furthermore, minimum and maximum benefits levels are defined.”

- *suicide during the first 2 years.*
- *For Physical impairment only*
 - *self-inflicted actions;*
 - *war or armed conflict (whether war is declared or not), civil unrest and social revolt;*
 - *being affected by alcohol or drugs not prescribed by a registered medical practitioner;*
 - *refusing medical treatment by a registered medical practitioner;*
 - *radio activity or nuclear explosion;*
 - *involvement in criminal acts.*
- *No rate differentiation may be made for any policyholder. In other words the same rate will apply to all policyholders. Rates may differ between groups for group schemes or affinity based distribution but no differentiation is permitted within a group.*
- *Maximum rates to policyholder: Maximum, prices to policyholder are set. No additional administration fee or levy may be added to the maximum premiums detailed, which must be the maximum total cost to the policyholder.*
 - *Max monthly prices to policyholder:*
 - *Life Cover Only, R5 + R3,5 per R1 000 of initial cover*
 - *Life and Physical impairment Cover, R5 + R4,25 per R1 000 of initial cover*
- *No rate differentiation for any policyholder. In other words the same rate will apply to all policyholders. Rates may differ between groups for group schemes or affinity based distribution but no differentiation factors are permitted within a group.*
- *Maximum rates to policyholder: Maximum monthly prices to policyholder are set. No additional administration fee or levy may be added to the maximum premiums detailed, which must be the maximum total cost to the policyholder.*
 - *Max annual prices to policyholder for compulsory benefits:*
 - *Option 1, R2,1 per R1 000 outstanding cover*
 - *Option 2, R2,8 per R1 000 outstanding cover.”*

- 4.4.3. The Panel considered the arguments of respondents to the follow-up questionnaire favouring differentiation between different products³¹ to be more convincing than the opposing view.
- 4.4.4. Having considered the evidence led and the National Treasury Discussion Paper referred to above, the Panel accordingly recommends that the LOA and SAIA, give due consideration to which other CCI products the Zimele format should be extended.
- 4.5. By whom and on what basis should the premium rates in respect of different product lines be fixed?

The Panel was of the view that premiums should always be market-related. The problem is to settle on a formula or the means of determining and adjusting an appropriate premium for each product line to achieve, as it is put by the LOA, the lowest possible rate consistent with sustainability. The Panel was of the view that it should be left to the LOA and SAIA, in conjunction with the bodies referred to above, to determine the maximum recommended rate for each CCI product line below the maximum cover that is determined for that product.

- 4.6. Should the proposed different models, with the inclusion of a predetermined maximum premium for each product line, be made compulsory by law?
- 4.6.1. The Zimele product standards, with a maximum premium rate, are not compulsory even for LOA members. There are incentives which could persuade member insurers to adopt the product. Those incentives may not be as attractive in the case of CCI as with other insurance products since the primary beneficiaries in the case of CCI are not, apart from the consumers themselves, the insurers but the credit providers. A case can thus be made out for making the duly designed CCI product obligatory should the consumer require such insurance.
- 4.6.2. Such a course would, however, involve a form of legislated premiums. Having listened to the NCR, the Panel has been persuaded that the prospects are good that the provisions and measures of the NCA will ensure that the

³¹ Chapter 7 section 4.5 item 4.9.

consumer is sufficiently advised to enable him or her to make a properly informed choice on whether to take out CCI and if so, on what terms; consequently, that it is not necessary to make the product compulsory if the consumer elects to apply for such insurance and in particular that premiums should not be regulated. Insurers should be encouraged but not compelled to insist that credit providers use the product standards and consumers should be educated as to their inherent benefits. The products standards should be a template for best practice.

4.7. Should commission (i.e. the introduction fee) for CCI products with a benefit level not exceeding the pre-determined level be capped?

- 4.7.1. The Panel was initially of the view that premiums should be regulated in this category but having listened to the views of the NCR, the Panel has been persuaded, as stated above, not to presume to recommend the fixing of premiums for this sector of the market.
- 4.7.2. When premiums are fixed by law there is no need for the capping of intermediary remuneration. But is there a need for capping commissions when premiums are not fixed by law but the amount of cover, as is suggested, is held to a pre-determined ceiling?
- 4.7.3. Commissions are not regulated in the case of assistance business, as has been pointed out in the National Treasury Discussion Paper, referred to above. So it is said, in paragraph 6.2:
- “Commission capping. Under the regulations to the Long-term Act, commission on assistance business is uncapped. This is the only line of business under either the Long or Short-term Act that enjoys this treatment. Although not originally intended for consumer protection, the caps on commission levels serve to limit the charges that intermediaries may add to the product. It does, however, not limit the overall cost of the product. Long-term insurance regulation allows for up-front commission structuring while short-term insurance regulation dictates an as-and-when structure.”*
- 4.7.4. One can only speculate as to why there is no commission cap in the case of assistance business.³² The reason may be historical or even cultural in the

³² See too chapter 6 section 4.

sense that funeral insurance in certain sectors of society sells itself and need not be sold. Another reason may be that the commission per policy is in any event so modest that it would serve as a disincentive for writing funeral policies should commissions be restricted by law,³³ whereas this form of insurance should be encouraged. Moreover, there is so little “fat” in this kind of business for intermediaries that it is unlikely that improper incentives would be offered to intermediaries on a scale that would affect premiums across the board, so that an important reason for commission capping is absent.³⁴

4.7.5. The recommendation of the Discussion Paper referred to above, in paragraph 6.4, reads as follows:

“Extend uncapped commissions currently in force for assistance business intermediaries to all micro-insurance products (irrespective of intermediary category) but require that commission be paid on an “as and when” basis. Given the low premiums on micro-insurance products, basic commission amounts required to viably sell such products, though low in absolute terms, are high relative to the value of the premium. Uncapped commissions is one of the factors enabling viable business in the funeral insurance market, where players have indicated that it takes on average about 6 months for the insurer and/or the agent/broker to break even. Uncapping commission on the defined micro-insurance product lines will allow some room for advice-based intermediation. In addition, the Charter standards (e.g. the Zimele product accreditation standards developed by the Life Offices Association based on the CAT Standards) will incentivise reasonable all-in prices, which will, in turn, limit commissions. Current industry practices in assistance business also signal that competition will serve to keep commission levels in check.”

³³ Other reasons may be:

- such business is often run on a group basis;
- no independent brokers are usually involved;
- premium collection can be problematic e.g by the use of “cyclists and runners” into remote areas;
- although life business, the cover is for relatively short terms (sometimes monthly in the case of funeral business, two years or so in the case of credit insurance on retailed goods);
- the prominence of administrators who often run these schemes, with the role of the insurer reduced to mere underwriting.

³⁴ See section 2 above. The cost of commission will, however, have been priced in the premiums, the level of which across the board will be determined by market forces.

As-and-when commissions will ensure that churn is not incentivised. It is not expected that mandated as-and-when commission structures will distort the market for micro-insurance. As the policy contract will by definition have a duration of a year or less, it will be difficult to justify upfront structuring and commission and a constant percentage of monthly premium would be more feasible. Short-term insurance is traditionally sold on an as-and-when basis, made viable by the fact that short-term insurance is subject to higher commission caps than long-term insurance. Micro-insurance will be premised on this model, but with the exception that commission levels will be uncapped, as is currently the case for funeral insurance. A significant proportion of the micro-insurance market, namely funeral policies are sold on a group-underwritten basis, already operates on this basis of uncapped, as-and-when commissions.

This situation will be monitored for any adverse impacts on consumer protection and National Treasury reserves the right to re-impose commission capping, should abuse be found.”

- 4.7.6. It is the view of the Panel that these considerations are persuasive, notwithstanding the important differences that exist between funeral insurance and CCI also at micro-insurance level, and that they should be supported, subject of course to comprehensive disclosure requirements.
- 4.8. To sum up this section: the Panel recommends that in line with the proposals in National Treasury’s Discussion Document, all CCI products with a benefit level below the waterline determined in the manner suggested above, be fully deregulated i.e that there will be no intermediary remuneration restrictions in respect of such micro-insurance products.

5. **THE LEVEL OF REMUNERATION**

- 5.1. As is stated in a previous section of this chapter, the Panel is divided on whether to recommend that the capping of the introduction fee be retained in respect of CCI products with a benefit value above the waterline mentioned above. If it is to be retained, it poses a further series of questions: are the current levels of remuneration for CCI sufficient to sustain intermediaries across the board? If not, what should the remuneration be and who should determine it?

- 5.2. There was some evidence, particularly on the short-term side, that the permitted rates of remuneration were insufficient to cover costs incurred, for instance, in the collection of premiums in rural areas, especially now that single premiums have been outlawed in terms of the NCA.³⁵ But that complaint relates mostly to administration costs which, if the recommendations in section 3 of this chapter are accepted, will no longer pose a problem.
- 5.3. There were no complaints that the level of the introduction fee as such was insufficient but it would nevertheless be the recommendation of the Panel that the whole issue of the level of intermediary remuneration be concurrently reviewed if the other recommendations of the Panel are accepted that certain provisions of the STIA, the LTIA, their regulations, and the NCA be amended.
- 5.4. Any such review, the Panel suggests, should collectively be undertaken by the LOA, SAIA, the FSB, National Treasury and the NCR, taking into account market forces and conditions.

6. WHICH ENTITY SHOULD ADMINISTER CONSUMER CREDIT INSURANCE?

- 6.1. There can be no doubt that the prudential control of the CCI industry should remain with the FSB.
- 6.2. As far as market conduct is concerned, the recommendation of the Panel is that it should be placed under the supervision and control of the NCR.
- 6.3. CCI, as is discussed in chapter 3³⁶, differs from other forms of insurance in a number of significant respects. Its main distinguishing feature is that it is contingent on credit being granted to the consumer by someone other than the insurer. As it was put by Mr **Casserly** in evidence: *“Credit life is not a primary product.”* Its prime purpose is not only to protect the consumer in the event of his or her death, disability or loss of occupation but also to cover the exposure of the credit provider to the indebtedness of the consumer. As such CCI is an ancillary product that is transaction-related. The principal beneficiary if the insured event occurs is not the consumer but the credit provider.

³⁵ Chapter 7 section 4.5 item 6.1.

³⁶ Chapter 3 section 3.

- 6.4. In the view of the Panel the entity exercising control over credit should logically and functionally also be the one to exercise control over CCI.
- 6.5. One of the main purposes of the NCA, as was mentioned in section 1.4 of chapter 3, is “*to provide for the general regulation of consumer credit*”. Consumer credit, in terms of the Act, extends to credit insurance. The NCR is obligated to assume responsibility for consumer protection, inclusive of credit insurance, and is thus par excellence the appropriate authority to whom the principal responsibility for regulating credit insurance ought to be assigned.
- 6.6. As is discussed in chapter 3, credit insurance is the only form of insurance singled out in the NCA. Section 106 of that Act deals specifically with credit insurance. Section 106 (2) provides that the credit provider may not offer or demand that the consumer purchase or maintain insurance that is unreasonable or unreasonably costly. The section does not provide for ministerial regulation by means of the imposition of maximum rates for credit insurance (as opposed to credit agreements) across the board. The reasonableness of the insurance or the costs will thus have to be determined by the NCR on an *ad hoc* basis whenever the issue is pertinently raised with his office.
- 6.7. There is a correlation between what was described in evidence as “extreme profit margins” and the remuneration paid to intermediaries. The evidence, particularly on the short-term side, was that up to 70% or more of the premium can sometimes be apportioned to remuneration paid to the credit provider, dealership or furniture retailer. Short-term insurers seek to differentiate, with an appeal to the FSB’s interpretative note referred to earlier,³⁷ between administrative work falling within the definition of “rendering services as intermediary” and other administrative work done that is not treated as intermediary work. This distinction, in the view of the Panel, is untenable. If it is work that is done for the insurer in the performance of the latter’s contractual obligations towards the insured it is by definition “rendering services as intermediary” and as such it is covered by the legislative cap. The excess may well represent a substantial degree of profit. It will often not matter whether that profit filtrates through to the credit provider, dealership or furniture retailer, as the case may be, or to the insurer since all these entities more likely than not belong to the same

³⁷ Chapter 6 section 2.11 and following.

financially-linked group. The profit settles in the group. Whether such profit is indeed excessive, whether it inflates the premium or the costs for which the consumer is ultimately held liable, are issues that would fall within the jurisdictional reach of the NCR.

- 6.8. The NCA as it stands does not presume to supersede the provisions of the STIA, the LTIA or FAIS dealing with CCI as a subset of insurance generally. It merely expands on the protection for consumers already apparent in those Acts. The suggestion now made is that it should become the main focus for consumer protection in the field of CCI and that a model for doing so should be developed in conjunction with the LOA, SAIA, the FSB, National Treasury and in particular the NCR.
- 6.9. The reasons for this proposal may be summarised as follows:
 - 6.9.1. CCI, as stated earlier, is a derivative of credit. It fulfils a subsidiary or supplementary function. Credit and CCI go hand in hand. As such it is both sensible and practical to combine the main custodial functions relating to credit and CCI under a single regulatory regime, that of the NCR.
 - 6.9.2. The NCA is a brand new specialist piece of legislation dedicated to consumer protection in the consumer credit market. The evidence is that consumers, especially those within the lower economic strata, are prone to being exploited when credit is granted and is combined with CCI in a single package. The NCR is best placed to take effective measures to contain the harm done to consumers in both respects.
 - 6.9.3. The NCA, as it stands, provides for more effective law enforcement mechanisms than the STIA, the LTIA and FAIS. So, for example, the NCR may issue compliance notices in terms of section 55 (“name and shame”), inspectors appointed under section 25 may investigate complaints in terms of section 139 (read with sections 153 – 155) , and the National Consumer Tribunal, established under section 26, is possessed of extensive powers (sections 149 – 152). The Tribunal may also impose an administrative fine of 10% of the respondent’s annual turnover during the preceding year or R1 million rand (section 151).
 - 6.9.4. Moreover, although the NCA has gone some way with credit insurance regulation, expanding on and clarifying some of the principles of FAIS, it can

readily be taken even further e.g. by introducing Ministerial control over the reasonableness of the cost of CCI across the board, especially at the lower income end of the market.

7. **AN OVERVIEW OF THE RECOMMENDATIONS OF THE PANEL ON INTERMEDIARY REMUNERATION**

- 7.1. The recommendation of some of the members of the Panel is that all forms of intermediary remuneration regulation should be dispensed with.
- 7.2. The other view is more nuanced. It is:
- there should be no regulation of remuneration payable to a broker, credit provider, dealership or furniture retailer in respect of CCI products with cover below certain predetermined levels;
 - the introduction fee for CCI products above the said levels should be legislatively regulated and improper incentives in respect thereof should be prohibited;
 - there should be no regulation of the servicing fee which includes any payment for administration work falling within the insurer's contractual obligations to the insured and which is outsourced to third parties, including brokers, credit providers, dealerships or furniture retailers.
- 7.3. The members of the Panel are in agreement in their recommendation that the NCR should assume control of market conduct of CCI as well as of intermediary remuneration where it is regulated.

8. **LEGISLATIVE AMENDMENTS**

- 8.1. The implementation of the proposals put forward in the preceding sections of this chapter would require further discussion and refinement by the LOA, SAIA, the FSB, National Treasury and the NCR.
- 8.2. Ultimately it would, in addition, require appropriate amendments not only to the NCA itself but also to the other Acts referred to earlier to ensure overall legislative effectiveness and harmony. So too it may require revision of the FAIS Code and the LOA and SAIA Codes of Conduct. But until these bodies have decided whether and to what extent the recommendations of the Panel should be accepted and

implemented it would serve little purpose to identify the specific sections that are in need of amendment.

CHAPTER 9

CELL CAPTIVES, UNDERWRITING MANAGERS AND PROFIT SHARING ARRANGEMENTS

1. BACKGROUND TO CELL CAPTIVES

- 1.1. Cell captives are a South African innovation.¹ Before their emergence furniture retailers in particular used to enter into agreements with conventional insurance companies whereby the retailers would market and administer insurance products on behalf of the insurer concerned in return for a commission and an administration fee. The insurer would then share the resulting underwriting profits with the retailer.
- 1.2. Such arrangements were open to the abuse that insurers would pay a fee merely for being associated with the scheme. The FSB subsequently clamped down on such practices, declaring that any profit originating from an insurance transaction should be earned by the insurer or should be paid to the premium paying policyholder.
- 1.3. An innovative response to this dilemma was the creation of cell captives. A cell captive was conceived as a regulated arrangement in terms of which an insurer and a client agreed to cooperate in making insurance products available to consumers as the selected customers of that client.
- 1.4. The client would invest in the insurer by means of a unique class of ordinary or preference shares. The insurer would record all insurance transactions associated with that client as the cell owner in a ring-fenced underwriting account (a “cell”). Commission and administration fees would be paid from the cell and the residual surplus in the cell would be held as retained income for the account of the client investor. Dividends would be declared from time to time, payable to the client.
- 1.5. From a consumer perspective, if not a regulatory one, a cell is mostly invisible. The responsibility for the administration of the cell was placed entirely on the insurer concerned, which had to meet all regulatory and statutory requirements as well as all

¹ Thus Mr **Goedhart** said in evidence: “It [Guardrisk Insurance Company] was formed in 1993 with a short-term insurance licence. The principle offering of Guardrisk was the cell captive structure via a shareholders agreement which was then approved by the Financial Services Board. We claim to be the first cell captive insurance company in the world. There might be some in Bermuda who disagree with us but we were certainly one of the first.”

the obligations to policyholders. In that respect it did not differ from conventionally written insurance.

1.6. Insurers require the prior consent of the FSB to venture into a cell captive arrangement. An important condition in all cell captive insurers' licences issued by the FSB is that no intermediary (broker) may own a cell.² This is due to the inherent conflict of interest that exists between advising a client about a product when the intermediary has an undisclosed vested interest in the product provider.³

1.7. Since the early days of cell captives there have been significant developments in the use and application of cells in the insurance industry.

Cells are nowadays used for third party programmes (such as retailers, cell phone companies, money lenders, motor dealers and the like). Cells have also found application in corporate risk management programmes for own risk (first party) retentions which is a form of self-insurance.⁴ The number of companies authorized to transact cell business has increased markedly,⁵ although few, so it has been said, are truly geared to do so professionally as a core focus.

1.8. The model has found favour because it enables a client of an insurer to function via the insurer as an insurer itself without having to incur the considerable expense⁶ or suffering the delays⁷ or assuming the onerous burden⁸ of incorporating its own insurance company. It provides an opportunity for clients to market branded insurance products to their customers and it allows the cell owner to extract profit from the business conducted through the cell.

² Typically the condition reads: "No cells may be made available to any other insurer or to any insurance intermediary except for purposes of providing cover for such insurer's or intermediary's own risk. Cells may be made available to intermediaries under binder agreements as envisaged in section 48(2) of the Act with the restrictions applicable to that section of the Act."

³ See too section 7 below.

⁴ According to Mr **Goedhart's** evidence: "Then we have first party cells and third party cells. First party cells is where clients subscribe for shares in our company, sign a shareholders agreement, incorporate a cell to write their own risks. On the third party cell side is where clients come to us; incorporate a cell captive in order to sell insurance to third parties."

⁵ According to Mr **Lombaard** of Pinnafrica "the industry is dominated by captive operators."

⁶ In the form of minimum capital and the cost of staffing and satisfying the regulator that the company can be managed properly and will be sustainable.

⁷ In getting the required regulatory approval to establish an insurance company which can be up to a year.

⁸ Of dealing with regulatory requirements such as quarterly returns, compliance with the financial sector charter, compliance with accounting standards and so forth.

- 1.9. By ring-fencing the cell insurance from its other core business operations the client is also provided with direct access to professional reinsurance markets without having to go through a traditional insurer, thereby potentially reducing costs in the supply chain.
- 1.10. Cell captives, in short, provide a cell owner with the opportunity not only to sell insurance products to the client's own customer base but at the same time to retain and finance its own risks.

2. **LEGAL REQUIREMENTS**

- 2.1. Cell captives are overseen by the FSB. Each prospective cell insurer must apply to the FSB for authorisation to operate as such. This involves providing the regulator with a detailed business plan, copies of the proposed cell subscription agreements and material information about the qualifications and experience of the proposed management of the insurer.
- 2.2. A cell may be incepted by any corporate entity. The FSB leaves it up to the authorised cell captive insurer to determine who it wishes to accept as a cell owner. The cell captive owner is, however, required to report to the FSB on a regular basis about cell captive data.
- 2.3. The cell captive insurer assumes ultimate underwriting risk in respect of policies issued in its name, regardless of the existence of a cell agreement. The cell agreement may contain a recapitalisation clause which obliges the cell owner to recapitalise the cell if underwriting results are negative. However, this risk attaches to the insurer and may not be passed on to policyholders. The cell captive insurer must therefore perform a thorough due diligence on all prospective (and current) cell owners to ensure their credit worthiness and business model sustainability.
- 2.4. When the cell owner invests capital with the cell captive insurer, a unique class of preference or ordinary shares is allocated to that client. A cell subscription agreement is entered into which regulates the commercial relationship between the insurer and the client. In addition, agreements may be entered into with the client or with a third party for administration services in connection with policies and claims attaching to the cell. In South Africa the legislation relies on contractual ring-fencing of cells, unlike certain foreign jurisdictions where protected captive cells have been introduced (each cell is protected from the results of other cells). In South Africa the onus of

ensuring that each cell is solvent and that risks are appropriately managed rests with the cell captive insurer's management and shareholders.

- 2.5. The insurer remains responsible for compliance with the relevant Insurance Act and regulations issued in terms thereof. In addition, the insurer may be impacted by legislation and regulations such as FAIS, FICA, the NCA and the PPR.

3. MARKET OPPORTUNITIES FOR CELLS

- 3.1. As a financial services market South Africa lags behind many other countries in the supply of affinity insurance solutions, as a result of which many opportunities exist for affinity groups to leverage these advantages.
- 3.2. The cell captive technology provides a cost-effective method to access these opportunities. In addition, cells provide a low-cost mechanism for BEE entrepreneurs to enter the insurance market, extending financial services to many previously neglected markets.
- 3.3. Furthermore, a number of cell insurers now offer underwriting managers a cell structure as a risk sharing mechanism and as a means to participate in underwriting profits associated with their book of business.

4. TYPICAL OPERATION OF A THIRD PARTY CELL

- 4.1. Cell captive structures are basically, as Mr **Goedhart** put it, "*ring-fenced joint ventures.*"⁹ There is nothing especially mysterious about cell captives. Essentially a cell captive is nothing other than a particular type of financial arrangement between the insurer and the proposed cell owner, believed to achieve commercial synergies for the participants and better financial returns for the cell owner but to which the consumer as the ultimate life insured is not a party. At the outset a cell subscription agreement is entered into and the client invests an agreed sum of capital. The quantum of capital generally determines the extent to which insurance business and risk is retained in the client's cell. The insurer and the cell owner agree a policy wording and rating or a

⁹ Mr **Kemp** described it in his evidence as follows:

"It's a contractual arrangement, it's like a partnership. What happens is, is that the promoter of the cell captive promotes the cell captive and takes a fee. So what we do is we take a percentage of the premium as a fee for providing the cell facility and then the balance of the premium becomes available to the cell owner after the expense of the cell which would include commission to an intermediary and in certain cases claims and management fees which would be paid to other ... (interjection)."

pricing method. An administration agreement is generally entered into with an administrator who is to be FAIS compliant for purposes of policy, premium and claims administration. The cell captive insurer will undertake a due diligence to establish the standing of the prospective cell owner as well as an evaluation of the business plan for the proposed insurance activities. In addition, the insurer will consider the costs to be paid to all parties and the marketing methods to be employed to ensure that these do not exploit the consumer and that regulations are complied with.

- 4.2. On a monthly basis the administrator accounts to the insurer by way of a bordereau relating to premium or claims or both. Premiums are remitted to the insurer net of any commissions and administration fees. Claims are generally reported by way of a claims bordereau which the insurer then pays. The insurer records these transactions in its financial records and prepares a set of cell financial statements for the client. Depending on the risks underwritten in a cell, the insurer itself or a professional reinsurer may reinsure some or all of the policies written in a cell. Reinsurance agreements will typically include a profit commission clause, payable on expiry of all risks underwritten in an underwriting period.
- 4.3. Examples of cell captives are a company, motor manufacturer or dealer which has placed extended warranty and motor plan business into a cell captive. As they manufacture the vehicle parts they are able to control the costs of the claims, thereby reducing the cost of providing the benefit to consumers and increasing their competitive advantage in the market.

5. THE INITIAL QUESTIONNAIRE RELATING TO CELL CAPTIVES

- 5.1. Question 1(f) read:

Do you participate in or run a cell captive/captive (in respect of the product concerned) and if so, please provide a brief description of the structure, the disclosures provided, the criteria for establishing a cell captive/captive and whether an intermediary can establish a cell captive/captive and under what circumstances. How do you deal with potential conflict of interest (if any)?

- 5.2. Eight insurers responded that they are currently parties to cell captive arrangements.

- 5.3. All appeared to be duly licensed by the FSB. The actual arrangements varied from case to case. In some cases the cell owners were trusts, underwriting managers,¹⁰ furniture traders, credit providers or motor dealerships. In some instances administrative work was done for which they were additionally remunerated.

6. THE FOLLOW-UP QUESTIONNAIRE RELATING TO CELL CAPTIVES

- 6.1. The question posed read:

9.1 Do you or do you not believe, and why, that cell captives facilitate:

- (a) a potential conflict of interest vis-à-vis consumers;*
- (b) a lack of transparency vis-à-vis consumers;*
- (c) a means of circumvention commission regulation?*

- 6.2. The question elicited responses from most of the respondents, including those who do not run cell captive operations themselves.

- 6.3. Many recognized the value of cell captives in principle if not always in practice. A sample of answers is given below.¹¹

¹⁰ See section 8 below.

¹¹ **Absa** (a) *A cell captive, properly structured, enables a cell captive owner to provide genuine value to its customers/ consumers by indemnifying certain of their risks in return for a premium. In this sense a cell captive operates exactly like any other insurer so the cell captive structure in itself should not lead to a potential conflict of interest.*

(b) *As mentioned above, a cell captive operates under exactly the same rules regarding disclosures and transparency as any other insurer. Consumers would therefore receive exactly the same information and disclosures (PPR, section 44 etc) as is the case with other insurers.*

(c) *Intermediaries are paid commission through cell captive structures, but, again, as is the case with any other insurer, a cell captive will be bound by the statutory commission regulations.*

Centriq: *“None of the above, provided there is adequate disclosure. Cell captives enable the corporate to have access to their own insurance licence without the regulatory and other administrative burden associated with a wholly owned captive insurance company. They are not about circumvention of*

commission regulations. They are about efficient and effective management of first and third party risks. Also, the party taking the risk in the cell should be entitled to earn the risk profits.

Guardrisk: *Before dealing with each point of this question, we would like to point out that the use of cell captives is similar if not almost exactly identical to the situation that exists where a retail group owns its own insurance company (wholly owned captive) for purposes of marketing underlying insurance products to its customer base.*

Momentum: *Cell captives allow non-insurers to offer insurance products to markets that insurers would not normally have done which ought to be beneficial for the consumer. Cell captives do not facilitate a conflict of interest as the cell owner is in no different position from an insurer providing products directly to the market and the cell is used as an alternative to obtaining an insurance licence and is subject to the same controls as an insurer would be to protect the consumer.*

Nedlife: *Nedgroup Life does not believe there is a potential conflict vis-à-vis consumers. Cell captives are an efficient risk/ reward structure obeying normal assurance principles. Profits generated in cell captives are no different to that generated in a traditional insurer as the same insurance, accounting and regulatory principles are applied. What cell captives do allow for is the participation in risk and reward on specific risks rather than in the general risk as a shareholder in an insurer.*

- 6.4. Many were not unaware of actual and potential of abuse, especially in the context of commission circumventions.¹²
- 6.5. On the issue of possible conflicts of interest there was a divergence of views.¹³

¹² **Absa:** *“Whilst we believe that cell captives offer a viable insurance structure, we believe that certain abuses nevertheless do take place in this market where the structure is misused to circumvent commission regulations. Should cases such as this come to the regulator’s attention, they should be dealt with accordingly, and not be used as an opportunity to attack cell captives as a whole.*

Guardrisk: *No, we are firmly of the view that the cell captive structure does not facilitate circumvention of the regulation. This view is based on senior council opinion that was obtained by the promoters of Guardrisk to facilitate the registration of the company for this business as the first cell captive insurer in the country.*

Hollard: *Yes, we do believe that cell captives could - possibly, in certain circumstances - be a means of circumventing commission regulations where the cell owner is also the insurance intermediary.*

Metropolitan: *Yes. Cell captives allow the cell owners (the intermediary, credit provider, or both) to derive profits from the cell captive far in excess of the regulated commission. Cell captives do not offer any significant advantage in terms of service, costs etc, and so can be said to be used primarily for the reason of deriving profits in excess of commission that would be available otherwise from an insurer.*

Momentum: *The cell captive ought not to facilitate contravention of commission regulations because independent intermediaries may not own a cell.*

Nedlife: *One would think that in order for brokers/intermediaries to circumvent commission regulation, the brokers would need to set up a cell in order to share in the underwriting profits and charge higher premiums to access greater "commissions" than legislation allows. However, the cell captives that we are aware of are prohibited in setting up cells for brokers/intermediaries or their associates. Hence in our view cell captives are not vehicles that organisations utilise to circumvent commission regulation.*

Pinnafrika: *Yes, captives extract profit revenue from the credit insurance portfolio, often in favour of the intermediary, which would otherwise be deemed to be nothing more than delayed commissions in excess of statutory limits.*

Relyant: *We do not believe that cell captives or in-house insurers doing third party business have been set up to circumvent commission regulation. It must, however, be noted that the costs of such business must be properly and effectively reimbursed to the connected parties who handle the insurance activities.*

Wesbank: *Yes, consumers do not understand how their premium is made up and may be paying higher premiums for no added benefit.*

¹³ **Guardrisk:** *No, we do not believe that the use of cell captives specifically facilitates a conflict of interest vis-a-vis consumers. The terms and conditions of the actual insurance contract and the scope of cover is in no way different to what is offered by a traditional insurer or that of a wholly owned captive.*

In the Guardrisk environment where our credit insurance clients predominantly operate in the motor vehicle trade market, the dealerships act as distribution points of products and they generally have more than one product available to market to the consumer. In other words, they do not necessarily only provide the consumer with one option being the policy underwritten by their Group’s cell captive insurer.

However, a potential of conflict of interest may arise in those instances where the dealership/retailer only provides the consumer with one product choice.

This situation is not unique to cell captives but prevails irrespective of the structural relationship between the dealership/retailer and the product provider, which could take the form of either a cell captive, a wholly owned captive, an underwriting manager or a normal agency agreement with any one traditional insurer.

This potential conflict is further limited by the fact that maximum commissions payable to dealerships/retailers are regulated which in practice means that all product providers remunerate the dealership at the same level.

A further potential conflict could arise where the retailer/dealership are part of a group of companies that may ultimately share in additional revenue emanating from the sale of the policies (e.g. profit share arrangements). However, this can easily be managed or overcome by the dealership/retailer disclosing to the policyholder that his group may participate in the underwriting profits (if any of the business).

In terms of claims, we believe that there is absolutely no conflict of interest as the insurance company e.g. Guardrisk is the party that is obliged to pay the claim (and not the dealership/retailer). To the contrary, because of the generally strong branding of the insurance product by the retailer and the primary customer relationship that exists between the retailer and the customer (the sale of the retailers vehicle), claims are generally dealt with in a generally more favourable manner than perhaps would be dealt with in a traditional insurance environment where no such primary customer relationship may exist.

- 6.6. Almost all the respondents supported improved disclosure to counteract the lack of transparency which is typical of cell captives.¹⁴
- 6.7. Many offered suggestions for improvement.¹⁵

Hollard: *We do feel that cell captives could create a potential conflict of interests between the cell owner and consumers. The main purpose of a cell captive is to allow the cell owner to share in the underwriting profits of the insurance business generated through the use of the cell owner's infrastructure, brand equity, "sales force" and client base. Where the cell owner is the decision-maker on the payment of claims (which should not be the case), this could translate into a disincentive to pay claims. This is especially problematic where the cell owner is also the insurance intermediary, which is not the purpose of a cell captive and something that the FSB should supervise. For an insurance intermediary to have a cell captive would constitute a means of earning more than the regulated commission. The FSB some years ago approved the establishment of cell captives in terms of which cell captive insurers issue shares in the cell to the infrastructure owner, conveying rights of ownership to the profit streams on insurance products sold, by way of dividend. An important restriction laid down by the FSB is that the "cell" may only distribute or "underwrite" insurance products which are directly related to the goods and services of the cell owner on the rationale that the latter provides a platform for the delivery of value-for-money, accessible products directly and cost-effectively for both the insurer and the consumer. However, it makes better sense from a prudential point of view to utilise the cell structure than to have a proliferation of small licences.*

Metropolitan: *Yes, Metropolitan believes that cell captives facilitate a conflict of interests because the intermediary stands to benefit handsomely from profits declared in the form of dividends emerging from the cell captive, and thus the intermediary's intentions are generally selfish and they increase premiums as far as possible rather than negotiate the best possible premium for the clients of the credit provider.*

Mutual & Federal: *There is no difference between a cell captive providing these covers or a wholly owned captive in a furniture trader for example. In both instances the furniture trader earns the profits from such transactions. In other words if the Commissioner feels there is conflict of interest because Monarch for example is owned by Lewis Stores then the self same conflict applies in a cell captive. We make no comment however on potential conflicts of interest.*

Nedlife: *Compared to other insurance companies, cell captives provide equal transparency vis-à-vis consumers. Due to cell captive's being insurance companies as well, they need to abide by all regulatory provisions and requirements that normal insurance companies abide by. Hence, transparency relative to a normal insurer would be the same. All marketing material issued by the cell captive states that the cell captive underwrites the business, so the customer is aware of who the cell captive provider is. However, the customer is not aware of who the cell owner is (note they also don't know who the owners of an insurer are either). So there could be a perception of lack of transparency in that regard.*

Regent Life: *It is a conflict of interest as the intermediary has an object interest in assessing matters such as claims payments.*

Relyant: *Cell captives do not lead to a conflict of interest any more than retailing groups have their in-house insurers or particular aligned insurers. Other financial institutions and banks etc all have their own insurance companies. Generally speaking, there is clear transparency and FAIS, the NCA and the applicable short and long term insurance and FAIS Ombudsmen, exercise sufficient control in the marketplace. Consumer groups also act as watchdogs.*

¹⁴ **Guardrisk:** *In addition, we would like to add that there is the potential for transparency to be enhanced by the dealership/retailer disclosing to the policy holder in instances where they may be part of a group that also owns the cell that their group may share in the underwriting profits generated by the business.*

Hollard: *Yes, we do feel that there is - potentially - a lack of transparency vis-a-vis consumers in a cell captive structure. This results from the rather complicated nature of the cell captive structure, which is difficult to explain to a typical consumer. Disclosure needs to be comprehensible and meaningful for the consumer, and needs to cover all potential conflicts of interest.*

Metropolitan: *Yes. Although commission and explicit costs may be declared, the remaining premium, which would otherwise be considered the "risk premium" required by the insurer to meet expected claims, generally consists more of pure profit than any true risk premium. This is not declared to consumers, who are thus unaware of the large profits being derived by the cell owner(s).*

Momentum: *The cell captive environment is highly regulated and each cell is separately audited therefore there is a high degree of control over the business. The only area where there could arguably be more disclosure and transparency is to inform the consumer that the credit provider has an interest in the insurance part of the transaction via a cell captive. However we believe that this is not necessary as these credit life products are branded in the name of the credit provider. For example with Wesbank the policy is actually sold and branded as a "Wesbank Policy". The fact that the policy is underwritten by Ability is in the small print. Therefore the consumer ought to be well aware that Wesbank has an interest in the insurance.*

¹⁵ **Channel:** *It may facilitate all of the above, if the intermediary receives the maximum commission in addition to dividends in a cell captive arrangement. However, as long as the client has an option to take out cover or not and where cover is compulsory, to be provided with alternative cover of his choice, and all these options are disclosed to the client, the potential conflict is addressed. As an*

7. CONCERNS ABOUT CELL CAPTIVES

- 7.1. Cell captives have come not only to fulfil an increasingly prominent role in insurance in South Africa, including CCI, but in all probability have also come to stay. As long as the practice is properly regulated and supervised there is no real call to oppose or discourage it.¹⁶ But there is a potential for exploitation of consumers and this should be recognized and taken into account by the industry and the relevant regulators.
- 7.2. Perhaps the main macro concern regarding cell captives are non-cell captive insurance companies offering unregulated profit participation structures such as offshore trusts which masquerade as “cell captives”. These insurance companies do not disclose their profit sharing mechanisms to the FSB and they are therefore open to abuse and secrecy. Regulated cell captive insurers, by contrast, are required to make full disclosure of their cell operations and report on their cell activities to the FSB as part of their annual statutory return.
- 7.3. That is a matter for the regulator concerned. The Panel recommends that the FSB should award cell captive licences only to insurers with the necessary skills and resources to conduct such business professionally, lest the cell business should become tainted by rogue operators using cells for ancillary reasons such as the circumvention of legislative strictures.
- 7.4. Because of their very nature cell captive structures are less than transparent towards the outside world and thus towards consumers. Consumers in particular may not always be aware:

alternative, the regulating of cell captives may be enhanced, e.g., the minimum capital required. This will ensure that the cell captive is operated soundly and can provide the insurance required.

Regulate cell captives properly so that misconduct does not take place.”

Hollard: *The FSB should implement and supervise the original guidelines that they put in place when it approved the cell captive structure, including a prohibition on insurance intermediaries owning cells. Standards for disclosures to prospective policyholders should be formulated specifically for these structures as standard disclosures used in the industry are not really applicable or helpful.*

Metropolitan: *Either find a way to regulate cell captives or get the FSB to allow insurance companies to be able to issue cells.*

Nedlife: *Cell captives have a role to play as they enable risk / reward sharing of interested parties who have joint interests in extracting value from brands and client bases. The client base benefit from these cell captives as they facilitate value added product offerings. Transparency could possibly be improved by disclosing who the cell owner is to the client.*

Regent Insurance: *Either deregulate commission or regulate cell captives on the same basis as insurance companies.*

Regent Life: *Remove the ability of cell captives being used to manage third party business. Cell captives should only be in place for self insurance.*

Wesbank: *Full disclosure to be given to the consumer. This would include details of what proportion of the premium is allocated to commissions and fees. Also which entity benefits, should there be surplus profits after claims have been met.*

¹⁶ See the responses collected in footnote 11.

- who the actual underwriter is who assumes responsibility vis-à-vis the consumer;
 - what additional payments, apart from the regulated commission, are made by way of dividends or otherwise to a motor dealership or a retailer operating through a cell captive.
- 7.5. This difficulty can, however, be overcome if it is made a requirement in the licence granted by the FSB that cell owners disclose such matters prominently to consumers, including their own interest in the cell captive structure.
- 7.6. As stated earlier in this chapter, it is invariably a requirement of a cell captive licence that an intermediary is not permitted to be a cell owner or an active participant in a cell captive structure. What appears to be contemplated in this connection are intermediaries in the conventional sense of a broker or someone in the position of a broker.¹⁷ The problem, as was pointed out earlier, is that “intermediary”, because of the wording of the two insurance Acts, has assumed the extended artificial meaning of someone who, apart from introducing the business, renders intermediary services as defined; consequently, the product supplier or the credit provider who additionally renders intermediary services by definition becomes an intermediary.¹⁸ Strictly speaking, such entities should thus be prohibited from operating as cell owners or from profiting from cell captive structures whereas in practice these are frequently the very businesses that enter into cell captive arrangements.
- 7.7. This consideration has a bearing on two potential malpractices: conflicts of interest and commission contraventions.
- 7.8. *Conflicts of interest* may occur because a motor dealership or a retailer would most likely be inclined to persuade the consumer to patronise the insurer with which the dealership or retailer is in a cell captive relationship rather than a rival insurer, contrary to the free choice rule referred to elsewhere.¹⁹
- 7.9. The problem of the potential conflicts of interest can be addressed if it is made a requirement of the issue of the licence and of the shareholders’ agreement that consumers who agree to take out insurance be duly informed of the existence of the

¹⁷ See chapter 6 section 2, 3 and 13.

¹⁸ See chapter 8 section 4 and 10 chapter 1 section 1.

¹⁹ See chapter 11 section 2.

captive cell arrangement and of the additional remuneration the motor dealership or retailer may in the result receive.

- 7.10. But there is also a second side to it. Because claims are paid from the proceeds of the cell and because any surplus in the proceeds is distributed to cell owners by way of dividends, the dealerships and retailers may be conflicted in being disinclined to settle claims as readily as would otherwise have been the case.²⁰
- 7.11. There is no simple solution to this point. It may well be more of a notional than a real problem but if it does occur it will be a case of a legitimate claim not being met, leaving the unsuccessful claimant with his or her remedies in law and through the relevant ombudsmen's organisation. But to the extent that it is a potential problem the FSB should bear it in mind in designing the licence it grants to particular cell owners.
- 7.12. *Commission contraventions* also have two aspects to it. The first is this. Where the dealership or retailer is a cell owner who also brings in business and does administrative work it is only entitled to the maximum permissible remuneration in terms of the two Acts. Any additional payment to another administrator (not being an underwriting manager in terms of section 48(2) of the STIA²¹) for also doing administrative work in respect of the same policy (as opposed to administrative work in connection with the cell captive operation²²) would be a contravention of the regulations since the remuneration is to be split where the administrative work is shared or duplicated.²³
- 7.13. The second aspect relates to the payment of dividends. If the dealership or retailer receives the maximum permitted remuneration as intermediary, any further payments made by way of dividends may be construed as a contravention of the commission regulations.
- 7.14. The short answer may be that the dividend payment is not conceived as remuneration for administrative work done as part and parcel of the insurer's obligations in implementing the policy²⁴ but is a return on an investment made and for a commercial

²⁰ See chapter 10 section 1.

²¹ See section 8 below.

²² See chapter 10 section 1.

²³ STIA regulation 5.1(3); LTIA regulation 3.2(3).

²⁴ See chapter 10 section 1.

- risk undertaken. If that is the true intention with the dividend payment it would not be affected by the intermediary remuneration regulations.
- 7.15. But of course that begs the question whether the cell capture structure may not in fact have been intended as a mere device or pretext for side-stepping or evading intermediary remuneration restrictions. That would always remain a question of fact and evidence, discussed in the section following. As a general proposition, and considering the rigmarole involved in establishing and the burden of administering a legitimate cell captive arrangement, it is in the opinion of the Panel somewhat unlikely that this would generally be the real but disguised purpose behind any cell captive business.
- 7.16. On the other hand, evidence was presented to the Panel that appeared to support the inference, firstly, that cell captive structures were on occasion being misused to circumvent commission restrictions on intermediaries and, secondly, that this was not an isolated instance.
- 7.17. The evidence was to the effect that the owner of a cell captive approached a motor dealer to become a “sub cell holder” in the cell.²⁵ In this manner the dealer would “share in the profitability of the policies sold by your dealership to the end customer”. The dealer would receive commission at the rate of 20% on credit life insurance. “In addition to this, for Credit Life, you will get a 10% administration fee. This brings your total upfront income on the Credit Life to 30%”. It was then demonstrated to the dealer what his total income would be, including the dividends that would accrue to him from the cell captive, based on a 10% claims rate.²⁶ The result of all this would be: “Assuming that the claims history was 10%, the DIVIDEND THRU OUR STRUCTURE would increase your net income after tax by 206%”.
- 7.18. In presenting the proposal the owner of the cell added: “The Deal has been set-up by one of the largest Independent Dealers in SA who felt that they were not getting a FAIR & TRANSPARENT deal on the Credit Life & Top-up products that their dealerships sold.”

²⁵ In a proposal the “rewards” were described as:

“ - Lower the claims, the greater is the Profitability
 - Credit Life & Top-up are one of the most lucrative insurance businesses
 - Potentially enormous reward for Non-insurance company to enter.”

²⁶ “Claims history can vary and 10% is just used for illustrative purposes. Industry experience shows that average claims are around this mark”.

- 7.19. The possibility can also not be discounted that insurers may be paying profit shares to retailers and other affinity groups on business originated by them; and that these are dressed up as royalties and administration fees to circumvent commission regulations. Evidence to that effect, relating to specific insurers, has not, however, been placed before the Panel.²⁷
- 7.20. Another fear that was expressed was that cell captives may have the unintended consequence of inflating premiums.
- 7.21. Finally, there were insurers who expressed concern that cell captives introduced a form of unfair competition as between insurers. The short answer is that nothing prevents them from also entering this field if it is sufficiently profitable for them to do so. If the proliferation of cell captives or the manner in which this form of business is being conducted should reach proportions that are regarded as harmful or unhealthy to the industry as a whole regulatory bodies are in place which are able to intervene and cope with any undesirable practices that may in time develop. As far as the Panel is able to discern the commercial advantages of cell captives outweigh their potential hazards for consumers, provided that these hazards are properly managed, as is suggested above, by both the industry itself and the various regulatory bodies.

8. UNDERWRITING MANAGERS

- 8.1. In the CCI distribution chain a distinction is apparent between:
- (i) intermediaries operating as conventional brokers, a species, according to the evidence, not conspicuous in the CCI space;
 - (ii) intermediaries introducing or generating new business for insurers, earning an introductory fee which is regulated;²⁸
 - (iii) intermediaries acting as administrators to whom administrative work is outsourced by insurers. The administrative work can consist of:
 - (a) performing administrative services in implementing the policy which the insurer is itself obliged to perform, such as issuing the policy, collecting

²⁷ See too section 9 below.

²⁸ Chapter 6 sections 2 and 13, chapter 8 section 3 and chapter 10 section 1.

- premiums, settling claims and effecting payments, the fee for which work is regulated²⁹; or
- (b) administrative work of a different kind e.g. managing a cell captive on behalf of the insurer, the fee for which is not regulated;
- (iv) intermediaries mandated to function as underwriting managers (“um’s”) under section 48(2)(c) of the STIA.³⁰
- 8.2. Um’s are entities having a particular contractual relationship with insurers in terms of so-called “binder agreements”, the minimum content of which is stipulated in section 48(2).³¹
- 8.3. The remuneration of um’s is not subject to the limitations that apply to the categories of intermediaries referred to above.³² They may thus receive remuneration in excess of the prescribed maximums and may furthermore be remunerated for additional services they render.
- 8.4. Typically an insurer would outsource a specialist field of short-term insurance (e.g. crop, professional indemnity, marine or motor warranty insurance) to an um who has the technical expertise and experience to underwrite and administer the particular type of insurance. The insurance risk may be placed with the insurer in question, with or without reinsurance, or it may be dealt with through a cell captive arrangement.³³ Insurers frequently have an understanding with such um’s and may even own one hundred percent of the shares in the um.
- 8.5. Um’s do not normally deal directly with members of the public in entering into policies.³⁴ Usually a broker is involved to deal with consumers.
- 8.6. Because of their specialised skills um’s are treated as a category on their own. As such they fulfil a valuable role in providing a mechanism to underwrite specialized forms of insurance in an efficient and cost-effective manner.

²⁹ The view of the Panel is that this is intermediary work as defined in the two Acts and their regulations. See chapter 6 sections 2 and 13, chapter 8 section 4 and chapter 10 section 1.

³⁰ The term “underwriting manager” is a remnant of the previous STIA. It is not used as such in the new Act but is still in common usage in the industry.

³¹ There is no equivalent of this section in the LTIA.

³² STIA section 48(2)(c). The binder agreement may contain a clause that the um is entitled to any remuneration other than by way of commission only. See too section 48(3).

³³ Sections 1-7 above.

³⁴ STIA section 48(3)(c).

- 8.7. But the topic is by no means free from difficulties. Section 48(2) is notoriously difficult to interpret in respect of matters not of immediate concern to CCI³⁵ and is patently and universally believed to be in need of revision.³⁶
- 8.8. One such problem, which is relevant, arises from section 48(2)(c) read with section 48(3). Section 48(2)(c) draws a distinction between two kinds of independent intermediaries:
- (i) those entitled to be remunerated by way of regulated commission only; and
 - (ii) those entitled to be remunerated other than by way of regulated commission only.
- 8.9. In terms of section 48(3) an independent intermediary of the second kind may not be associated, in entering into a policy, with another independent intermediary (of the first or second kind) who is rendering services as an intermediary or who has received an application for a policy, if the other independent intermediary falls into any of the four categories of relationships referred to in the subsection (shareholding, creditor-debtor, defined family relationship).
- 8.10. Having regard to responses received, two questions arising from the wording of section 48(2) exercised the mind of the Panel:
- (i) can one independent intermediary be remunerated, both in full as a section 48(1) independent intermediary (regarding regulated commission) and as a section 48(2)(c) independent intermediary (regarding unregulated remuneration) in respect of the same policy?
 - (ii) can two independent intermediaries be remunerated in respect of the same policy, the one receiving full regulated commission in terms of section 48(1) and the other unregulated remuneration as a section 48(2)(c) intermediary?

³⁵ So, for instance, the FAIS registration of um's is an issue between the FSB and the short-term industry. Furthermore, an insurer is only allowed one underwriting manager per "kind of policy", which limits the insurer's ability to outsource to intermediaries and from competing with its own underwriting managers. This has resulted in different interpretations as to what "kind of policy" means. Is a motor policy with a different brand or aimed at particular affinity group or particular type of car a different kind of policy? Some insurers interpret "kind of policy" as class of business and use um's for specialization - other insurers have many motor um's for example with each motor policy being a different 'kind' of motor policy. This list of problems mentioned is not exhaustive.

³⁶ Any such revision will of course be coloured by any revisions done to section 48 of the STIA in accordance with the recommendations suggested in chapter 8.

- 8.11. The answer to the first question, in the view of the Panel, is no and to the second is yes.
- 8.12. The reasoning in respect of the first question is this:
- section 48(2)(c) contemplates a term in the agreement entitling the administrator to “any remuneration other than by way of commission only”; - there is thus a contradistinction between these two forms of remuneration;
 - the administrator is entitled to the former;
 - the administrator is entitled to it “only”;
 - hence the administrator is not entitled to the commission “also”.
- 8.13. The reasoning in respect of the second question is this:
- section 48(3)(b) of the STIA, as stated above, contemplates two kinds of independent intermediaries: one entitled to commission and the other entitled to remuneration other than commission;
 - an intermediary of the second kind shall not “enter into any short-term policy in relation to which another independent intermediary” (of the first or second kind) “render (sic) services as intermediary” if the other falls within categories (i) to (iv) mentioned in the subsection;
 - that implies that if the other does not fall within the prohibited categories, the intermediary of the second kind may be so associated with the other.
- 8.14. This reasoning leads to a further conclusion: if the two kinds of intermediaries may not be so associated if they are, as it is stated in category (iv), “related within the second degree of consanguinity or affinity to the former”³⁷, it follows *a fortiori* that one and the same intermediary cannot assume the persona of both kinds of intermediaries and claim both kinds of remuneration. Put differently, if two entities so related, wearing two different hats, cannot be so associated, one entity, purporting to wear two hats, cannot do so either.
- 8.15. But because their remuneration is not limited even when they render administrative services that would otherwise have been subject to commission regulation it does create the opportunity for “remuneration arbitrage.”

³⁷ An argument has been raised by one of the insurers that the phrase “consanguinity or affinity” refers to natural persons only and hence not to company structures. “Consanguinity” may linguistically well refer to natural persons only. But that implies that “affinity” has a different meaning and is not so restricted.

- 8.16. Since um's may also share in the profits arising from the business that is under them it furthermore creates potential conflicts of interest.
- 8.17. In this regard the Ombudsman for Short-term Insurance has expressed concern about the way some um's conduct themselves. They have the insurers "underwriting pen" and are mandated to underwrite business and pay claims. To all intents and purposes they act as insurers, without being exposed to the insurance risk and without the disciplines that are relevant to insurers being applied to them. The Ombudsman has specifically pointed to the fact that there is an incentive to repudiate claims as this will lead to enhanced profit and, insofar as there are profit-sharing arrangements in place, a larger income to the um.
- 8.18. Respondents were asked, in the follow-up questionnaire:

10.1. Do you or do you not believe, and why, that underwriting managers facilitate:

- (a) a potential conflict of interest vis-à-vis consumers;*
- (b) a lack of transparency vis-à-vis consumers;*
- (c) a means of circumvention commission regulation?*

10.2 If so, what do you suggest should be done to improve the situation?

A sample of responses is given below.³⁸

³⁸ **Absa Life:** *We do not believe that underwriting managers (um's) facilitate a conflict of interest, as they perform specific administrative and specialist underwriting functions for which they are remunerated. Essentially, they are performing services that the insurer could itself provide if it had the in-house expertise and capacity. It has become a wide-spread practice to utilise the services of um's specifically for niche and highly specialised areas of insurance business. They in turn work through intermediaries to source business, and the latter are remunerated according to the applicable commission regulations. There is a segregation of tasks and services between the UM and the intermediary, and each is remunerated accordingly.*

Centriq: *None of the above. Underwriting Management Agencies are outsource arrangements allowing the insurer access to underwriting skills which would not otherwise be available. Underwriting Management Agencies are not about circumvention of commission regulations. They are rather about synergy in business.*

Holland:

(a) No, we do not believe that underwriting managers ("um's") facilitate a potential conflict of interests vis-a-vis consumers, provided that they are structured and managed by the insurer concerned in accordance with the regulation. In terms of section 48(2) and (3) of the Short-term Insurance Act ("STLA"), an underwriting manager (which is what it was called under the 1943 Insurance Act – the 1998 STLA only refers to it as a section 48(2) and (3) intermediary) is an intermediary that "earns other than by way of commission only", i.e. it earns commission, profit shares, administration fees and/or a combination of these. An ordinary commission-earning broker may not be remunerated in this fashion. Section 48 contemplates three types of intermediaries – the um, an ordinary commission-earning broker and a broker with binding authority, which also earns commission. The latter two may also be remunerated by way of administration fees for performing administrative work on an outsourced basis for the insurer, which would not normally be classed as "intermediary services" under section 48 of the STLA. The um is an insurer agent and is not permitted to take applications for insurance directly from consumers, although it may deal directly with policyholders on other matters relating to their policies. It may only take applications for insurance from ordinary independent intermediaries. There is consequently no risk of a conflict of interests. A conflict may only arise if an ordinary intermediary is styled as a um in order to earn "other than commission only" as contemplated in the STLA (the LTIA does not currently recognise um's, although the Act is being amended to correct this). In this latter instance there is a conflict of interests, as the intermediary is incentivised not to shop around for the best deal for the customer, and is additionally responsible for adjudicating claims on business it has introduced. An

8.19. Section 48(4) of the STIA makes the insurer contractually responsible for policies written by an um but this may not necessarily be sufficient to ensure that the potential abuses mentioned above are properly addressed and that consumers are not in the result prejudiced.

insurer may not have more than one um per kind of policy - this is to prevent any conflict of interests. Unfortunately, this does not always happen in practice. Consequently, a consumer may be faced with multiple products from one insurer, whether a um is employed or not, which is not the fault of the um: this complexity is caused by section 48 of the STIA itself which is vaguely worded and which has resulted in some regulatory arbitrage.

(b) No, we do not believe that underwriting managers facilitate a lack of transparency vis-a-vis consumers. However, some um's in the market are not um's in the strict sense of the Act, as stated above. This may constitute a misrepresentation and result in a lack of transparency about their true nature. Our comments under (a) are here equally applicable.

(c) No, we do not believe that underwriting managers are a means of circumventing commission regulations - but we must qualify that statement by saying that this is provided that the Act is strictly adhered to. We are aware that there are so-called "underwriting managers" operating in the market that do not meet all the criteria in the STIA, in order to earn more than the regulated commission. um's may earn a share of the profits and administration fees in addition to commission in terms of the STIA. This is attractive to an ordinary intermediary, who is strictly speaking an ordinary commission-earning broker and who may not earn more than the capped commission amounts, depending on the type of policy. A um's role is aligned to that of the insurer.

10.2 *If so, what do you suggest should be done to improve the situation?*

We suggest firstly that section 48 needs to be reworded and refined to adequately describe, define and regulate the different types of intermediaries. The definition of "underwriting manager" in the 1943 Insurance Act was clearer than the current one. The definition of "services as intermediary" needs better definition too. Genuine um's should be encouraged to become members of the South African Underwriting Managers Association (SAUMA), which has been established under the auspices of the SALA – previously regarded as the mouthpiece of um's by the FSB - and to subscribe to their Code of Conduct. There should be a different form of accreditation and supervision for um's as they are not conventional intermediaries and serve a useful role as an "outsourced" division and product "risk manager" of an insurer, to all intents and purposes, an insurer without a licence. It makes more prudential sense for the industry and the FSB to have properly managed and regulated um's operating under the umbrella of well-regulated and well-capitalised insurers, than a proliferation of small niche licences for all um's, with their attendant financial soundness and capital adequacy issues. Um's promote greater, specialised product choice for consumers. Finally, we feel that Treasury needs to look at commissions in the short-term industry: the regulation has not kept pace with the market or the economy. The regulated commission is insufficient for ordinary commission-earning brokers to run a worthwhile business and they need and do supplement their normal duties with outsourced work - some of which is insurer work - on behalf of the insurer, for a fee or as an "underwriting manager". These comments should not detract from our view, however, that stricto sensu, underwriting managers are a valuable and simple structure. We believe that the solution to all these obfuscating structures is to deregulate and de-cap commissions with complete transparency and disclosure of all and any information that would impact on an intermediary's ability to give completely independent advice to a policyholder. The only distinction to be drawn then would be between a wholesale (um) intermediary and a retail one (a normal broker).

Relyant: *We are not sure why, in respect of this submission and questionnaire, underwriting managers have been addressed. An underwriting manager may deal only via an insurance broker. This is prescribed by legislation. We hold the view that the Insurance Act should allow underwriting managers to deal directly with clients as an underwriting manager is the agent and representative of the insurer and acts as a quasi branch.*

The Short-Term Insurance Act clearly sets out issues relating to the ownership of an underwriting manager with which we agree. Generally speaking, we have not noted underwriting managers dealing particularly in credit insurance as such activities are handled via the lending institutions themselves and aligned brokers or independent brokers.

8.20. Um's clearly have a valuable role to play, also for CCI. We would therefore recommend:

- that um's be accepted as an integral part of the delivery of insurance services to the market;
- that any regulatory ambiguity with regard to um's be determined by the regulator, more particularly the NCR;
- that guidelines for um market conduct be drafted with a view to the avoidance of remuneration arbitrage and potential conflicts of evidence in the field of CCI;
- that such guidelines be drafted by the dedicated composite committee referred to in chapter 12³⁹ in conjunction with the FSB and the NCR.

8.21. A further issue to be considered is whether there is a need for analogous legislation in the long-term insurance market. The view of the Panel is that this would only be a potential issue if the Panel's recommendations in chapter 8 relating to intermediary remuneration are not accepted.

9. PROFIT-SHARING ARRANGEMENTS

9.1. Profit-sharing arrangements are an inherent dimension of both cell captive and um agreements, and legally so. As indicated, there are opportunities for abuse and recommendations in this regard have been made above.

9.2. Profit-sharing arrangements with intermediaries other than those in FSB approved cell captive arrangements or um's are clearly not permissible within the ambit of the intermediary remuneration limitations imposed by the regulations. Any excess over the permitted limit would constitute a contravention in terms of the statutory provisions discussed in chapter 6.

9.3. Respondents were asked in the first questionnaire whether they had "*any other profit share arrangement with intermediaries rewarding them for quality or quantity of business on a collective basis*" One respondent only owned up to a profit share arrangement with a motor warranty administrator "for good risk management." Taking the response at face value, this was not regarded by the Panel as a form of payment for administrative work within the meaning of the relevant regulations.

³⁹ Chapter 12 section 3.6.

CHAPTER 10
INSTANCES AND ISSUES OF NON-COMPLIANCE WITH INTERMEDIARY
REMUNERATION REGULATIONS

1. THE PANEL'S APPROACH

- 1.1. The Terms of Reference, fairly interpreted, require the Panel, amongst other things:
- to make recommendations on improvements to the present regulatory environment; and
 - to investigate possible contraventions of restrictions in the LTIA and the STIA, as well as in the Codes of Conduct of the LOA and SAIA, of remuneration paid to intermediaries.
- 1.2. Item 7 of the Terms of Reference states: *“This is essentially an enquiry into market practices that may impact negatively on consumer protection rather than into the practices of individual companies. Should it nevertheless be deemed necessary to single out one or more companies in the report such company or companies will be afforded a reasonable opportunity of responding to what is proposed to be said about it or them in the report.”*
- 1.3. One of the Panel's key recommendations¹ is that the regulation of the servicing fee should be scrapped. But it may not happen and as long as the servicing fee remains on the statute book as a regulated item the uncertainty as to its proper interpretation will persist. The Panel believes that it is necessary, as guidance for the future and thus for the sake of consumer protection generally, to describe and comment on some of the practices and structures of individual insurers it encountered in the course of its enquiry.
- 1.4. The other area of concern related to payments made to intermediaries in terms of section 48(1) and to underwriting managers in terms of section 48(2) of the STIA.² The Panel came to the conclusion firstly, that one independent intermediary may not be remunerated, both in full as a section 48(1) independent intermediary (regarding regulated commission) and as a section 48(2)(c) independent intermediary (regarding unregulated remuneration) in respect of the same policy; and secondly, that two independent intermediaries may be remunerated in respect of the same policy, the one

¹ See chapter 8 section 3.

² See chapter 9 section 8.

receiving full regulated commission in terms of section 48(1) and the other unregulated remuneration as a section 48(2)(c) intermediary, but not if they are inter-related companies in the same group of companies.³

- 1.5. Whenever the Panel came to the provisional conclusion that there was evidence that a practice of an individual insurer appeared to contravene the commission regulations, such insurer was first invited to respond to what the Panel proposed to say about it. All the insurers who were so informed duly responded and in several cases the Panel was satisfied with the explanations received.
- 1.6. Some insurers were, however, informed that they would be mentioned by name in the report, for the reason stated above, but in not a single instance was it found necessary for the Panel to make a recommendation that any further action be taken against any insurer by the LOA or SAIA.
- 1.7. Some of those insurers objected to being named on the ground that it would be interpreted as a “naming and shaming” exercise. That is not the intention of the Panel and having regard to what is actually said about individual insurers in the paragraphs that follow, and in the absence of any allegation or imputation of impropriety on the part of any individual insurer, the report is not reasonably capable of being so construed.
- 1.8. The Panel did not regard it as part of its function to analyse and draw conclusions on whether individual transactions of individual insurers may have contravened some or other legislative provision. Its conclusions relate to general practices and not to individual transactions.
- 1.9. Some insurers reported that in the course of preparing their responses to the initial questionnaire they discovered isolated instances of what, on reflection, appeared to be contraventions of the commission regulations.⁴ These irregularities have all been corrected and in the view of the Panel need not be separately tabulated in this report.

³ See, chapter 9 section 8.

⁴ Examples are: an insurer paid a bank with which it is associated an incentive fee, apart from the regulated commission, for introducing a new retail branch sales incentive scheme. The payment was reversed. In another case an insurer’s sales representative, without authority to do so, promised payments in excess of the regulated commission to a motor dealership. The promise was later retracted by the insurer and no payments were actually made. A third example occurred when a management decision was taken to switch short term credit life insurance business from one company in a group to a life company in the group. The commissions and fees for the services structure were inadvertently replicated.

- 1.10. In chapter 6 the Panel analysed the law on intermediary remuneration as it currently stands and in chapter 8 it made certain recommendations as to how the situation can be improved for consumers generally.
- 1.11. In looking at possible contraventions of the two Insurance Acts, their regulations and the industry codes, the following considerations were taken into account:
- the matter was in each case approached on the footing of the law as it stood at the time the contraventions were thought to have been committed;
 - the law on intermediary remuneration as it currently stands is more fully described in chapter 3 section 1.2 and chapter 6 sections 2 and 3;
 - the LOA Code but not the LTIA nor the STIA or their regulations contains express prohibitions against rewards or incentives being paid by insurers to intermediaries;
 - the prohibition is simply to the effect that remuneration may not exceed the prescribed maximums laid down;
 - non-monetary rewards or incentives are, however, expressly prohibited under both Acts;
 - the LTIA and its regulations in effect distinguish between the introduction and the servicing fee with a separate maximum percentage of the premium for each;
 - the STIA and its regulations also distinguish between these two kinds of activities but has a composite fee in the form of a percentage in respect of motor business as opposed to other types of business;
 - the LTIA, but not the STIA, draws a further distinction, for the purpose of determining the permitted tariff, between:
 - (a) life policies providing term cover only which are (i) individual policies or (ii) incorporated in group schemes which are credit schemes either with or without administrative work and
 - (b) health and disability policies which are (i) individual policies or (ii) incorporated in group schemes which are credit schemes either with or without administrative work. Administrative work is defined to mean “*work in connection with the handling of enquiries, maintaining administrative records and the receipt and processing of claims under a group scheme*”;

- where the consumer (and not the group common denominator⁵) is the policyholder the scheme is by definition not a group scheme and any rate claimed for administrative work would thus constitute a contravention of the regulations.
- 1.12. The issue that is most controversial centres on the payment of remuneration by insurers to motor dealerships, furniture retailers or other credit providers for administrative work done or other services rendered or for value received.⁶
- 1.13. On the Panel's interpretation of the phrases "services as intermediary" and "independent intermediary" in both the LTIA and the STIA and their regulations, any outsourcing by an insurer to an outsider of any of the functions falling within the description of such services would be subject, as far as the payment of remuneration for it is concerned, to intermediary remuneration regulation in those Acts.
- 1.14. The activities mentioned in the legislation (leaving aside the introduction of new business) and for which remuneration is payable up to the prescribed maximum, are all functions which the insurer is in any event obliged to perform in terms of the express or tacit terms of the policy, either by itself or through an agent or sub-contractor.
- 1.15. The approach adopted by the Panel, in deciding whether an insurer overpaid an intermediary for outsourcing administrative work or for other services or goods, is essentially a practical one: whether such work, services or goods are in any event due by the insurer in terms of the policy. If yes, only the stipulated remuneration is permitted and any excess paid would represent a contravention; if no, there is no restriction on the amount that may be payable.
- 1.16. To this there is one caveat: the transaction must be genuine and not, judged on the probabilities, a disguised payment for introducing business or for doing administrative or other contractual work.⁷
- 1.17. Activities that would typically fall within the concept of regulated activities would include:
- preparing and processing the application form;

⁵ See chapter 6 section 3.12.

⁶ See chapter 6 sections 2 and 3 and chapter 8 sections 4 and 8.

⁷ See chapter 8 sections 3 and 8.

- preparing and issuing the policy;
 - dealing with enquiries;
 - sending out notices;
 - collecting or receiving premiums;
 - processing non-payments and lapsing of policies;
 - receiving and evaluating claims;
 - settling claims;
 - repudiating claims;
 - dealing with ombudsman's queries.
- 1.18. Activities that would normally fall outside the range would be:
- product design;
 - designing and supplying stationery;
 - head office functions;
 - call centre functions;
 - IT work;
 - advertising and marketing;
 - head office functions;
 - keeping records, and the like.
- 1.19. Where the same entity performs functions falling into both categories the intermediary remuneration is only limited in respect of the first category. The composite fee will notionally have to be apportioned between the two parts. To the extent of the excess there is no contravention.⁸
- 1.20. So too, where different entities perform different functions falling into the first category qualifying them for different fees, no more than the regulated remuneration is payable to them in aggregate. The stipulated remuneration will either have to be apportioned between them or the overpayment will constitute a contravention of the regulations.⁹
- 1.21. Against that background the Panel assessed certain industry practices that were disclosed in the initial and follow-up questionnaires and in the course of the evidence given at the hearings.

⁸ See chapter 6 section 2.22.

⁹ See chapter 6 section 2.23

1.22. What is said in the paragraphs that follow about the structures of some individual insurers would naturally also apply to other insurers which did not participate in the enquiry but adopted substantially identical practices.¹⁰

2. PAYMENT OF REMUNERATION IN EXCESS OF THE STATUTORY MAXIMUMS

2.1. As discussed earlier, the remuneration payable for the rendering of intermediary services is pegged at different levels. The relevant level will depend on the interpretation of the definitions of “intermediary services” in the two Insurance Acts and their regulations.

2.2. Those definitions are far from lucid and insurers and intermediaries cannot be blamed for not always being certain whether a particular payment practice was permitted or not. It is not surprising that different insurers mentioned that they took the precaution of soliciting legal advice on the legitimacy of proposed practices.

2.3. The Panel has its own views on how the situation can be rectified in future,¹¹ but for present purposes it has to determine whether payments made to intermediaries by some insurers fell foul of the regulations as they stand at present.

2.4. The Panel came to the conclusion that some contraventions of the relevant commission regulations did occur. That too was the effect of testimony given in general terms. On the evidence placed before it and on the view the Panel took of the meaning of “administrative work” and of section 48(2) of the STIA, structures put in place by some insurers, invariably on the basis of legal advice obtained, are not, in the opinion of the Panel, in conformity with the regulations. There may be other instances as well but the Panel could only act on the evidence that was presented to it.

2.5. Regent Life Assurance Company Ltd.

2.5.1. It is appropriate to commence with this company, a member of the LOA, since it was a report about it in the financial press that triggered the present enquiry.

2.5.2. In its response to a request for information in the initial questionnaire, “*relating to practices from 1 August 2006 to current*”, the following was said:

¹⁰ Appendix 7 is a list of insurers which did participate in the enquiry.

¹¹ See, in general, chapter 8.

- (i) *“In the past we have paid intermediaries for other services rendered. The primary service that was rendered was the provision of their database of clients in order for us to utilize this to sell additional policies...This practice has been stopped entirely.”*
- (ii) *“In addition to this we paid amounts of approximately 1% to 2% of the premium directly to the sales agents of the intermediaries concerned. This practice has been stopped entirely.”*
- (iii) *“Purchase of client information as a fixed fee per lead from an entity that does not perform any sale of policies or receive any commissions.”*
- (iv) *“Payment made for useage of brand and database. Practice stopped.”*
- (v) *“Payments made for sales generated through a telecentre in certain instances exceeded the maximum commission payable, which was shared between the telecentre and the intermediary. The practice was stopped.”*

2.5.3. Mr **Hoosen** gave evidence on behalf of the company. His evidence is summarized in chapter 7.

2.5.4. Mr Hoosen was confronted with the gist of the reports in Personal Finance of 7 and 14 July 2007 which caused this enquiry to be launched.¹²

2.5.5. The allegations as far as commission contraventions were concerned were that *“overrider commissions”* were paid to motor dealerships of 27.5% of premiums or more, which meant that dealerships were paid total commissions in excess of 50% of the gross written premium (GWP).

2.5.6. These allegations were not denied. Regent Life’s explanation, as appears both from the report and par 2.5.2 above, was that the payments, to quote the report, *“were for the dealers to provide Regent Life with client data.”*

2.5.7. The practice of payments made for the use of their client data base to third parties who also happen to be intermediaries as defined, is further discussed below. The view of the Panel is that the practice is not prohibited by the commission regulations, provided that the payments were genuinely conceived as consideration for the use of the data base and not as a contrived means of additional payments for introducing the product or doing administrative work.

2.5.8. The issue is, therefore, whether the payments made by Regent Life fell within the proviso.

¹² A copy of the report of 7 July 2007 is annexed as Appendix 1.

2.5.9. In the report reference is made to a “*Smoking gun left in the inbox*”. In it, addressed to executives, Mr Hoosen was reported to have said:

“I am enclosing an agreement which all dealers need to sign for any payment they receive that is in excess of the 25.6%. We will treat this as a payment for advertising and the use of their databases...”

2.5.10. Regent Life subsequently gave the following explanation for the email: “*The gist of the background to the email was as follows: due to our concern over the excess payments made to intermediaries we decided to stop these payments. We realised however that if we did so we would be uncompetitive. We accordingly embarked upon investigating a legitimate solution to remain competitive. Having taken legal advice we decided to pay the intermediaries for their data that could be productively used through mining the data and conducting sales on that basis. On an arms length basis without the intermediaries having to sell any policies on our behalf, we found this to be a viable business proposition that would realise a return on capital or funds paid. As such the email was a blanket instruction to our sales management to go ahead and negotiate this with intermediaries. It was not a contrived attempt to legitimize the additional payment as you seek to suggest but a genuine payment in line with our legal advice.*”

2.5.11. In view of the close link between the cessation of the admittedly excessive payments and the newly conceived payments for the client information, the Panel remains unconvinced that the payments for data base were not on the probabilities intended as a form of substitute additional payment to dealerships. Although the information received was no doubt valuable to the company in generating new business this, in the view of the Panel, was incidental and not the prime reason for the payment. To the extent that the aggregate of the payments made to the intermediary concerned exceeded 22.5% of the premium permitted, such payments constituted contraventions of the LTIA and its regulations.

2.5.12. The gist of these sentiments was conveyed to Regent Life by way of a letter.

2.5.13. In response Regent Life made various points, inter alia:

2.5.13.1. that irregularities in the industry is wide-spread; that as far back as 2002 and at his own request Mr Hoosen held a meeting with the FSB to draw their attention to “*certain irregularities in the insurance industry*”; that this was followed by further meetings with the FSB and with the LOA in an attempt to

persuade them to *“take steps to eliminate the undesirable practices in the insurance industry”*;

2.5.13.2. that nothing came of these meetings and that it was only as a result of the exposé in the press that the present commission was launched;

2.5.13.3. that Regent Life, having co-operated with and made full disclosure to the Panel *“in order to provide it with as much information and assistance as it could, with a view to the panel making recommendations that would ultimately lead to the elimination of these practices in the insurance industry,”* so it is stated, *“now finds itself in the unenviable position of the submissions it voluntarily made to the panel, being used against it by the panel in what seems to be a ‘naming and shaming’ exercise”*.

2.5.14. With reference to the Panel’s provisional finding that the data base payments were substituted commission payments and as such constituted contraventions of the relevant statutory provisions and LOA Code, Regent Life referred to a legal opinion it obtained, dealing specifically with database payments made to motor dealerships, and dated 8 August 2005. This was shortly after the “smoking gun email” of 19 July 2005, although Regent Life states that the advice was given to it verbally and by email before it forwarded the email of that date. The opinion was premised on the assumption that leasing by dealerships of their client data bases to Regent Life were genuine commercial transactions of rental and as such not governed by the LTIA. The Panel, as stated earlier, is in agreement with the legal conclusion stated in the opinion but not, having once again reviewed the evidence on a balance of probabilities, with the assumption on which it proceeded.

2.5.15. The question of gift vouchers is dealt with below.

2.5.16. Having concluded that its provisional view was correct and that Regent Life did contravene the commission regulations as well as the LOA Code, the Panel is not without sympathy for the position in which the company now finds itself.

2.5.17. The Panel accepts Mr Hoosen’s evidence that he encountered certain irregularities, not identified, and that he reported them to the FSB and the LOA on more than one occasion but to no avail, which on the face of it appeared to give the impression that the practices were not regarded as serious. Implicit in that explanation, however, is the concession that it was necessary for his company to do likewise in order to do business on an equal footing.

2.5.18. Regent Life made the valid point that the Panel cannot be confident that it has identified “*all those in the industry who may have trespassed*” and that there is thus “*a real risk, if naming occurred, of selective and manifestly unfair targeting.*” The Panel agrees. But in the final analysis, the fact that others may have done likewise may be an explanation, it is not an exoneration.

2.5.19. Regent Life, in its various responses, gave the Panel the assurance that practices that could be regarded as illegal have all been discontinued. The Panel accepts that reassurance. As far as the Panel is concerned, beyond reporting its conclusion, as it must, that contraventions had been committed by Regent Life, it makes no further recommendation as to any further action to be taken against Regent Life.

2.6. **Pinnafrica Life Limited** (long-term licence)

Pinnafrica Insurance Limited (short-term licence)

2.6.1. In his evidence, summarised in chapter 7 section 2.3, Mr **Lombaard** elaborated on the responses furnished to the initial questionnaire, several of which call for comment in this chapter.

2.6.2. *Marketing agreements in terms of which Pinnafrica contributes to the cost of marketing expenses incurred by intermediaries.*

In the Panel’s letter to Pinnafrica it was said “*It is difficult to conceive why such payments should be made other than as additional remittance to the intermediary. On the face of it, such payments, if in aggregate they exceed the permitted maximum, would therefore appear to be a contravention of the regulations. The practice, so it has been explained, is being phased out.*”

2.6.3. In its reply Pinnafrica did not seek to justify the practice but made two points: firstly, that it has been forthright and truthful in its submissions to the Panel throughout the duration of the Enquiry, in the spirit of the Terms of Reference of the Panel. The Panel unreservedly accepts that statement. The second point was that the practices as described in its response were wide spread in the industry. The Panel also agrees. It is so recorded. But by the same token it is also recorded that Pinnafrica participated in the practice which has been phased out.

2.6.4. *Payment of administration fees in addition to regulated commissions.* To the extent of any excess, such payments by their very description constitute commission contraventions. What has been said in the previous paragraph applies equally to this one. The practice, so the Panel was assured, is being phased out.

2.6.5. *Outsourcing of administrative functions.*

On the application of the criteria mentioned above, payments made for outsourcing any work the policy obliges the insurer to do itself constitute contraventions if they exceed the permitted maximum. What has been said above, applies to this situation as well.

2.6.6. As in other cases, the Panel does not believe that it is imperative, beyond recording its finding, to recommend any further action.

2.7. **Hollard Life Assurance Company Limited**

The Hollard Insurance Company Limited

2.7.1. Credit life is written under Hollard's long-term licence; its other products are issued under its short-term licence.

2.7.2. Hollard was asked by the Panel:

"7.11 Do you make payment to third parties other than motor dealerships for outsourcing administrative work in connection with credit life and extended cover policies?"

7.12 If so,

(a) what is the nature of such work;

(b) what is the amount of such payment;

(c) is the payment expressed as a percentage of GWP?"

2.7.3. Hollard responded by letter that it completely outsourced the administration work in connection with the policies, as well as other work, to a wholly owned administration company for amounts varying by product between 2.5% - 7.5% of GWP.

2.7.4. It said: *"These functions may normally be performed by an insurer and are outsourced purely for efficiency and/or economic reasons."* Hollard also explained that it would be economically unworkable for it to seek to apportion the regulated commission between the dealership and the third party doing the actual administrative work.

2.7.5. Furthermore:

"Insurer functions are exactly that: insurer activities. Outsourcing them does not make them "intermediary" functions per se. Where they are administrative in nature and where they are outsourced to an entity which is not ordinarily understood to be an "intermediary" then they should not be limited to commission as regulated and these entities should be able to be remunerated by way of market-related fees."

2.7.6. Hollard in evidence placed considerable store on the FSB's interpretative note issued

in 1998,¹³ as a result of which, as it was put,¹⁴ “...it also allowed for certain structures then to be put in place in terms of which an intermediary would get the commission. A non-intermediary, for instance, an administrator or an outsourced arm of the insurer would be paid administration fees which were not regulated the same way that commission was; and likewise, claims management bureaux, those sort of things, could also be paid fees which were unregulated. That allowed then various structures to be put in place where the insurer would have these various outsourced agents, administrators, the like, that they would pay fees and not commissions.”

2.7.7. The structures consisted of outsourcing the administrative work in regards to the policy. In addition, work was outsourced to claims management bureaux and loss adjusters. Even though at least some of the work done would fall within the definition of “rendering services as an intermediary” in the applicable Insurance Act,¹⁵ it was deemed by Hollard, having taken legal advice on the matter, to be permitted because these entities were not “intermediaries in the ordinary sense.”¹⁶

2.7.8. Hollard wrote: “The administration company that Hollard utilises for credit insurance is a 100% wholly-owned subsidiary of Hollard. It accordingly acts as an internal division of Hollard. The fees paid to this administration company cannot therefore be seen as payment for “services rendered as intermediary” as it is effectively Hollard performing its own work itself. Hollard is in effect simply reimbursing a division in terms of an internal arrangement.”

2.7.9. Hollard further wrote: “These functions may normally be performed by an insurer and are outsourced purely for efficiency and/or economic reasons. In particular, we are thinking of claims management functions performed by claims bureaux and the services provided by loss adjusters. The legislation could surely not have intended the consequences of limiting these sorts of fees to commission only as regulated by the two Insurance Acts.”

2.7.10. That is not, however, what the Acts say. As was stated earlier¹⁷ once “intermediary” is defined with reference to “services as an intermediary” and such work is in turn defined and the payment for such work is regulated it follows that all work falling

¹³ See chapter 6 section 2.11 and following.

¹⁴ By Ms **Thurling**.

¹⁵ See chapter 6 sections 2 and 3.

¹⁶ In its response to the follow-up questionnaire, it was explained in these terms in item 7.11.1: *Non-intermediaries are paid fees rather than regulated commission. For products other than credit life, administrative work is paid on a fee basis, the fee being dependent on the nature of the work provided. A policy fee is paid by the client for the services rendered by the intermediary for his benefit. All other fees and commissions are paid by us.*

The commission limitations are for those intermediaries performing intermediary services as defined in the Act. Non-intermediaries and non-intermediary services are in our view entitled to remuneration which is not subject to commission regulations.

¹⁷ Chapter 6 section 2.15.

- within the definition can never *not* be regulated, whether or not the entity doing it would not ordinarily be understood to be an intermediary.
- 2.7.11. Hollard maintains that it put this structure in place on the strength of both the FSB's Interpretative Note of December 1998¹⁸ and legal advice it obtained on its meaning.
- 2.7.12. In the view of the Panel the FSB's interpretative note, whatever it may mean, cannot add to or alter the meaning of the relevant phrases in the two Acts. The Panel nevertheless accepts that Hollard believed that the structure it put in place was legal and was sanctioned by the FSB.
- 2.7.13. Since Hollard would in any event pay the maximum permissible rate of remuneration to the motor dealership, and since a significant part of the work outsourced did fall within the definition, it follows that any payment made in addition to the outsourcing company would exceed the permitted maximums. That being so, it matters not that some of the work done also fell outside the definition for which any remuneration was payable.
- 2.7.14. To the extent of such overpayments the structure put in place by Hollard was not, in the view of the Panel, in conformity with the commission regulations, properly interpreted.
- 2.7.15. However, seen in the context of the evidence placed before the Panel, the contraventions are, in the view of the Panel, of a technical nature and not deliberate.
- 2.7.16. Moreover, it is apparent from what is said in paragraphs 2.7.7 and 2.7.8 above that Hollard's structure of an internal or inter-company administrator does not have the effect of prejudicing consumers, in like manner that there can be no prejudice to consumers if the intermediary services are rendered by employees of the insurer instead of by a separate company within the group. One cannot, however, ignore the fact that separate legal entities are involved which are separately remunerated for such services.
- 2.7.17. In the circumstances the Panel does not recommend that any action be taken against Hollard, save for suggesting that it should, in the light of the remarks made by the Panel, enter into discussions about the matter with the FSB, either individually or in conjunction with the LOA and SAIA.

¹⁸ The interpretative note is discussed in chapter 6.

2.7.18. Hollard was also asked whether it paid an additional administration fee of 15% of GWP to a maximum of R500 to the intermediary. Hollard responded that this is a dealer service fee, negotiated and chargeable not by it but by the intermediary to the consumer in terms of section 8(5) of the STIA. As Hollard rightly pointed out: *“There is currently nothing that prevents an “intermediary” from negotiating and charging a fee to the policyholder for services rendered on the policyholder’s behalf. This fee is not paid by the insurer, and is common in many other segments of the market.”*

2.8. Centriq Insurance Holdings Ltd

2.8.1. Centriq does business under both a long-term and a short-term licence. Under its long-term licence it pays a motor dealership dealing in new and second hand cars 7.5% of the premium commission and 15% of the premium administration fee as remuneration.

2.8.2. In addition Centriq has a separate agreement with an independent administrator without links to the motor dealership in terms of which it outsources claims and monthly reporting and pays the administrator a 10% of the premium fee for doing so. Such work falls within the definition of intermediary services discussed above. To the extent that the aggregate remuneration for intermediary services exceeds the maximum permitted under the regulations, such payments would consequently constitute contraventions of the relevant regulations.

2.8.3. The Panel nevertheless accepts that Centriq believed that its conduct was sanctioned, based on an interpretation of the interpretative note issued by the FSB that was widely held in the industry.

2.8.4. In the circumstances and beyond formally recording its finding that this particular structure of Centriq is not in conformity with the provisions of the LTIA, the Panel recommends no further action against Centriq, save for suggesting that Centriq should, in the light of the remarks made by the Panel, enter into discussions about the matter with the FSB.

2.9. Monarch Insurance Company Ltd

2.9.1. Monarch is a subsidiary of Lewis Stores (Pty) Ltd (“Lewis Stores”), a company in the Lewis group of companies, selling household and related goods on credit. Monarch acts as Lewis Stores’ insurance arm and offers insurance cover in respect of material damage to goods, loss of employment and death and disability.

- 2.9.2. Lewis Stores operates mainly in the lower income groups (LSM 4-7) where the average incomes are between R4,000-R5,000 per month. Monarch accordingly describes itself as “a micro-insurer”.
- 2.9.3. Monarch employs no staff. All its distribution and administrative functions are outsourced to two companies. The one is Lewis Stores itself. The other is a separate company, Transqua Administrative Services (Pty) Ltd, which is unrelated to the Lewis group of companies. All aspects of “advice” for purposes of the FAIS Act are outsourced to the latter company.
- 2.9.4. Lewis Stores does all the administrative work in regard to the policies issued by Monarch. It is accordingly an “intermediary” within the meaning of the STIA.
- 2.9.5. But Lewis Store does more than that. It operates at various levels:
- it is the supplier of goods to the consumer;
 - it is the credit provider;
 - it is an intermediary within the meaning of section 48(1) of the STIA;
 - it also acts as Monarch’s exclusive claims administrator in terms of a separate Claims Administration Agreement within the meaning of section 48(2) of the STIA.
- 2.9.6. The activities of Lewis Stores thus embrace every administrative function that an insurer would ordinarily handle, including accounting functions, tax compliance, day to day management and claims management. Such activities far exceed the rendering of “services as intermediary.”
- 2.9.7. According to Monarch it remunerates Lewis Stores, expressed as a percentage of the GWP, as follows:
- acting as intermediary: 20%
 - acting as administrator:
 - collection and accounting of premiums 13%
 - administration and management services
for running the business of Monarch 12%
 - claims administration 3.6%.
- 2.9.8. The total paid to Lewis Stores thus exceeds the permitted maximum.

2.9.9. However, section 48(2)(c) acknowledges that an administrator, also known as an underwriting manager, may be paid a remuneration, if so agreed, “other than by way of commission only.”

2.9.10. Monarch’s structures thus starkly raise two more or less controversial issues:

- (i) can one independent intermediary operate as, and be remunerated, both as a section 48(1) independent intermediary (regarding regulated commission) and as a section 48(2) independent intermediary (regarding unregulated remuneration) in respect of the same policy?
- (ii) can two independent intermediaries be remunerated in respect of the same policy, the one receiving regulated commission in terms of section 48(1) and the other unregulated remuneration in terms of section 48(2)?

2.9.11. The answer to the first question, in the view of the Panel, is no and to the second is yes.¹⁹

2.9.12. The reasoning in respect of the first question is this:

- section 48(2)(c) contemplates a term in the agreement entitling the administrator to “any remuneration other than by way of commission only”;
- there is thus a contradistinction between these two forms of remuneration;
- the administrator is entitled to the former;
- the administrator is entitled to it “only”;
- hence the administrator is not entitled to the commission “also”.

2.9.13. The reasoning in respect of the second question is this:

- section 48(3)(b) of the STIA contemplates two kinds of independent intermediaries: one entitled to commission and the other entitled to remuneration other than commission;
- an intermediary of the second kind shall not “enter into any short-term policy in relation to which another independent intermediary” (of the first or second kind) “render (sic) services as intermediary” if the other falls within categories (i) to (iv) mentioned in the subsection;

¹⁹ See chapter 9 section 8.7 – 8.14.

- that implies that if the other does not fall within the prohibited categories, the intermediary of the second kind may be so associated with the other.

2.9.14. This line of reasoning leads to a further conclusion: if the two kinds of intermediaries may not be so associated if they are, as it is stated in category (iv), “related within the second degree of consanguinity or affinity to the former”, it follows *a fortiori* that one and the same intermediary cannot assume the persona of both kinds of intermediaries and claim both kinds of remuneration. Put differently, if two entities so related, wearing two different hats, cannot be so associated, one entity, purporting to wear both hats, cannot do so either.²⁰

2.9.15. To revert to Monarch’s facts, it follows, on the strength of what is said both in sections 2.9.12 and 2.9.14 above, that on the Panel’s interpretation of the relevant legislation, Lewis Stores cannot be remunerated in the manner set out in sections 2.9.7 without contravening the STIA.

2.9.16. The Panel recognizes that this conclusion is squarely based on its own interpretation of the relevant sections of the STIA.

2.9.17. Monarch has informed the Panel, and the Panel accepts, that Monarch acted on legal advice throughout in structuring its group business in the manner it has done.

2.9.18. Beyond recording its own view that such a structure is not in conformity with the provisions of the STIA, the Panel recommends no further action save for suggesting that Monarch should, in the light of the remarks made by the Panel, enter into discussions about the matter with the FSB.

2.10. **Relyant Insurance Company Ltd**

2.10.1. Relyant Insurance Co Ltd, Ellerine Furnishers (Pty) Ltd, Ellerine Services (Pty) Ltd and Ellerine Trading (Pty) Ltd all belong to the same group of companies.

2.10.2. According to a letter received from Relyant Insurance, African Bank Investments Ltd acquired the shares of the Ellerine Group of companies.

Having investigated the issues raised in correspondence with the Panel, this company decided, in order to align the practices of Relyant Insurance with those of companies within its own group, to discontinue the Relyant Insurance arrangement “*without*

²⁰ See Chapter 9 Section 8.

conceding that there was any impropriety with regard to the arrangements in question which has been based on reputable legal advice”, with retrospective effect from 1 September 2007.

2.10.3. Relyant Insurance acted throughout as the insurer in respect of CCI business generated by the group.

2.10.4. In respect of the stores owned by Ellerine Furnishers (Pty) Ltd:

- (i) Ellerine Furnishers act as the intermediary for purposes of section 48(1) of the STIA;
- (ii) Ellerine Services (Pty) Ltd acted as administrator in terms of section 48(2) of the STIA;
- (iii) Ellerine Services in turn contracted with Ellerine Furnishers to fulfil the outsourced services.

2.10.5. The work done by Ellerine Furnishers would mostly fall within the definition of “services as intermediary” in the STIA.

2.10.6. Ellerine Services is paid 25% of premiums received for policy administration and maintenance and 20% of premiums for claims processing and handling services, of which 90% is in turn paid to Ellerine Furnishers.

2.10.7. In addition Ellerine Furnishers are paid 20% of the premiums permitted by the STIA.

2.10.8. In respect of the stores owned by Ellerine Trading (Pty) Ltd., Ellerine Trading acts as both intermediary in terms of section 48(1) and as administrator in terms of section 48(2), for which it receives remuneration from Relyant Insurance of 20% of premiums received as a sales commission, 25% for administering the policy and 20% for claims handling.

2.10.9. The work done by Ellerine Trading also falls within the definition of “services as intermediary” in the STIA.

2.10.10. The above structures raise two more or less controversial issues:

- (i) can one independent intermediary operate as, and be remunerated, both as a section 48(1) independent intermediary (regarding regulated commission) and as a section 48(2) independent intermediary (regarding unregulated remuneration) in respect of the same policy?
- (ii) can two independent intermediaries be remunerated in respect of the same policy, the one receiving regulated commission in terms of section 48(1) and the other unregulated remuneration in terms of section 48(2)?

2.10.11. The answer to the first question, in the view of the Panel, is no and to the second is yes.²¹

2.10.12. The reasoning in respect of the first question is this:

- section 48(2)(c) contemplates a term in the agreement entitling the administrator to “any remuneration other than by way of commission only”;
- there is thus a contradistinction between these two forms of remuneration;
- the administrator is entitled to the former;
- the administrator is entitled to it “only”;
- hence the administrator is not entitled to the commission “also”.

2.10.13. The reasoning in respect of the second question is this:

- section 48(3)(b) of the STIA contemplates two kinds of independent intermediaries: one entitled to commission and the other entitled to remuneration other than commission;
- an intermediary of the second kind shall not “enter into any short-term policy in relation to which another independent intermediary” (of the first or second kind) “render (sic) services as intermediary” if the other falls within categories (i) to (iv) mentioned in the subsection;
- that implies that if the other does not fall within the prohibited categories, the intermediary of the second kind may be so associated with the other.

2.10.14. This line of reasoning leads to a further conclusion: if the two kinds of intermediaries may not be so associated if they are, as it is stated in category (iv), “related within the second degree of consanguinity or affinity to the former”, it follows *a fortiori* that one and the same intermediary cannot assume the persona of both kinds of intermediaries and claim both kinds of remuneration. Put differently, if two entities so related, wearing two different hats, cannot be so associated, one entity, purporting to wear both hats, cannot do so either.

2.10.15. To revert to Relyant Insurance’s facts, it follows, on the strength of what is said both in sections 2.10.12 and 2.10.14 above, that Ellerine Furnishers and Ellerine Trading cannot be remunerated in the manner described above without contravening the STIA.

²¹ See Chapter 9 Section 8.

- 2.10.16. The fact that the ultimate profit remains within the group is no answer, in the Panel's view, to the point that different legal entities are involved.
- 2.10.17. The Panel recognizes that its conclusion that there has been a contravention of the commission regulations is squarely based on its own interpretation of a section in the STIA that is capable of different interpretations.
- 2.10.18. It is plain that Relyant Insurance has throughout acted on legal advice in structuring its group business in the way it has done. The Panel agrees with some but, with respect, not with all aspects of the legal opinion that was forwarded to it. The Panel nevertheless accepts that the arrangements Relyant Insurance put into place on the strength of the legal advice it received, did not involve the payment of improper incentives and that all fees charged were duly disclosed to consumers.
- 2.10.19. Beyond recording its own view that the structure described above contravenes the provisions of the STIA, the Panel recommends no further action, save for suggesting that Relyant Insurance should, in the light of the remarks made by the Panel, enter into discussions about the matter with the FSB.
- 2.10.20. See, further, the next section regarding Relyant Insurance's sister company, Customer Protection Insurance.

2.11. **Customer Protection Insurance Company Ltd**

- 2.11.1. Customer Protection Insurance Co Ltd (CPIC) belongs to the same group of companies as Relyant Insurance Co, Ellerine Services and Ellerine Furnishers, referred to in the previous section.
- 2.11.2. Due to mergers within the group and with effect from the end of May 2007, CPIC, according to a letter addressed to SAIA for the attention of the Panel, was no longer underwriting insurance business and was in run-off.
- 2.11.3. According to a later letter from CPIC, a public company acquired the shares of the Ellerine Group of companies. Having investigated the issues raised in correspondence with the Panel, this company decided, in order to align the practices of CPIC with its own practices, to discontinue the CPIC's arrangement "*without conceding that there was any impropriety with regard to the arrangements in question which has been based on reputable legal advice*", with retrospective effect from 1 September 2007.
- 2.11.4. To the extent that CPIC structured its past business, broadly speaking, on the same basis as Relyant Insurance, with due regard to legal advice given to it, the remarks

made in the previous section applies in equal measure to it and does not have to be restated.

3. **NON-MONETARY GIFTS AND VOUCHERS**

- 3.1. Gift vouchers have been commonly used, according to the evidence, to incentivise intermediaries and their staff. This form of additional incentive payment, together with TV sets, pop-up toasters and holiday jaunts, are expressly forbidden, irrespective of whether the gift is destined for the intermediary or members of its staff.
- 3.2. According to **Regent Life** this practice, as far as it was concerned, had ceased by November 2006. Some more recent instances from other companies have been reported but in the Panel's view these appear to have been isolated instances that require no further discussion or action. The publicity surrounding the circumstances giving rise to this enquiry should in itself serve to ensure the end of gift vouchers as a general practice.

4. **CONTRIBUTING TO AN INTERMEDIARY'S MARKETING COSTS AND INFRASTRUCTURE**

- 4.1. While such payments do not technically qualify as administrative work in terms of the insurer's contract, the probabilities are that almost invariably it would have been conceived as a form of additional intermediary remuneration. The same is true for other contributions e.g. to the cost of production of an intermediary's Club Magazine, and the like.²²
- 4.2. No further action is recommended by the Panel in this regard.

5. **PAYMENT FOR THE USE OF AN INTERMEDIARY'S DATA BASE**

- 5.1. A number of insurers testified that payments were made to intermediaries for the use of their client data base as a means of generating new business in the future.²³ In line with the approach outlined above, these payments were not seen by the Panel as part and parcel of the insurer's contractual duties to the credit provider and the consumer. *Prima facie*, therefore, the practice would not constitute a contravention of the

²² See too other examples quoted in the LOA's relevant Code.

²³ See chapter 7.

commission regulations. But there is the rider mentioned above. If such payments are found to be disguised rewards for introducing business or doing administrative work they would, to the extent of the excess, constitute commission contraventions.

- 5.2. In a number of other instances similar payments were made by other insurers. The Panel was concerned that the payments were made as a proportion of the premium rather than as an arms-length negotiated consideration. Nevertheless the Panel could not on a balance of probabilities make a finding that such payments were conceived as disguised rewards for introducing the business or for doing administrative work in excess of the regulated commission.

6. **PAYMENT OF ROYALTIES FOR THE USE OF AN INTERMEDIARY'S BRAND NAME**

- 6.1. The concept of intellectual property licensing agreements was more fully explained by Mr **Lombaard** of **Pinnafrika** in his evidence. Although these payments are made to intermediaries, as defined, they are not, in the Panel's view, intermediary payments properly so called. The payment of royalties on a case-by case basis and not as a percentage of the premium but as a factor of turnover or profit is not policy-related at all. These are payments made not as remuneration for services rendered by the intermediary in giving effect to the policy but for the use of the particular credit provider's brand name and reputation in enhancing the insurer's business. There is no basis for suggesting that these are disguised incentive or remuneration payments. In the view of the Panel these payments do not constitute contraventions of the relevant regulations.
- 6.2. Other insurers, too, testified that additional payments were made to intermediaries for the use of their brand names. So, for instance, one insurer explained that it pays royalties on the credit life side, ranging from 1% to 10% of the premium, to the holder of registered trademarks "*where this brand is used in marketing material, application forms and policy wordings and is recognised as a feature in engendering customer confidence in the insurance product and is utilised to attract customers in the insurance space*". Even when a payment exceeding the maximum is made to someone who is otherwise an intermediary it would not, in the opinion of the Panel, be irregular since the payment would not be for a service for which the insurer is liable in terms of the policy.

- 6.3. In its response to the initial questionnaire **Hollard** mentioned that royalties were historically paid to the holders of registered trademarks where Hollard used their brands in marketing material, application forms and policy wordings. Such royalties ranged from 1% to 10% of the premium. Such payment would only be made to the intermediary if the intermediary co-incidentally happened to be the owner of the trademark. The payment of royalties had in any event ceased in June 2007 as a practical consideration stemming from the implementation of the NCA.
- 6.4. Such payments, not falling within the contractual obligations of the insurer towards the policyholder, would not as a rule be subject to commission regulations, unless it were in truth a disguised form of intermediary remuneration.
- 6.5. The Panel raised with Hollard the question why the payment was expressed as a percentage of the premium rather than as a negotiated consideration unrelated to the premium.
- 6.6. Hollard responded: *“The payment for the trademark usage is linked to the premium in order to relate the payment to the effectiveness of the non-insurance brand in promoting a sale of the insurance product. We could pay a set fee or negotiated consideration unrelated to the premium but the nature of the payment is such that we wish to establish the extent to which the non-insurance brand impacts on consumers and is a component of their decision making process in purchasing the insurance product. Linking the trademark fee to the premium allows us to establish this. It is the most practical solution because of the difficulty in calculating the value of the non- insurance brand, which is intangible. Legal advice sought and received advised that there was nothing untoward in calculating the payment in this manner. It is a sensible commercial arrangement. “*
- 6.7. The Panel has no reason to question Hollard’s assertion that these are transactions in the normal course and not a mechanism to circumvent the commission regulations.

7. PAYMENT MADE FOR ADVICE

An arrangement between the intermediary and the consumer that the latter would pay a fee for completing the application forms or for advice or other services would not be contrary to the regulations.²⁴ Such fees would of course have to be properly disclosed to the consumer.²⁵

²⁴ See chapter 6 section 9.

²⁵ See, in general, chapter 11.

8. INCREASED PREMIUM RATES

- 8.1. Item 1(c) of the initial questionnaire reads: *“Does the insurance premium levied to the client exceed the premium received by the insurer (with the excess premium being kept by the intermediary)?”*
- 8.2. The question was interpreted by most respondents as relating to the collection of premiums. Most answered the question in the negative. Some stated that the intermediary recovering the premium may retain the permitted commission and pay over the balance. None saw this as a form of collecting excessive commissions.

9. PRE-DELIVERY INSPECTION AND REPAIR WORK

- 9.1. Once again the Panel did not regard such work as a function which the insurer is in any event obliged to perform in terms of the express or tacit terms of the policy, either by itself or through an agent or subcontractor.
- 9.2. Such work, unless simply a front for additional introductory or servicing payments, would not therefore constitute commission contraventions.
- 9.3. In its directive 9.A.ii., first issued on 30 January 2004 and revised and re-issued for industry comment on 3 March 2008, the FSB declared: *“A short-term insurer, as part of the risk analysis, may require that a vehicle be inspected for mechanical faults and that the insurer is provided with a report on the findings. An inspection fee may be paid by the insurer provided that the payment of such fee is only paid to a third party who is not the independent intermediary or the underwriting manager and only upon receipt of the inspection report for a vehicle.”*
- 9.4. It is, with respect, not clear to the Panel why the payment for such work should only be made to a third party and not to the motor dealership which does the work. The dealership does not do such work in its capacity as an independent intermediary. Not being “services as intermediary” (introducing the business to the insurer, servicing the policy), the payment for the inspection and repair work is not regulated. Consequently the dealership is not conflicted if it should issue the inspection and repair certificate to the insurer. It would only be questionable if it were in truth a bogus incentive but that will always be a question of fact.²⁶

²⁶ As for the reference to underwriting managers, see chapter 9 section 8.7 and following.

CHAPTER 11

MARKET CONDUCT REGULATION

1. SOME INTRODUCTORY REMARKS

- 1.1. Market conduct issues would include matters such as
 - lack of proper disclosure;
 - pre-sale misselling;
 - lack of awareness by consumers of the existence of the policy or of limitations to and exclusions of the cover;
 - denying a debtor the free choice of offering another policy as collateral security instead of the CCI policy proposed by the credit provider;
 - conflicts of interest to the detriment of consumers;
 - ambiguously worded policy provisions;
 - unreasonably wide exclusion clauses;
 - unfair time bar clauses, and the like.
- 1.2. These issues are, of course, typical of insurance in general rather than of CCI in particular; and not all of them relate primarily to insurers. Some are also true for product suppliers and credit providers, acting as “intermediaries” as that term is understood in the STIA and the LTIA and their regulations.
- 1.3. On some of these issues there is statutory regulation. These are dealt with in the paragraphs that follow. Others are not regulated. They are discussed in chapter 12.
- 1.4. Market regulation by itself is not enough. Regulation without the authority and the inclination by the regulator to monitor the industry and to investigate and enforce instances of non-compliance becomes a mere paper exercise. But even that is not sufficient. Adequate market regulation requires commitment and effort on the part of:
 - the regulator with the manpower to supervise the market on an on-going, hands-on basis by means of on-site visits and formal inspections and the authority to act decisively if instances of non-compliance are encountered. Such instances must be pursued through the application of administrative remedies and other effective law enforcement measures. It is the recommendation of the Panel that market control should be placed under the supervision of the NCR;

- the industry developing a distinct culture of compliance, individually and through its trade organisations, thereby serving not only their own interests but also those of their customers;
 - consumers themselves. As a result of the current socio-economic developments in South Africa consumers are increasingly exposed to new and sophisticated financial products and services. Consumers must be educated to understand these products and to appreciate and enforce their rights. There is an urgent need for representative and strong consumer organisations. Consumer activism is an imperative for truly effective market regulation.
- 1.5. One last remark. Consumers are not passive parties to CCI policies. Even when the credit provider is the policyholder and the consumer is the life insured, the consumer has a duty to be vigilant as to how the policy, for which the consumer is the ultimate premium payer, affects his or her interests. Consumers must be placed in the position where they can make informed decisions. That means that they must not be misinformed and that all the information necessary to enable them to make appropriate decisions is given to them. But once that point has been reached consumers must take responsibility for their own decisions. They should not be favoured at the expense of the other parties to the contract if, for instance, they choose not to read the contract or if the decisions they afterwards make prove to have been unwise. Consumer protection means fairness for some, overprotection unfairness for others.

2. **THE STIA**

- 2.1. Apart from regulating intermediary remuneration, neither the STIA nor the regulations issued in terms thereof contain a general set of provisions or a code purporting to regulate the conduct of insurers or, for that matter, of intermediaries. And while the legislative source of credit insurance is to be found in the STIA and the LTIA, making it possible for credit insurance to be conducted under either of these laws, no direct reference to credit insurance is made under either Act.
- 2.2. But there is one exception which deserves special mention and that is the so-called “Free Choice” rule.

- 2.2.1. Both the STIA (in section 43) and the LTIA (in section 44) contain provisions in terms of which a prospective policyholder, who is required to take out insurance as security for a loan, must be granted the choice of arranging other insurance cover. The debtor is thus not obliged to agree to the insurance cover proposed by the credit provider.
- 2.2.2. Section 44 of the LTIA contains an exception to this rule in subsection (4). The free choice rule does not apply to a long-term insurer if it lends money to one of its policyholders upon the security of a long-term policy issued by itself.
- 2.2.3. The STIA in subsection (5) also sets out an exception to the free choice rule. The rule shall not apply in the case of a short-term policy *“which is required to be made available in relation to a contract in terms of which money is loaned upon the security of the mortgage of immovable property”*.
- 2.2.4. Subsection (5) proceeds to state that where a new policy is then to be entered into, the premiums payable under that policy *“shall be reasonable in relation to the premiums generally charged by insurers under similar policies”*.
- 2.2.5. The rule of thumb applied by the FSB to determine the reasonableness of the premiums charged to the policyholder is to require the submission in comparable cases of the premiums of four different insurers. A certificate by the Registrar of Short-Term Insurance is deemed to be sufficient evidence of the reasonableness of the premium.
- 2.2.6. The NCA has now introduced a similar provision into sections 44 of the LTIA and 43 of the STIA respectively. This provision – subsection (5) in the LTIA and subsection (6) in the STIA – reads that “this section” does not apply if the policy or its policy benefits *“is made available for the purpose of protecting the interests of a creditor under a credit agreement to which the National Credit Act, 2005, applies”*.
- 2.2.7. However, in the NCA itself the principle of free choice has been re-established in relation to CCI required to be taken out and maintained by a consumer during the term of a credit agreement. This free choice rule is to be found in section 106 (4) (a), read with subsection 106 (6) of the NCA: the consumer must be given, and be informed of, the right *“to waive”* the policy proposed to the consumer by the credit provider and to substitute a policy of the consumer’s own choice. If the consumer opts for the latter, the credit provider may require the consumer to provide the credit

provider with certain directions (i.e. to pay the premiums on the consumer's policy; and naming the credit provider "as a loss payee" under the policy up to the settlement value on the happening of the insured event; and requiring the insurer to settle the consumer's obligation under the credit agreement as a first charge against the proceeds.)

2.2.8. If premiums have been paid annually the consumer is entitled to be refunded the unused portion of the final year's premium (subsection (7)).

2.2.9. The re-entrenchment of the rule in section 106 of the NCA, after abolishing it in the Insurance Acts, is seen as a facilitation to the credit provider, where the consumer has opted for a policy of his choice, to take control of that policy in the sense of keeping it alive and dealing with its proceeds when the insured event has occurred.

2.2.10. Practical circumstances, so it was testified to the Panel, tend to prevent the free choice rule from achieving its intended effect - for two main reasons:

- (i) the systems of credit providers cannot accommodate an external policy which the consumer may have wanted to introduce;
- (ii) it is virtually impossible for a consumer to obtain CCI privately, either at all or at a better price.

2.2.11. Thus it was said in evidence by Mr **Ketola**, a financial analyst:

"I would say 99% of the people, maybe more, 99.9% end up buying the in-house product. Not only for the convenience as the retailers and product providers claim, I do think they're still trying their best to make it hard for people to use external products. And I think they're doing everything within the bounds of the law to not give clients choice. Because on the interest side, on the credit extension side I think it has worked a lot better, so they're having to make up the margins somewhere. So if you're losing something on the interest side and in terms of asset growth, you're probably going to tighten up even more here."

2.2.12. This statement is borne out by the evidence of Mr **Ross** who said:

"Well, that has been addressed by the National Credit Act so the freedom of choice exists but from a process point of view it's so much simpler to deal with the bank that you're dealing with. I mean, if I was going through that kind of route it just makes your life so much simpler. And I think in coming back to the competitive nature of the product, the competition sits with the bank, it doesn't sit with the insurance provider."

2.2.13. Mr **Ketola** suggested that one of the reasons why CCI is so profitable is the lack of choice to the consumer. Whilst the NCA was designed to protect consumers on this front it has had almost no impact. The immediate availability of the in-house policy at the point of sale, compared to delays associated with an external policy, is given as the main reason why the credit provider's policy prevails.

2.2.14. In its response to the follow-up questionnaire, **Guardrisk** commented as follows on the advent of the NCA: *"It has deprived the customer of choice, has increased costs to the customer and ultimately exposed the customer to higher risk."*

2.2.15. In its submission to the Panel,¹ **FinMark Trust** also commented on the "free choice rule". It said:² *"Although, according to South African legislation, retailers are not allowed to force consumers to buy the insurance product they offer, they have effectively embedded the insurance product with the credit offered through the sales process."* And again:³ *"Moreover, where the credit provider proposes use of a particular insurer, the consumer must be given, and be informed of, the right to choose an alternate insurer... However, we recognize that there may exist a significant gap between what the NCA and FAIS requires from credit retailers in terms of the insurance sales process and the actual sales practices that occur."*

3. **THE LTIA**

As stated above, section 44 of the LTIA corresponds to section 43 of the STIA and what is said in the preceding paragraphs about short-term insurers apply in equal measure to long-term insurers.

4. **THE FAIS ACT**

- 4.1. The primary objective of the FAIS Act (FAIS) is to regulate not intermediary remuneration but market conduct in the financial services industry.
- 4.2. Its approach is functional. Whoever renders "financial services" as a regular feature of its business is required to be authorised (that is to say, licensed) under FAIS, irrespective of any provision in any other law. An insurer who operates in the market

¹ Appendix 16.

² In paragraph 2.

³ In paragraphs 7 and 9.

through employees, tied brokers or tied agents thus needs to apply for a licence under FAIS.

- 4.3. Proper market conduct rules are circumscribed in codes of conduct promulgated under FAIS. Section 16 sets out the relevant principles requiring, in particular, that a client must be able to make informed decisions and be treated honestly and fairly. The interests of the client are paramount.
- 4.4. A code of conduct must specifically contain provisions relating to *“adequate disclosures of relevant material information, including disclosures of actual or potential own interests...”* (section 16(2)(a)).
- 4.5. A further requirement, as is also mentioned in chapter 5, is that a person who renders a financial service must observe *“all applicable statutory or common law requirements applicable to the conduct of business”* (section 16(1)(e)).
- 4.6. FAIS therefore requires no more than proper disclosures to prospective policyholders and due compliance with the provisions of other laws.

5. THE FAIS GENERAL CODE OF CONDUCT

- 5.1. FAIS and its Codes do not accord any significance to credit insurance as such. Because credit insurance is a “financial product” as per the FAIS definition, “advice” and/or “intermediary service” in relation thereto fall to be regulated by the market conduct rules expounded by FAIS. FAIS makes provision for the publication of different codes of conduct depending on the sector which it serves (section 15(2)(a)). A General Code of Conduct is applicable to all financial services providers and their representatives while specific codes apply to banks, investment managers and forex dealers respectively.
- 5.2. Credit insurance falls under the General Code since there are no specific codes applicable to particular categories of insurance such as CCI.
- 5.3. In paragraph 3(1)(a) the emphasis is on factually correct and timeously provided information (*“so as to afford the client reasonably sufficient time to make an informed decision about the proposed transaction”*) and in plain and non-misleading language; all amounts, fees, remuneration and so forth must be expressed in specific monetary terms or, where not reasonably so determinable, the basis of calculation must be adequately described.

- 5.4. In addition, paragraph 7(1)(c) requires “full and appropriate information” to be given to the client on
- the nature and extent of monetary obligations assumed by the client vis-à-vis the product supplier (e.g. the insurer);
 - similar obligations assumed by the client vis-à-vis the financial services provider (i.e. the intermediary);
 - the nature, extent and frequency of any incentive, remuneration, commission, fee or the like which will or may become payable by the product supplier to the intermediary.
- 5.5. Where maximum amounts or rates are prescribed by a law, the financial services provider may elect to disclose either the actual amount or the prescribed maximum amount or rate.
- 5.6. In an insurance transaction where maximum remuneration for intermediaries is prescribed, a financial services provider need therefore not disclose to the prospective policyholder more than what is to be found in the two Insurance Acts.
- 5.7. Paragraph 14 contains provisions relating to the advertising of the information to be provided and the disclosures to be made in the case of direct marketing, meaning “*the rendering of financial services by way of telephone, internet, media insert, direct mail, or electronic mail...*” This includes, in paragraph 15(3)(e) and (f), “*charges and fees to be levied against the product*” and “*commission, consideration, fees, charges or brokerages payable to the direct marketer by the client, or by the product supplier or by any other person.*”
- 5.8. FAIS and its Codes are somewhat lacking in effective enforcement measures. There is no law enforcement provision or sanction for non-compliance in the Code itself. The non-disclosure of remuneration payable by the insurer to an intermediary is probably unlikely, as matters stand at present, to be branded as “material” for purposes of suspending or withdrawing a licence under FAIS.
- 5.9. A contravention of sections 15 and 16 of FAIS or of any provision of the Codes is also not criminalised (section 36). An aggrieved client is thus left to pursue the civil remedies provided for by FAIS (section 33) or the common law or by the FAIS Ombud.

5.10. The FAIS Ombud forwarded two of his determinations relating to CCI to the Panel, illustrating the General Code in operation.⁴

5.11.1. In the first one he upheld a complaint against a direct marketer of a credit life policy to secure a personal loan of R25,000. The complainant's claim on the policy was rejected by the insurer on the grounds of "*an alleged non-disclosure by the deceased of a pre-existing medical condition which contributed to the cause of death.*"

5.11.2. Significant findings made by the FAIS Ombud were:

- that the telephonic explanation given to the deceased of the terms and conditions of the policy, having regard to the deceased's personal circumstances and standard of education, was not sufficiently clear and detailed to comply with the requirements of the General Code;
- that the "free choice" rule of section 44 of the LTIA, referred to earlier in this chapter, had also not been complied with.

5.11.3. In the result the direct marketer was ordered to pay the outstanding indebtedness due by the deceased to the credit provider. (The Panel expresses no view on the correctness or otherwise of the form of relief granted.)

5.12.1. In the second case the claim on the policy, a credit life policy to secure a mortgage loan issued to the complainant and her husband, was rejected on the grounds that the complainant's husband died of a pre-existing condition within the contractual waiting period of 24 months of the commencement of the policy.

5.12.2. The finding on the merits against the direct marketer was that the exclusion clause on which the claim was rejected was not properly explained to the complainant and was not explained at all to the deceased who was not a party to the telephonic conversation with the direct marketer's employee, and that these failures were contrary to the requirements of the General Code.

5.12.3. Once again the marketer was ordered to pay "*the outstanding indebtedness on the bond.*"

6. THE POLICYHOLDER PROTECTION RULES (PPR)

6.1. The PPR, promulgated under sections 62 and 63 of the LTIA and the STIA respectively, were initially conceived to elaborate on the regulation of market conduct

⁴ See too chapter 12 section 2

- in the long-term and short-term insurance industries. These functions were largely taken over by FAIS when it came into force on 1 October 2004 and the FAIS Codes.
- 6.2. The remaining and somewhat attenuated rules of the PPR are either insurer specific or apply to insurers who are not registered as financial service providers. The first category includes rules relating to agreements with intermediaries, cancellation of policies, cooling-off, the handling of claims, policy loans and similar matters. Under the latter category are rules relating to direct marketing where no advice is furnished by or on behalf of the insurer.
 - 6.3. As in the case of the FAIS Codes, proper information and disclosures are at the root of most of these rules. Thus there are specific rules on the disclosure of charges and fees, commission, brokerages and the like, where the obligation to pay rests on the policyholder.
 - 6.4. In summary, it can be said, that the PPR serve to regulate market conduct when the insurer is not covered by FAIS or its Codes. Although the market conduct regulations are not as comprehensive as under FAIS, the PPR are concerned with additional market conduct issues specific to insurers.
 - 6.5. The PPR, although requiring disclosure, contain no provisions specifying the maximum level of intermediary remuneration.
 - 6.6. Criminal penalties are prescribed for contraventions of the PPR but no provision is made for any administrative or civil sanctions.

7. **THE NCA**

- 7.1. The NCA and the regulations issued in terms thereof are discussed in some detail in chapter 3 section 1.4. Section 106 is a self-contained provision dealing with various aspects of credit insurance in particular as opposed to credit agreements in general.
- 7.2. Section 106 prescribes market conduct for credit providers rather than insurers.
- 7.3. Subsection (5)(b) requires that disclosure be made to the consumer in the prescribed manner and form of
 - “(i) the cost to the consumer of any insurance supplied;*
 - and*
 - “(ii) the amount of any fee, commission, remuneration or benefit receivable by the credit provider, in relation to that insurance;...”*

- 7.4. Subsection 106(5)(c) requires the credit provider to explain the terms and conditions of the insurance policy to the consumer and provide the consumer with a copy of the policy.
- 7.5. One controversial practice of the past, single premium credit insurance, has been banished by subsection 106(4)(b) of the NCA with effect from 1 June 2007.⁵ Prior to that date it was possible for an insurer to debit the entire premium at the beginning of the credit period, with interest being capitalised, and to retain these benefits even if the policy had not run its course.

⁵ See too, chapter 3 section 1.4.23 and chapter 12 section 14.

CHAPTER 12

MARKET MISCONDUCT

1. SOME INTRODUCTORY REMARKS

- 1.1. CCI extends over a wide variety of product lines and is issued by a wide variety of insurers active in a wide variety of insurance sectors. Not every proposition, true for one product and one insurer, is necessarily true for another. Bancassurance and furniture retailing, to mention one example, may both involve CCI of one kind or another but otherwise they have little in common. A product which is price and cost sensitive in one sector may not be so in another. And conduct deemed questionable in one area will not necessarily occur in the other.
- 1.2. The Panel has no compulsory investigative powers to obtain statements and documents or compel evidence. What was placed before it was done so on a voluntary basis. The Panel can only comment on and draw conclusions from the voluntary written submissions and oral evidence by interested parties. The incidents of misconduct mentioned in submissions and evidence were often of a general and anecdotal nature and unless self-confessed were not linked to particular insurers.
- 1.3. In the paragraphs that follow we identify and list the manifestations of misconduct within this field that we have encountered and make recommendations on how in our opinion they can best be addressed and redressed by the industry.¹
- 1.4. Judging by the responses received from insurers² there is consensus that the NCA, even though it has only been operative for some months, has gone some way and will

¹ The aim must be to anticipate and pre-empt consumer complaints about market conduct. Should there nevertheless be cause for complaint the complainant's first port of call should be to the relevant ombudsman's organization, more particularly, and depending on the nature of the complaint, the Long-term Ombudsman, the Short-term Ombudsman, the Credit Information Ombud or the FAIS Ombud.

² Insurers were asked in the follow-up questionnaire whether the NCA affected their business. The response across the board was that it had a massive negative impact on the volume of credit insurance business, largely due to the banning of single premium payments, with a corresponding increase in administrative costs. Typical responses were:

'Policies are now paid monthly as opposed to premium being financed upfront and commission is accordingly paid monthly as opposed to upfront. The impact on commission payments appears to be an unintended consequence of the NCA. Furthermore, as premium is paid monthly instead of upfront, the policy can potentially lapse when the consumer needs it most, for example when he is sick or disabled he may omit to pay the premium and consequently does not receive the insurance cover he needs.'

"Sales reduced significantly. This due to factors such as reduced commission incentives of sales staff (i.e. commissions are now earned monthly as opposed to earned up front for the term premium), preference for warranty sales (which is still allowed as a term

continue to do so in eradicating some of the malpractices that have given the industry a bad name in the past.³

2. THE GUMEDE DETERMINATION

- 2.1. On 29 January 2008 the FAIS Ombud released his determination in the matter of *Gumede v JDG Trading (Pty) Ltd (trading as Barnetts)*.⁴ The complainant was a domestic assistant with a standard 6 education earning a wage of R300 per week. The respondent is a wholly owned subsidiary of the JD Group which trades throughout the country via 928 outlets under different brand names. One of those outlets was Barnett's, a dealer in furniture and appliances in Port Shepstone. On 14 October 2006 (before the NCA became operative) the complainant purchased a television set and a mini oven on credit for R2,799 and paid for a television licence. The total amount payable in terms of the documentation given to her was R6,468, an increase in excess 115%. That amount included finance charges of R1,668, insurance premiums of R344, a "contract fee" of R102 and delivery charges of R348. The package for which she signed included "a goods insurance policy", an "extended guarantee contract" and a "credit life policy", all of which, so she complained, were never explained to her and which she never intended or agreed to purchase. In addition she herself took delivery of the goods at the store.
- 2.2. The case serves as a classic example of market misconduct in the furniture retail business and demonstrates the wide divergence that sometimes occur between market conduct regulation, on the one hand, and actual compliance, on the other. The reprehensible actions of the sales lady on the floor, asking the complainant to sign without proper explanation a series of documents, some with blank spaces, are

product under the NCA, and therefore retains its term commissioning status), higher lapse rates and more stringent credit scoring requirements."

It has also had a marked effect, so it was reported, on disclosures and policy wordings.

³ As to the past, see chapter 3 section 1.9. As to the effect of the NCA, Mr **Lategan** said that "...there were certainly practices that were not right and you'll see a major theme is that the National Credit Act then already implemented some measures to address some of those things ..." Mr **Casserly** who gave evidence in his private capacity but from an intermediary perspective, said about the NCA: "So I think that from a credit insurance perspective a lot of the abuse, the serious abuse if I can put it that way, has now been washed out of the system and the National Credit Act is primarily responsible for that".

⁴ Case no FOC3097/06-07/KZN(3).

- governed by provisions in FAIS and the General Code and were, in addition, contrary to directives from the respondent's head office. Yet it did and does happen.
- 2.3. The FAIS Ombud duly upheld the complaint. Having found that the complainant was never properly informed of the “add-ons” and that the loan agreement was of no force and effect, the entire transaction was treated as if it were a purchase for cash, notwithstanding that neither party ever intended it to be a cash purchase and the complainant could not have afforded it at the time.
- 2.4. After dealing with the merits of the case, the FAIS Ombud said:
- “[141] It would be extremely naive of me to think that this is an isolated or exceptional case. This Office is in receipt of other such complaints involving the JD group. Nor does it appear that this abuse is confined to the JD group. This is happening throughout the retail furniture industry.*
- [142] These kinds of practices must be stopped. We cannot allow poor and vulnerable people in the position of Complainant to be exploited. The Respondent is clearly circumventing the FAIS Act with its ‘point and sign’ policy and practice. Vulnerable people are duped into incurring enormous debt when all they wanted was a simple piece of furniture or appliance. It would be fair to say that Complainant has paid expensive finance and other charges to acquire the furniture that she wanted in the first place. People in the position of Complainant, usually illiterate, semi-literate or financially illiterate and poor, end up paying more than double the purchase price for furniture and appliances. The Respondent is raking in huge profits merely by generating paper transactions.”*
- 2.5. The FAIS Ombud thereupon referred his determination to the FSB, the NCR, the Competition Commission and the LOA, saying, as far as the LOA was concerned:
- “155.9 The insurance industry and in particular the Life Offices Association (LOA) needs to take note of the types of insurance products being sold by furniture retailers and take steps to ensure that the product being sold to the consumer is necessary in the circumstances, affordable, written in plain language and most importantly is in the interests of the consumer. I am therefore sending a copy of the determination to the LOA for their attention.”*
- 2.6. Although this was strictly speaking a short-term insurance matter⁵ not falling within its own sphere of influence, the LOA referred the matter to this Panel to deal with it as part of its investigations.
- 2.7. The core of the determination was that the sales lady at the store who dealt with the complainant gave her “advice” within the meaning of that term in the FAIS Act. To

⁵ The insurer involved, RMB Structured Insurance Ltd, is a member of neither the LOA nor SAIA.

the extent that she was not a qualified and registered financial adviser, and purported in respect of a financial product to render advice that did not measure up to the requirements of the FAIS legislation, the respondent, *“in conducting this transaction failed to comply with the FAIS Act.”*

- 2.8. There can be little doubt that the transaction fell foul of the FAIS legislation in a number of significant respects, particularly because the complainant was never put in a position where she could make an informed decision about the entire sales package. But it is questionable whether it amounted to the giving of “advice” when, on the complainant’s own version, *“she was presented with a number of documents and was merely asked to sign the forms at designated places”*. The respondent in its staff training manuals was rightly at pains to emphasize the vital distinction between “factual information” and “advice.” It is with respect arguable that the FAIS Ombud gave too liberal an interpretation to “advice” and that the actions of the sales lady fell within the former rather than the latter category.⁶
- 2.9. The evidence of Mr **Shaw** quoted earlier⁷ was that it is simply not practical to require everyone on the sales floor to be FAIS compliant. If any customer wanted advice about a product the instruction was that he or she should routinely be directed to a dedicated call centre where advice was dispensed by personnel trained to do so. What the sales lady on the floor did was simply to require the complainant, after she had decided what she wanted to purchase, to sign a number of documents. If such a “point and sign” procedure is consistently interpreted to be tantamount to the giving of advice it may have the unintended consequences of either inhibiting trade, to the detriment of consumers such as the complainant who may no longer have access to such articles, or of inflating the price of the goods to an even greater degree as the additional cost of training every member of the sales personnel to be FAIS compliant is passed on to the consumer.⁸

⁶ Because the issue of “advice” is problematic and has given rise to some uncertainty in the market, we attach, as a contribution to the debate, an elaboration on “advice” in the context of the Gumede determination, being appendix 15 to this report.

⁷ See chapter 7.

⁸ See footnote 6.

2.10. The many instances of market misconduct evidenced by what occurred in this case⁹ are further discussed under the different topic headings in the paragraphs that follow.

3. LACK OF PROPER DISCLOSURE

3.1. Disclosure is the cornerstone of consumer protection. Lack of disclosure, in a broad sense, can take various forms:

- misinformation;
- failure to disclose relevant information;
- failure to explain what has been disclosed.

3.2. The need to disclose in that broad sense is not of course confined to CCI; it is applicable to all contractual relationships and is governed overall by the common law.

3.3. Within the field of insurance generally and CCI in particular the two insurance Acts and their regulations, the FAIS Act and the General Code and the NCA all have specific disclosure provisions which were discussed in chapter 11.

3.4. In the paragraphs that follow we mention different manifestations within the field of CCI of a lack of proper disclosure.

3.5. Not disclosing costs and charges

3.5.1. Both the FAIS legislation and the NCA, discussed in chapter 11, require all costs, charges and fees payable by the consumer to the insurer, the credit provider or the intermediary to be disclosed to the consumer. Failure to do so would of course render the culprit liable to the sanctions of those pieces of legislation.¹⁰

3.5.2. Any fee, commission, remuneration or benefit receivable by the credit provider (as intermediary) is also to be disclosed to the consumer in terms of the NCA.

3.5.3. As far as the disclosure of charges and fees are concerned, **Capital Alliance** in its initial written submission stated:

“Consideration should be given to imposing consistent, possibly standardised, disclosure obligations regarding commissions and other fees and charges levied by all parties. The aim should be to ensure that consumers will understand the services provided and fees levied by all parties in the value chain,

⁹ See too paragraph 153 of the Gumede determination.

¹⁰ If advertising in newspapers is anything to go by, retailers do not always paint an accurate picture for consumers. So, for instance, a TV set was advertised as having a cash prize of R2199 and a “total repayable” of R3127.38 if credit is granted, whereas, if the sums are made, the total repayable amount is R3942; the comparable figures for a fridge was R6999 (cash prize), R9697.71 (total repayable) and R10722 (actual repayable amount).

as well as what proportion of their gross contribution is in fact utilised to provide insured risk benefits.”

3.5.4. The following relevant questions were asked of insurers in the follow-up questionnaire:

“12.1 Do you or do you not believe, and why, that there should be proper disclosure to consumers of all or some of the following:

- (i) all the components of the premium;*
- (j) the permitted remuneration payable to the intermediary/retailer/dealer/credit provider by the insurer*
- (k) any additional payments made or consideration granted, in addition to the permitted remuneration, made by the insurer to the intermediary/retailer/dealer/credit provider;*
- (l) any charges on the insured for services rendered by the intermediary for the benefit of the insured and which is to be collected by the insurer to be paid over to the intermediary;*
- (m) the insurer’s claims ratio per product line*
- (n) the insurer’s ratio of rejection of claims per number of claims made per product line.”*

3.5.5. All of the 20 or so insurers who responded declared themselves in favour of (j), (k) and (l) and reported full disclosure in terms of the requirements of the two Insurance Acts.

3.5.6. At the same time they expressed themselves strongly against (i) (with one or two exceptions), (m) and (n). Some of the reasoning is mentioned in the footnotes.¹¹

¹¹ **Absa:** *Re: (i) it is our view that not all components of a premium need to be disclosed, other than the commission being received by the intermediary, and the costs directly associated with the administration of the policy in the forms of policy fees. The allocation of internal costs of the business are a propriety business secret and disclosing this to the public at large would violate the company’s right to secrecy in this regard, while disclosure to this level would not benefit the consumer. Furthermore, one does not find other non-insurance industries having to disclose all details of how their pricing is made up.*

Re: (m) and (n) disclosures of claims and rejection ratios per product line by themselves would not accurately reflect the reasons behind such ratios, without the addition of further extensive explanations. Market forces would dictate whether an insurer’s claims practices are acceptable to the market.

Holland: *(i) no, we do not believe that it is practical to provide a full breakdown of the premium per policy around risk, expenses, profit margin and the like: the client buys a value proposition which requires an assessment of benefit versus total price. We are, however, in favour of disclosing commission and other distribution costs.*

(m) no, as this is technical and would be meaningless to a prospective policyholder in the absence of detailed, comprehensible information. It would just serve to confuse the consumer and be negatively misleading as there may be valid grounds for a low loss ratio, eg. a low frequency, but high quantum profile of risk and policies where the risk increases over time, such as on mortgage protection policies.

3.5.7 The Panel has been persuaded by the arguments raised against (i), (m) and (n). Since the other matters are comprehended by the existing legislative provisions, the Panel's recommendation is that the status quo be maintained in this regard.

3.6 Not highlighting sensitive terms and conditions¹²

3.6.1 All the insurers who responded, favoured the disclosure to consumers of the following matters raised in the follow-up questionnaire:

Metropolitan: (i) No. Profit elements can be hidden by insurers within declared expense, commission and risk premium components, and so the value of this is limited. Metropolitan already declares commission and expenses, and this information, together with the knowledge of the total premium should allow consumers to make an informed decision.

(m) No. Claims ratios change month to month, and it has to be asked whether a consumer would be able to make use of such information, or whether it would only be confusing? We believe that credit life business should be kept simple for the consumer, and that claims ratio information would only be of value to a few consumers. In addition, the requirement to show values which regularly change will necessitate regular changes to documentation which is otherwise printed in bulk and in advance. This will increase the cost of producing material for customers, which will ultimately be passed back to customers in the form of higher premiums.

(n) No. As for m) this will require regular changes to documentation, and printing in smaller amounts, which will lead to higher premiums eventually. In addition, insurers are unlikely to reject many claims (and in fact often pay ex-gratia claims) as the insurance, besides offering protection to the customer, also offers protection to the credit provider, who most often is the policyholder or the corporate client of the intermediary. If an insurer rejects a lot of claims the credit provider is likely to want to move the business elsewhere. There is thus a self-regulating mechanism at work here which does not require any regulation and is likely to keep rejections to a minimum.

Nedlife: (i) Disagree, the 'profit margin' of the insurer and any other expenses including marketing costs does not need to be disclosed. The consumer needs to know how much of the premium is made up of commission. The decision must then be made on whether the cost of the credit life is affordable and is suitable to meet the need of the consumer. This is also not common practice on any other consumer goods sold in the open market.

(m) Disagree, Nedgroup Life do not believe that this is material to the consumer as they need to know what cover they have, is it at an acceptable price and the terms of payment.

This type of disclosure is also not common practice on any consumer goods sold in the open market. For example, retailers do not print on their goods how much the actual goods cost in relation to the total purchase price (eg. The actual cost of the cereal in a box of corn flakes) There should be differentiation within the financial services industry to ensure that consumer demand will ultimately determine the price of credit life insurance as it does in most other industries in free market economies around the world.

From an actuarial perspective there are also many challenges and difficulties in implementing this: (a) claims ratios vary over time and it would be misleading and confusing to take snapshots eg. In the early years claims are generally lower and a new company would 'unfairly' be seen to be paying lower claims than a mature provider (b) reserving should be taken into account which is a concept that would be difficult to communicate to clients (c) some product lines subsidise other product lines so taking a single product line in isolation may lead to incorrect observations as to the claims payments of particular providers.

(n) Disagree, Nedgroup Life do not believe that this is material to the consumer as they need to know what cover they have, is it at an acceptable price and the terms of payment.

Repudiation rates also differ over time and to take a historical snapshot would incorrectly show different repudiation rates for different product lines depending on the duration in force of the books in question. Comparisons would be difficult.

Pinnafrica: (i) No. Product benefits must be explained in the context of its price. There are many factors affecting pricing in product combinations, and the explanation of the various items making up the total premium will lead to customer confusion. It would be like explaining to a car buyer what the price is of every single component in the vehicle.

(m) No. The insurer's claims ratio is not of the concern of the policyholder. Profitability is of concern to the shareholders. The policy holder is concerned by the price vs. value.

Relyant: Much of the above would be burdensome to the insurer and meaningless to the lower LSM groups. There are no additional charges made (other than the gross premium) which would need any explanation. The items contained in (m) and (n) above would, in our view, be of no concern to our client base and merely lead to confusion. All applicable disclosures as required by the Short-Term Insurance Act, FAIS and the NCA are made to the consumer and no further information should be provided.

¹² See too sections 6 and 9 below.

“12.1 Do you or do you not believe, and why, that there should be proper disclosure to consumers of all or some of the following:

- (a) the free choice to consumers between insurers and credit insurance products;
- (b) exclusions, pre-existing conditions and limitations of cover;
- (c) an explanation of the meaning of pre-existing conditions and of what they exclude;
- (d) any waiting periods, pre- and post-sale;
- (e) any lapsing provisions;
- (f) an explanation of the consequences for the consumer of non-payment of any instalment or premium;
- (g) an explanation of the importance to the consumer of informing family members or representatives of the existence of the policy in the event of the death or totally disabling disability of the consumer;
- (h) any time barring clauses;”

3.6.2. Some insurers rightly cautioned against “overloading” the disclosure requirement. The point is made by **Liberty** in its response to the follow-up questionnaire: *“Liberty is of the view that the disclosure should be standardised. The sales process, whereby the credit life sale is embedded into the sale of credit for convenience of customer, does not allow for lengthy policy documents or disclosure as suggested in one. We are of the view that the client would not experience value in very lengthy disclosure requirements.”*

3.6.3. On the issue of standardisation of policy terms and conditions the numbers were, however, more or less evenly divided.¹³

3.6.4. The Panel supports the standardisation of *terminology*. As to the standardisation of *terms* the Panel supports it to a limited extent:

- limitations to the coverage and exclusion clauses, further discussed below, should be standardised and highlighted;
- so too, in the Panel’s view, should the consequences of the non-payment of instalments in time be spelt out and standardised if such a failure should lead to the lapsing of the policy and the possible invalidation of a subsequent claim.

¹³ **Clientèle:** *Consistent terminology is desirable but not consistent policy terms and conditions.*

Metropolitan: *No. Any standardisation removes product differentiation and competition between insurers.*

- 3.6.5. How these matters should be formulated and which other terms and conditions should be selected for highlighting are matters best left to the LOA and SAIA.
- 3.6.6. The Panel recommends that the two organisations establish a composite subcommittee dedicated to dealing specifically with CCI, including the issue of standard terms per product line.
- 3.6.7. Any such standard terms approved by the subcommittee and the other structures of the two organisations should, the Panel believes, then be escalated to the industry codes.
- 3.6.8. This should not be the only function of the dedicated composite subcommittee referred to above. As will appear from the remainder of this chapter and other chapters following it, the Panel believes that there are a number of other functions that should be assigned to such a subcommittee.

3.7. Not highlighting the health declaration

- 3.7.1. A comparable issue in regard to health declarations was raised by the Long-term Ombudsman who wrote:

“Credit life policies do often have the Terms and Conditions and the Health Declaration in what could be termed “small print.” The policyholder is asked to sign a form which is often attached to other forms that have to be signed at the date of credit provision. Amongst all the declarations the complainant has to sign is often a health declaration. This declaration is so important to the application for insurance that consideration should be given to highlighting it so that the policyholder’s attention is specifically drawn to the health declaration.”

- 3.7.2. It is recommended that the dedicated subcommittee referred to above give due consideration to these suggestions.

3.8. The need for a follow-up letter

- 3.8.1. The question posed in the follow-up questionnaire read:

“12.4 Do you or do you not agree, and why, with the suggestion made in evidence that every new policyholder should receive a follow-up letter explaining and highlighting all or some of the matters referred to in the opening paragraph of this section?”

3.8.2. The majority of the insurers were against the suggestion but there were also arguments raised in its favour.¹⁴

3.8.3. In the Panel's view there is merit in the suggestion of **Regent Insurance**: "*Policyholders should be sent a welcome letter together with the policy, highlighting important issues.*" This should be made a standard industry practice. A similar suggestion was made by **Consumerwatch**, a consumer organisation: "*A one-page summary of the insurance details should be sent out with monthly statements, as these statements are always kept in a safe place, and it would serve as a constant reminder*".

3.9. Not informing complainants of their recourse to Ombudsman's offices

3.9.1. This issue, following on suggestions from the Long-term Ombudsman, was raised in the following terms in the follow-up questionnaire:

"12.6 Do you or do you not believe, and why, that it should be a standardised procedure that the consumer should be referred to the relevant ombudsman's office whenever a credit insurer refuses to comply with or meet a request, complaint or claim from a consumer?"

3.9.2. The question was misunderstood by some insurers in their responses to mean that every such refusal should automatically be referred to the relevant ombudsman's office. Such a suggestion would not be practical.

3.9.3. Properly understood the question presupposes that a complainant who does not get satisfaction should routinely be informed of his or her right to approach an ombudsman's office, not only when a claim is formally rejected but also when a request is refused or a complaint is dismissed. In that sense the Panel supports the

¹⁴ **Absa**: *We do believe that, ideally, follow-up disclosure would add to the consumer's better understanding of the product he has purchased. However, once again this could push up the cost of the lower premium market to unaffordable levels. One way of ensuring such disclosure would be to insert such information into the policy contract sent out to the client.*

Clientèle: *This can be done as a 'belt and braces' option. (However, experience would suggest that it will have little overall effect on the actual level of complaints. This is at least in part as a result of the fact that few South African's read such documents received in the mail, and where it subsequently suits them, can often suggest that they did not receive them or failed to understand them.)*

Guardrisk: *We do not believe this is appropriate in all instances. Credit life is sold in a variety of ways (bank branch, call centre, cellphone sms) and a follow up letter is not always possible or appropriate. The relative incremental cost is high, and the customer will not perceive significant additional value in another follow up letter.*

Liberty: *We do not believe this is appropriate in all instances. Credit life is sold in a variety of ways (bank branch, call centre, cellphone sms) and a follow up letter is not always possible or appropriate. The relative incremental cost is high, and the customer will not perceive significant additional value in another follow up letter.*

Metropolitan: *Metropolitan does agree that consumers should be presented with all relevant documentation containing necessary disclosures, but this can be presented at application stage in a clear format and need not be sent as a follow-up letter.*

Relyant: *We believe that this would be beneficial and could be sent out with the next applicable statement forwarded to the credit receiver.*

suggestion which it recommends should be implemented as an industry practice and accommodated in the relevant codes of conduct.

3.9.4. The Office of the Ombudsman for Long-term Insurance has raised a special problem.

“In some cases the credit provider institutes re-possession procedures while our office is busy dealing with a complaint. Complainants tend to come to our office at a stage when the credit provider/insurer has already declined any potential claim (even when re-possession has already taken place). This causes a problem in the office as we are then dealing with the situation where the horse has already bolted. Where the repossession proceedings have not yet been instituted we are sometimes requested to provide the complainant with a letter advising the credit provider that a complaint has been lodged with the office and that a resolution has not yet been reached. This tends to halt potential proceedings.”

3.9.5. This does not appear to be a problem that is intrinsic to CCI but it could alleviate the position if it is made an additional industry practice, to be considered by the dedicated committee referred to earlier, that a consumer be informed of his or her recourse to the relevant ombudsman’s office whenever an insurer or credit provider is about to take legal proceedings against the life insured.

4. **PRE-SALE MISSELLING BY INTERMEDIARIES**

4.1. This complaint is not of course peculiar to CCI. It is a generalisation, but nevertheless not wide of the mark, that there is what was described in evidence as *“the shine factor”*, especially with motor cars, which tend to blind consumers that their only other interest is the amount of the monthly instalment. Such an atmosphere is conducive to exploitation by unscrupulous intermediaries.

4.2. Misselling is a form of misrepresentation giving rise to the ordinary common law remedies of rescission.

4.3. The Short-term Ombudsman gave the example of an extended motor warranty being sold on the basis that *“it is an extension of the manufacturer’s warranty and covers everything”* whereas, firstly, the manufacturer’s warranty had already expired when the policy was sold and the cover, secondly, was otherwise severely limited by the terms of the policy which, thirdly, were not explained and, fourthly, reduced as the mileage of the vehicle increased.

4.4. The *Gumede* determination¹⁵ is another instance. The complainant was not told that the documents she signed contained insurance products and she was misled as to the amount for which she was liable. Other examples appear from the paragraphs that follow.

5. LACK OF AWARENESS BY CONSUMERS OF THE EXISTENCE OF THE CONSUMER CREDIT INSURANCE POLICY

5.1. CCI is frequently sold as part of a package comprehending the sale of the asset, the credit agreement, the product insurance and CCI agreements, with a single composite instalment covering the consumer's various obligations to pay. The Long-term Ombudsman gives the example of the payment of a clothing account which includes the repayment of credit as well as the premiums for CCI and possibly some funeral insurance as well. The FAIS Ombud's *Gumede* determination, quoted earlier, is another striking instance.¹⁶ Unless the consumer's attention is specifically drawn to this tangle of transactions he or she may not be aware of the existence of the CCI.¹⁷ This is particularly so since CCI is mostly taken out at the insistence of the credit provider, rather than the life insured, as a form of collateral security for the repayment of the outstanding debt. As such the life insured, who may not even be the policyholder, may be a more or less passive party, apart from being obliged to pay the premium as part of the package.

5.2. So too, many consumers may not be aware that they are policyholders of the life company because their policies are often sold under the "white label" of the finance house that is being used.¹⁸

5.3. The submission of the Long-term Ombudsman continues: "*When the account holder defaults on the repayment of his credit the premium also falls into arrears. The account payer may not be aware of the dual effect of the non-payment of his account and is then taken by surprise when a*

¹⁵ See section 2 above.

¹⁶ See par 54 of the FAIS Ombud's determination.

¹⁷ In response to the follow-up questionnaire **Consumerwatch** said: "*It's very clear that most people don't even know they're buying credit life insurance – in fact, I've handled many cases – furniture ones – where the customer was not even given policy documents, so in the event of their disability or death, no-one would be any the wiser and no claim would be made.*"

And again: "*because consumers acquire [credit insurance] by default. They don't set out to buy life insurance, they set out to buy a fridge, for example, and acquire it by default, mostly without any real understanding of how it happened.*"

¹⁸ The point is well made in the article by **Personal Finance** of 7 July 2007 which caused this enquiry to be launched.

claim is submitted but declined, the insurer relying on the lapsing of the policy due to non-payment of the premiums.

- 5.4. A different aspect of the problem arises in the case of death, disability and perhaps retrenchment claims when the life assured may have been aware of the policy but his or her family members who are to initiate a claim may not be. This aspect is also mentioned below under the heading of “Time bars.”
- 5.5. Insurers were asked in the follow-up questionnaire:
- 13.1 Do you agree or disagree with evidence that was given that:*
- (a) consumers are sometimes confused or misled by the fact that they pay a composite instalment for the purchase of an asset, for finance charges, for the premium for the insurance of the asset, for the premium for the credit insurance and sometimes for the premium for funeral cover;*
- (b) consumers (or their families in the case of death or disablement) may not always be aware of the fact that credit insurance exists and that a claim can be made;*
- 5.6. None of the respondents challenged the correctness of the evidence. As to “the cure”, both aspects were treated as disclosure issues. A sample of suggestions made is given in the footnotes in respect of (a)¹⁹ and (b)²⁰.

¹⁹ **Alexandeer Forbes:** *Yes, however the client should receive a statement detailing the breakdown.*

Metropolitan: *It should be a requirement that the cost of the loan in terms of instalments, and the cost of credit insurance should be shown separately. This will also help ensure that credit providers do not charge interest on insurance premiums.*

Relyant: *Lower LSM group consumers generally prefer to have one instalment provided to them in respect of all indebtedness which would incorporate the insurance component. We do not believe that it makes sense to confuse the consumer and in our own group we have not had any problems of this nature in the past.*

Wesbank: *Agree. It is our belief that sometimes the consumer does not fully understand what insurance products he has been sold. He is sold an instalment, which often includes an insurance component.*

Full disclosure to be given by the intermediary, to the consumer at point of sale. Thereafter, the insurer should provide the consumer with a policy document, containing full disclosure and the insurer should inform the credit provider that their interest has been noted.

²⁰ **Centriq:** *A breakdown of the costs should be disclosed at the point of sale, claims procedures and family awareness including notification of cover to beneficiaries should be highlighted and agreed at the point of sale, time barring periods for instituting claims should be extended to a minimum of twelve months for death and disability claims.*

Guardrisk: *In respect of 13.1.b – our suggestion would be to send the consumer a communiqué on an annual basis.*

Metropolitan: *It should be suggested to consumers upon approval of insurance that they make their families aware of the insurance.*

Pinnafrica: *Yes. This is a common problem across most classes of personal insurance business, including car and home insurance.*

Relyant: *As regards the death and disablement claims, we have explained earlier that the credit follow-up process generally leads to a situation whereby the credit provider and its aligned insurer becomes aware of the reason for non-payment of the instalment sale agreement and the insurance policy which then leads to settlement of a claim.*

Wesbank: *Agree. This has become increasingly important as the credit provider is also unaware of the existence of a policy and will not therefore lodge a claim on the consumer's behalf.*

- 5.7. The Panel recommends:
- (i) as to the first issue:
 - that both the identities and capacities of the participants in the distribution chain be disclosed to the consumer;
 - that a breakdown be provided to the consumer of how the instalment payable is made up;
 - (ii) as to the second issue: that consumers be advised, at the point of sale and in appropriate cases, to inform their family of the existence of the policy;
 - (iii) that the dedicated subcommittee referred to above be tasked to devise the best means of giving effect to these recommendations.

6. **FAILURE TO EXPLAIN THE TERMS OF THE POLICY, THE LIMITATIONS AND THE EXCLUSIONS OF COVER**

- 6.1. In its presentation to the Panel the office of the Long-term Ombudsman, quoting from its 2006 Annual Report, described this problem as it relates to credit life insurance as follows:

“When application is made for credit, a policy sale is often linked to the credit sale. The policy thus becomes part of the “package”. These so-called credit life policies provide cover for consumers who might not otherwise obtain insurance cover at all ... In most such instances cover is offered irrespective of their state of health but subject to the terms and provisions of the master policy, which invariably exclude liability if the insured event relates back to a pre-existing medical condition. Premiums may be lower than they would have been had the policy been underwritten and issued without any exclusions.

This is all to the good - provided the applicants fully understand what they are or are not getting for the extra money they pay.

A typical pre-existing exclusion clause may read as follows:

“The insurer shall not be obliged to make any payment in respect of any condition or event arising directly from or traceable to any physical defect or infirmity of which the life insured was aware and which had its origin prior to the issue of the policy”

Should a claim arise and it is related to “any physical defect or infirmity of which the life insured was aware and which had its origin prior to the issue of the policy” the insurer would be entitled to decline the claim.

Exclusion clauses that are unambiguously worded are not inherently bad - they may keep premiums down and protect the insurer against the spectre of anti-selection.

We regularly receive complaints about claims that are declined because of the above type of exclusion. In many instances the complainants allege that they or the life assured were not informed, either properly or at all, of the existence or the implications of the exclusion clause at the time that the policy was sold to them. Complainants often misinterpret the absence of medical questions and investigations as an indication that the medical condition of the life insured is of no relevance to the benefit payment. Expectations are thus created at the point of sale which are not fulfilled at the point of claim.

A concern of the office is that applicants for credit life policies are not properly made aware of how severe the application of the pre-existing conditions clause can be. A pre-existing condition such as hypertension may lead to the repudiation of a claim for a heart attack or a stroke as the insured event may be traceable to the insured’s condition prior to the issue of the policy. In fact, if the life insured suffers from any serious medical condition, such policies may in effect provide little more than accident cover.

An applicant for a credit life policy who is made aware of the extent and implications of the exclusion clause would at least be in a position, if so minded, to shop around to determine whether alternative, albeit more expensive, options are available. The Long-term Insurance Act, 1998 requires that the applicant should have free choice to purchase cover. But a choice can only be fully free if it is fully informed.²¹

The sales of these policies are often conducted telephonically and by furniture, car or similar salespersons. Complaints coming to us about misinformation of this nature occurring after 1 October 2004 are routinely referred to the FAIS Ombud for the attention of his office. But the cure is in the hands of the marketers of these products at the time of sale not in the hands of an ombudsman at the time of complaint.”

²¹ The life insured’s free choice to substitute his or her own policy for the policy suggested by the credit provider, is discussed more fully in chapter 11 section 2.

- 6.2. As appears from the paragraph on extended warranties below the problem that consumers do not always appreciate the extent and implications of limitations and exclusions to the cover is not confined to credit life but applies, with one apparent exception, to all forms of CCI.
- 6.3. The one exception is the furniture retail business. Insurers in that sector were at pains to explain that preconditions are either waived or treated generously by insurers in favour of consumers so as not to alienate them for future business.²² The risk of anti-selection and dubious claims is thus built into the rates which, for that reason, must be higher than would otherwise have been the case.²³
- 6.4. It is recommended that the matter be referred to the dedicated committee or committees of the LOA and SAIA, referred to earlier, to consider annexing a special page to or a box in the policy in which the consumer's attention is specifically directed to the core provisions of the policy, highlighting exactly what is due *by* the consumer by way of payments and what is due *to* the consumer by way of benefits.

7. FOISTING POLICIES ON CONSUMERS

²² Thus it was said in evidence by Mr **Shaw**, speaking for SAIA:

"I think that the retailing industry themselves through their own insurance operations, were forerunners in the market place in removing the HIV/AIDS exclusion and in fact all elements of pre-existing conditions were taken out of the policies because they said we have, as the lower income groups, we need to provide a cover for them and the premiums were hiked at the time to take care of this contingency, and we'll talk a bit more about that.

MR SMITH: *Are you saying that the retailers don't have any pre-existing exclusions at all?*

MR SHAW: *They don't have in their policies because they were taken out. And that is the furniture retailer's operation. I'm not talking about any other types of retailers that sell, the Pick 'n Pays and those sorts of people, I'm talking about those who sell furniture, white and brown goods.*

CHAIRPERSON: *So it's built into the rate?*

MR SHAW: *Built into the rate, yes. It was a problem because essentially they wanted to pay the claim. I know that there was a perception that was mentioned earlier that the premium rates were very high but there's a perception to pay the claims because it prevents a bad debt on the other side and so they wanted to give it the widest form of cover that they could with as much in the way of extension, because there was no underwriting, you had the cover and you were to be indemnified if any event actually occurred, unless there was a seriously unlawful event, and those conditions and exclusions are in the policies."*

And again:

"But the mindset of the retailer is: Listen, we want to pay the claim, if there is a claim, because we don't want a reputational issue. We want the client to come back because he's slowly, over a period of years - and for many of the retailers, the NCA has created other complications but because a person has been a good payer for 11 of 12 years, is going to be buying more things down the line, now of course you've got to do this whole financial assessment, which is a separate issue and it's created other complications. But they want to keep the client on their books as long as they can."

²³ But see too chapter 13 sections 2 and 5.

- 7.1. The consumer is either unaware that he or she is a party to a CCI policy, in which case the matter is covered by what was said earlier in this section; or the debtor was so aware but the CCI policy was automatically issued as a secondary product, contrary to the “free choice” rule discussed in chapter 11²⁴ or the debtor was wrongly pressurised into signing up for a policy, in which case it may serve as an instance of misselling discussed above.
- 7.2. A variation on this theme occurs when the debtor is induced to take out a policy which is unnecessary or inappropriate for its stated purpose,²⁵ which is also akin to misselling, discussed earlier.

8. **AMBIGUOUS AND OBSCURE POLICY LANGUAGE**

- 8.1. The FAIS legislation requires plain, unambiguous and non-misleading language to be used in the policies. The Panel called for copies of policies used in its follow-up questionnaire. Our impression, on looking at these policies, is that insurers do strive to simplify and clarify the language used therein.²⁶ Enough examples to the contrary have, however, been quoted by the Long-term, Short-term and FAIS Ombudsmen to be cause for concern.
- 8.2. The recommendation of the Panel is that the dedicated subcommittee of the LOA and SAIA referred to above,²⁷ be asked to communicate with the various ombudsman’s organisations with the request to inform the subcommittee whenever they encounter examples of unacceptably obscure language. The information thus

²⁴ Section 2.

²⁵ An example of a policy being foisted on a party comes from the office of the Ombudsman for Long-term Insurance. The children of a 75 year old man decide to give him a second hand Mercedes Benz motorcar as a present. The dealer insisted that life policies be taken out to secure the purchase price not only by the children but by the father as well. It took the ombudsman’s office to have the father’s policy cancelled when the debt was eventually paid off by the children. A comparable situation can occur, referred to by **Consumerwatch**, that a consumer may be required to take out a new life policies every time a new item of furniture is purchased. Depending on the circumstances this may be an abuse.

²⁶ Mr **Van Zijl**, the previous Short-term Ombudsman, gave this example of misleading language in his evidence: “*For example, in one case that I had the policy was in the form of a booklet and the limitations were in the paste-in loose leaf, and the limitations were on the underside of that loose leaf. And according to the Claims Manager he says that’s the most looked at part, that’s trying to pull the wool over my eyes, because you can’t expect Joe Public to look underneath a paste-in for the limitations of his policy.*” Later in his evidence he added: “*...a lot of companies have gone for plain English, they’ve got on one side of the page what is covered and on the other side what is not covered, so any unsophisticated person can clearly see what is the score there.*”

²⁷ Section 3.6.8

gathered can be used to improve standardisation of clauses, as is recommended elsewhere in this section.

9. EXCESSIVELY WIDE LIMITATIONS AND EXCLUSION CLAUSES

- 9.1. It is one issue whether the consumer was aware of terms in the policy that would limit or exclude a claim on it;²⁸ it is another matter whether the terms concerned, viewed objectively, are always reasonable.
- 9.2. This issue is not peculiar to CCI. Waiting periods and exclusion clauses have been a hot topic in the insurance industry for many years. They are, in the absence of underwriting, a necessary corrective and underwriting is not always feasible²⁹ especially in the case of low-priced policies, notably CCI policies.³⁰

²⁸ Compare sections 3.6 and 6 above.

²⁹ The following case note from the Long-term Ombudsman office can serve as a typical example of the operation of an exclusion clause that is not unreasonable:

“The life insured applied for a policy on 14 October 2005. During September 2005 he fell ill and consulted a doctor “who advised him that he had heart failure, but that he had fully recovered and that he can proceed with his normal daily work.” Only after the entry date, during February 2006, certain tests were performed and a diagnosis of cardiac amyloidosis was made. On 16 July 2006 he died of cardiac amyloidosis. The insurer declined the claim as “the cause of death is traceable to a medical condition that existed before the inception date of” the policy. The beneficiary took the view that, as the diagnosis of cardiac amyloidosis was made after the entry date of the policy, the claim should be met.

The policy provides for the following:

“The insurer shall not be obliged to make any payment in respect of any condition or event arising directly or indirectly from or traceable to any physical defect or medical condition of which the Life Assured was aware and which had its origin prior to the issue date of the policy.”

We referred the matter to a specialist physician, a member of the medical panel who advises this office from time. His report stated that “Mr E was aware that he had heart disease needing ongoing treatment and further investigation before inception of the insurance. This was the disease responsible for his death...”

We agreed with his view and informed that complainant accordingly. In the result the complaint was not upheld.”

³⁰ Mr Ross, in his evidence, explained, as far as credit insurance is concerned:

“So underwriting is viewed as a process killer because it delays the process, it takes time, it adds a whole lot of additional complexities in terms of going through formal complete underwriting, getting bloods, asking all sorts of questions. So that's why, particularly for smaller cover amounts the pre-existing conditions of different types are predominant, the majority of the market players would use pre-existing conditions.”

And again:

“...from an underwriting point of view there were only four participants who did underwriting and all the other participants used a pre-existing condition and then that determines what type of pre-existing condition was applied.”

And again:

“In the Credit Life market place, because of the process involved, if I was an insurer in this market I would use pre-existing conditions. So it's a matter of making it reasonable and understandable to the consumer.”

As for micro-lending:

9.3. Common as these limiting clauses in the policy documentation are, equally common are complaints that they are wider than they should be to protect insurers and that the reliance by insurers on such clauses to escape liability borders on consumer exploitation.

9.4. Exclusion clauses were raised as a separate topic with insurers in the follow -up questionnaire.

9.4.1. The first question posed was:

“11.1 There was evidence to the effect that “limitations and exclusions are so vast that they can even be described as ‘a licence to print money’”. Do you agree with that statement and if not, why not?”

9.4.2. Predictably insurers were unanimous in disagreeing with the proposition.

9.4.3. The next question posed was perhaps more to the point:

“11.2 Do you or do you not believe, and why, that any form of pre-existing conditions as a defence to a claim on the policy:

(a) should be abolished entirely;

(b) should be retained, at the discretion of the insurer concerned, provided they are unambiguously worded, specific, properly explained and highlighted;

(c) should be standardised throughout the industry in respect of the particular credit insurance product?”

9.4.4. Again, all insurers responded negatively to the first question and positively to the second.³¹ As far as standardisation is concerned there were mixed responses.³² The

“Basically because it's such a low amount of money, they're just pricing for it. So the anti-selective risk there is minimal and they're saying if the maximum we're going to pay out is R10 000, it's a bit like a funeral policy, they just price for it.”

³¹ **Absa:** *(a)- (c) We believe that pre-existing conditions have a definite place in the acceptance of risk in the credit insurance market, and contribute to the affordability of cover by obviating the need to carry out costly underwriting procedures for each case. However, it is agreed that the nature and effect of such a feature in the policy should be clearly disclosed and explained to the client through proper disclosure mechanisms, especially in the lower end of the market. There is scope for a standardised approach to the wording and definition of such clauses in policies, as this will facilitate a common understanding amongst consumers.*

Alexander Forbes: *Pre-existing conditions are important terms that reduce underwriting and therefore cost (for small sums assured medical underwriting is impractical). It is critical that, as with other terms in the policy, the advisor explains the impact thereof.*

Metropolitan *is in agreement with point (b) that pre-existing exclusions should be at the discretion of the insurer, but clearly worded, explained and highlighted. Insurers are in the business of accepting risk, and so should have discretion as to what risks they are prepared to accept. Insurers using credit life group schemes should also be allowed to protect the majority of members who would not claim for reasons excluded (such as suicide) against likely premium increases that would result from the removal of pre-existing exclusions.*

majority of responses were either against standardisation or were non-committal. A representative sample of responses to all the questions is in the footnotes.

9.4.5. The third question posed read:

“11.3 How would 11.2(a), if implemented, affect:

- (a) your business;*
- (b) consumers generally?”*

Momentum: *It must be borne in mind that with credit life there is no or limited underwriting and therefore limitations such as pre-existing conditions and certain other exclusions are reasonable. If these were not allowed the cost of the product would be exorbitant. We agree that the exclusions should be reasonable.*

Historical claims ratios of between 30% and 60% do not point towards excessive limitations.

We believe that any form of pre-existing conditions as a defence to a claim on the policy should be retained, at the discretion of the insurer concerned, provided they are unambiguously worded, specific, properly explained and highlighted. Abolition of exclusion of pre-existing conditions would only be feasible in the light of stricter underwriting, with a commensurate increase in costs and an increase in premiums. This is already a requirement in law.

Nedlife: *No. The costs of not having a pre-existing clause would be excessive and undermine the fundamental nature of the non-underwritten business model. Pre-existing clauses are inserted to protect both the policyholder and the insurance company against unfair consumer practice and anti selection practices. Excessive anti selection behaviour can result in a specific product being totally unprofitable which will result in premiums being increased. This would result in all policyholders being negatively impacted. Pre-existing clauses are aimed to protect all policyholders within a particular product. If these pre-existing conditions were to be removed premiums could increase significantly: effectively the majority of clients would be penalised by the minority who anti-select against the insurer.*

Relyant: *Generally speaking, the insurers and aligned furniture retailers go out of their way to remove exclusions and limitations in order to settle a claim and keep their client happy and desire to continue to sell household goods to the client during his/her lifespan.*

³² **Hollard:** *Possibly YES, as long as this cannot be viewed as anti-competitive (which could negatively affect competition in the market) and provided that the clauses are properly worded and are comprehensible to an ordinary consumer. It is a drastic move to standardise any wording - it would be preferable to draw up some guidelines as to how these clauses should be worded, as it would be inappropriate for the regulator to prescribe to insurers how they should underwrite. We are aware that there are some case law precedents on the interpretation of pre-existing conditions and perhaps regard could be had to these in the preparation of such guidelines. Different insurers may want to exclude different risks. Standardising wordings may result in some insurers not being able to control or manage certain risks and therefore certain market segments not being serviced by new products. It may be appropriate in the LSM 1 to 5 market segment to standardise wordings to facilitate access (as has been done with the Zimele and Mzansi products), but this is not appropriate in more sophisticated markets. It would limit an insurance company's ability to innovate and manage large and unusual risks, thereby reducing competition.*

Nedlife: *No as this would reduce future product development, competition and innovation, all of which could have a negative impact on customer experience within the credit life market.*

Pinnafrica: *No. Product differentiation and innovation provides competitive advantages and improvements which, in open market conditions where normal competitive forces are at play, are to the benefit of the consumer.*

Wesbank: *Yes, they should be retained at the discretion of the insurer, provided they are unambiguously worded, specific, properly explained and highlighted. In addition to this, there should be a 12 month each way pre-existing condition so that the consumer is not prejudiced.*

- 9.4.6. The response of the insurers canvassed was generally that it would harm insurers without benefiting consumers if waiting periods and exclusion clauses were to be abolished for all product lines.³³
- 9.5. From the submissions received and the evidence of the offices of the Long-term and Short-term Ombudsmen,³⁴ it would appear that excessively wide limitation and exclusion clauses effectively or largely neutralizing the cover in the policy, do sometimes occur in the case of CCI. Any such clauses would, in the Panel's view, be tantamount to a cynical abuse by the insurer of the more powerful position it occupies vis-à-vis the consumer.
- 9.6. Particular examples of such clauses in current policies have not, however, been quoted to the Panel. The examples of policies submitted by insurers in response to the follow-up questionnaire have not revealed any waiting periods or exception clauses which struck the Panel as excessive or unconscionable.
- 9.7. Notwithstanding the reservations expressed about standardisation of waiting periods and exclusion clauses, the Panel believes that such a practice should be encouraged. It would introduce greater certainty into the entire industry and pre-empt the likelihood of consumer exploitation.
- 9.8. The recommendations of the Panel are:

³³ **Guardrisk:** *This will significantly increase the cost of underwriting the risk which will ultimately be borne by the consumer by virtue of increased premiums.*

Hollard: *If exclusions of cover for pre-existing conditions were entirely abolished:*

(a) Our business would be negatively affected, in that consumers would anti-select against us, it would be difficult to assess the correct premium to charge for a particular risk, what to reserve for claims, how to assess reinsurance requirements and how to underwrite generally. We may have to load premiums to cater for this, which may make products unrealistically expensive.

(b) This would result ultimately in more expensive products for consumers in that the premiums would of necessity have to increase to take care of the unknown in the form of size, number and frequency of claims on a particular product and how much to reserve. The premiums would have to be increased too to cover those sub-standard risks which would remain unknown and which would now be covered. To cope with this, some insurers may narrow the cover under a particular product (e.g. by only covering certain risks and excluding others altogether) in order to protect themselves, which means less cover for a consumer. In addition, whereas currently there is little underwriting on these products, insurers may be forced to require more comprehensive underwriting, obliging potential insureds to undergo medical examinations and provide detailed medical and other information up front before being granted cover. For small sums insured, this would be impractical owing to the size of the premium. This will be lengthy, time-consuming and inconvenient for the consumer and ultimately slow down the credit granting process, and business generally, as the retailer (for example) will not sell items on credit until the relevant credit insurance is in place. If an insurer is not adequately reserved on a particular product, the size of a particular claim or claims on a scheme could prejudice its financial soundness, which would not be in its clients' interests.

We are therefore of the view that it is not in consumers' interests to abolish pre-existing conditions entirely and hence we agree with the proposal in 11.2(b).

³⁴ See too the Press release of **National Consumer Watch** of 31 August 2007.

- (i) that the dedicated subcommittee of the LOA and SAIA referred to above devise a series of standardized clauses dealing with waiting periods and exclusions in the CCI industry that are appropriate for different CCI policies;³⁵
- (ii) that such clauses be accommodated in the industry codes;
- (iii) that the dedicated committee liaise with the relevant Ombudsman's organizations to invite them to advise the subcommittees of any instances of grossly excessive waiting periods or exclusion clauses.

10. EXTENDED WARRANTIES³⁶

10.1. The office of the Short-term Ombudsman expressed serious concerns about this product.³⁷ It reported "*a disproportionately high number of complaints*" about it. Apart from the question whether it is properly conceived to be an insurance product,³⁸ the manner of the sale of the product appeared to be open to criticism,³⁹ the wording of policies was often ambiguous and filled with "*technical industry jargon*";⁴⁰ limitations to the cover and exclusions were not highlighted or explained⁴¹ and insurers are sometimes unduly technical in rejecting claims.^{42 43}

³⁵ The LOA's Zimele product standards can serve as a prototype. As Mr **Joubert** put it in evidence: "*...what we found in the past is that this is the sort of thing where self-regulation really works well. We can often sort of bring it in gently by saying these are recommendations endorsed by the LOA Board and a year later we would then formalise it into the code of conduct because you don't actually need to formalise it as part of a binding code of conduct, it really works well.*"

³⁶ See too chapter 3 section 2.

³⁷ The Short-term Ombudsman's submission reads: "*The idea is that the product is supposed to give you peace of mind when you buy a second hand vehicle as it promises to pay for all mechanical breakdowns you may experience with the vehicle. The fact that most second hand vehicles are sold on a voetstoots basis creates an ideal selling opportunity and enables the seller to pass the risk of comebacks onto an insurer.*"

³⁸ See chapter 3 section 2.

³⁹ "*Fine print is never explained and often the policy is not even available at point of sale.*" As it was put by Mr **Van Zijl**, in his evidence: "*So it has created enormous problems because from complaints we've had that is the basis upon which a lot of these policies were sold. Especially to unsophisticated people. They were told this policy will cover any form of problem that you have, and they were never told about the limitations, exclusions and that sort of thing.*" Mr van Zijl was also critical of the role of some underwriting managers. See chapter 9 on underwriting managers.

⁴⁰ "*Although not a specific peril or covered component, benefits are also limited (usually by as much as 50%) if overheating was found to be the cause of the damage. We usually point out to insurers that a car overheats because of the failure of another part. Overheating seldom occurs independently.*" And again: "*These policies also often provide that in the event of more than one part/component failing, then only one would be covered. This can of course have serious implications where two major components fail at the same time.*"

⁴¹ "*The policy is sold on second hand vehicles, often with very high mileage, yet cover is severely limited depending on the mileage of the vehicle and wear and tear is often used to further limit benefits.*" Mr **van Zijl** put it more dramatically: "*Limitations and Exclusions are so vast that they can be described as 'a licence to print money.'*"

⁴² "*The last problem area I want to address relate to the requirement on these policies for the vehicle to undergo regular services. Although one can't fault the requirement, the implementation of this condition again leaves much to be desired. If the client missed a*

10.2. According to the Short-term Ombudsman the product promises more than it delivers⁴⁴ and is in need, as it was put, of “*a major overhaul.*” The points of criticism raised deserve serious consideration by the short-term industry and the Panel recommends that the dedicated subcommittee referred to above gives the matter its urgent attention.

11. DIRECT MARKETING

11.1. Direct marketing is dealt with in the FAIS General Code and the PPR referred to in chapter 11.

11.2. The Long-term Ombudsman reported “*that a lot of credit life is sold through direct marketing and the complaints that we receive often relate to directly marketed policies.*” The complaints were “*mostly and more pertinently...that they weren’t told at the time of the sale that there were these exclusion clauses, that they were under the impression that because they were not sent for any medical investigation that the medical condition of the person did not affect the policy at all.*”

11.3. The answer, according to the Ombudsman’s office, is, once again, proper disclosure at the point of sale. This in turn means that the personnel dealing with the sale should be properly trained and have a code of conduct governing the procedure when the sale is

service interval (even marginally) the claim is rejected irrespective of whether the service would have made a difference to the loss or not.”

⁴³ The Short-term Ombudsman provided the Panel with two case studies illustrating the point:

1 *The Insured bought a second-hand bakkie on 1 February 2006. At the time of the purchase, the bakkie had already covered 237 000 kilometres. The salesman of the bakkie also sold a motor warranty policy to the complainant. A month later, i.e. on 3 March 2006, the engine seized. The total cost of repair of the engine was R13 906. The Insurer tendered R2 666.66, being one third of the insured amount of R8 000, and rejected the balance of the claim relying on the exclusion of ‘wear and tear’.*

The Ombudsman pointed out to the Insurer that the fact that the bakkie had already covered 237 000 kilometres was well known to the salesman who sold the policy on behalf of the Insurer and that the loss occurred after the vehicle had done a mere 1600 kilometres since purchase. It was unreasonable for the Insurer to reject the claim based on the alleged ‘wear and tear’ and it was ultimately persuaded to pay the full benefit of R8 000.00

2 *When the Insured took out his Engine Warranty Policy on the 16th January 2003, he pointed out to the Broker that the Pajero had previously been serviced every 10,000 Kms. until 120,000 Kms. He then arranged to have the service intervals changed from every 10,000 Kms. to every 20,000 Kms. At 176,000 Kms. he had a problem with the Pajero’s differential and when he lodged a claim, it was repudiated because he had failed to service the vehicle every 10,000 Kms. The Ombudsman pointed out to the Insurer that the Insured had reasonably been brought under the impression that a service every 20,000 Kms. was in order. The Insurer agreed that there was confusion with regard to the service period and that the Insured should be given the benefit of the doubt. The claim was then admitted on condition that in future the Insured serviced his Mitsubishi Pajero every 10,000 Kms. as is in fact provided for by the manufacturer.*

⁴⁴ “*The warranty product appears to be structured in such a way that the insurer’s risk of making a loss is virtually eliminated and that the claim is unlikely to ever exceed the value of the premiums paid.*” On the product value proposition see chapter 13.

made. More is required than merely a standard script because the problem arises when the consumer asks questions falling outside the script.

11.4. Following on the suggestions of the office certain questions were asked of insurers in the follow-up questionnaire. The first was:

“2.4 If you are engaged in direct marketing of credit insurance:

(a) A copy of the standard script your agents would put to a consumer;

(b) Whether, and if so, what training is given to personnel interacting with the public in selling credit insurance.”

11.5. All the insurers involved in direct marketing confirmed that due training of staff is a given, sometimes by credit providers or by intermediaries.⁴⁵ Even so, these insurers should take note of the remarks of the Long-term Ombudsman.

11.6. The second question was:

“12.5 Do you or do you not believe, and why, that in the case of direct marketing of credit insurance the script should be standardised throughout the credit insurance industry?”

11.7. The answer, to a man, was no.⁴⁶ The reasons given are convincing. The most that can be suggested is that the dedicated subcommittees of the LOA and SAIA prepare a

⁴⁵ **Channel Life:** *All new staff members go through an intensive training schedule to ensure they understand the industry they work in. All agents selling credit insurance are enrolled in the FETC:Retail Insurance qualification (NQF4) to ensure compliance with the requirements of the FAIS Act.*

Nedlife: *Although Nedgroup Life is not involved in direct marketing, trained Nedgroup Life staff members visit and support all intermediary channels selling Nedgroup Life products. This is to ensure that all intermediaries receive relevant product training and on-going support.*

Relyant: *All staff who sell furniture and appliances offer insurance in the form of a ‘tick the box’ approach and any answers of any nature whatsoever which might arise from the simplistic form provided in respect of insurance, are referred to a comprehensive FAIS compliance Call Centre by the staff within the store. Such Call Centre staff are fully versed in all aspects of the insurance policies and are conversant in the following languages: English, Afrikaans, Zulu, Sotho, Xhosa, Pedi.*

Generally speaking we have found that the tick box approach coupled with the Call Centre has led to a very efficient function as, and when, questions regarding the insurance aspects are required. At the time of the introduction of the Financial Advisors and Intermediary Services Act (FAIS), discussions were held with the Financial Services Board regarding the manner in which the process would be handled. A basic product sold is to the consumer and detail is explained as, and when, required by the Call Centre since it would have been an impossible task for each branch of the credit provider (numbering approximately 1 150 in all around South Africa) to have installed fully trained and FAIS compliant persons in each branch. Absences due to illness and leave and other causes would have compounded the problem, hence the need for the dual approach.

Wesbank: *All staff, offering credit insurance and credit life insurance are only permitted to interact with customers when they have completed their FAIS training and have the required credits. These staff are then mandated to sell these products under WesBank’s FSP licence. Qualified staff are listed on our FAIS register, which in turn is submitted to the appropriate authorities.*

⁴⁶ **Absa:**

4.6-4.8 Given that credit insurance is marketed across a wide range of income groups in South Africa, we believe that for the LSM 1-5 a range of simplified products should be developed which are “pre-packaged” and contain a known level of cover for a

suggested template of core questions and answers for possible use by insurers. It is necessary to identify the “soft” areas of possible misunderstanding and to give prominence to issues such as any payments due to be made by the consumer to any party, the consequences of a default in any payment made, and the benefits due to the consumer and any limitations to and exclusions thereto.

12. TIME BARS

12.1. The requirement that a claim is to be made on the policy within a given timeframe, and the problems that arise when the requirement is not complied with, are not unique to CCI. The principle of time barring clauses in insurance policies is not in dispute. What may be debatable are two issues: one, the period that is allowed may not be reasonable and two, the life assured or the beneficiary or potential claimant under the policy may not be aware of the existence of the policy and hence of the time restraint. The latter point may but will not normally arise when the credit provider is the policyholder.

12.2. The second aspect is of course a disclosure issue, discussed in general terms in the paragraphs above. All the insurers to the follow-up questionnaire agreed that it was

known premium, as well as possibly other standard features. A policyholder acquiring such a product would know, through consumer education, that such product meets certain requirements, and he would not need to carry out enquiries on a range of other products to compare benefits, features and premium levels. This would be similar in concept to the Mzansi bank account, the recently-launched Fundisa collective investment scheme, or the Zimele product.

(Once again, competition laws should be kept in mind if there was to be industry collaboration regarding such an approach. Such proposed market segmentation could violate Section 4 of the Competition Act, and an exemption might need to be sought at an industry level in this regard).

For the market outside of LSM 1-5, current practices would continue to apply.

12.5 *In the absence of the alignment of all similar product features across all similar product ranges, standardised scripts would serve no purpose. However, if the range of “pre-packaged products” referred to in 4.6 above were to be implemented industry-wide, then such standardisation could be feasible.*

Hollard: *No, we do not believe that direct marketing scripts for credit insurance products should be standardised, since not all credit insurance products are the same. This would only create more confusion. Perhaps those portions of the scripts that relate to standardised terms in a policy or standard meanings, such as the meaning of a pre-existing condition or “days of grace”, could be standardised in scripts. We are not in favour of standardising as much as possible as this stifles innovation and is anti-competitive. It may arguably also create more supervisory work.*

Liberty: *Absolutely not. Certain components may be standardised, but the direct marketing script is a source of competitive advantage and differentiation*

Metropolitan: *No. Direct Marketers differentiate themselves and the quality of their marketing through the scripts used. FAIS already requires minimum disclosures and any further standardisation will remove the competitive element of marketing. Guidelines, or a code of conduct, could be agreed upon, however.*

Momentum: *No – for competitive reasons where an insurer believes its product is better than that of a competitor it should be able to exploit that difference.*

Pinnafrica: *No. Again, product benefits must differ, and sales techniques is a commercial advantage. Common disclosure requirements would be acceptable.*

vital that there should be proper disclosure to the consumer of any time barring clause.

12.3. The first issue is one for the industry. Respondents to the follow-up questionnaire were asked to reply to the following question:

“12.3 Do you or do you not believe, and why, that there should be no time barring provision in the policy (other than prescription) in the event that the consumer dies or is totally disabled?”

12.4. The responses received show that the industry regards time barring clauses as essential, even though individual complainants may in particular circumstances suffer as a result. A sample of answers received is in the footnotes.⁴⁷

⁴⁷ **Absa:** *Time barring provisions are used in insurance contracts to ensure that, once a claim has been refused by the insurer, the policyholder should act expeditiously to bring an action under the policy should he so wish. Most clauses contain a period of 90 days or more for this purpose, which period is considered reasonable for the claimant to gather sufficient facts to launch his case. However, it is conceded that should the claimant die, or suffer total disability, a time-bar clause could operate to the detriment of his estate or him personally, and for this reason, consideration could be given to a further extension, or suspension for a reasonable period, of such time-bar until such time as attention can once again be given to continuing with the action by an executor or other representative of the claimant.*

Alexander Forbes: *No from an administration perspective, there needs to be some reasonable time limit, otherwise long term reserving requirements will become complex.*

Centriq: *Yes there should be time barring clauses incorporated in these policies however they should be extended to say twelve months to allow for a reasonable period of bereavement before the beneficiaries have the opportunity to apply their minds to these issues. No time barring will however result in serious reserving issues for the insurers which will not be in the insurers ultimate interests.*

Guardrisk: *We believe that there should be a time barring provision in the policy. The main reason being to enable insurers to be in a position to adequately and accurately set aside reserves relating to outstanding claims.*

Hollard: *We believe that a time-barring provision is necessary and we would support a period of twelve months in the event of death and total disablement, as ordinary prescription periods may be too long. Unlimited periods compromise the insurer's ability to assess a claim in terms of the policy conditions. It is also not in the interests of the insurer's financial soundness to have to keep reserves for too long on claims that require a full pay-out. It also means that claims are not finalised, which means that the claim is left pending for long periods of time, which can facilitate fraud.*

Liberty: *For long term contracts the 3 year prescription period is sufficient. If the term of the credit life contract is very short (1 or 2 months) it would be reasonable to have shorter barring provisions.*

Momentum: *There must be some period to prevent claimants waiting until unfavourable evidence is lost or destroyed before claiming. Time barring also affects the way in which insurers reserve for claims that have been incurred but not yet reported, and there should be a stipulated period, that is reasonable to both parties.*

Nedlife: *There should be a reasonable time barring provision. Death claims should be differentiated from disability claims as the insurer needs access the relevant medical information timeously to adequately assess a disability claim.*

Claims received outside of the time barring period should still be assessed to give the client the benefit. These claims may still be repudiated based on this provision if the Life Company is prejudiced by not being able to obtain necessary information due to the time taken to submit a claim.

Nedgroup Life currently honours claims received outside of time barring periods although the claim is still assessed to ensure that there is no intention to defraud the life company.

Pinnafrica: *Time barring is necessary. The insurer has a right to earn a profit from insurance operation. If there is no time barring, the insurer will not be able to adequately reserve for claims which has been incurred but not reported, and would therefore not be able to manage its reports and accounts properly. For example, if no time bar exists, claims can be submitted 2 years after the claim was incurred. The insurer would have already declared its accounts without the knowledge of an impending claim. However, the time bar period must be reasonable.*

Real People: *In respect of disability, a time bar is crucial in minimising risks, as there is no underwriting on clients. Removing such a time bar would lead to an unavoidable increase in premiums.*

12.5. The follow-up questionnaire also posed the following question:

13.1 Do you agree or disagree with evidence that was given that:

(c) the time barring periods for instituting claims is generally too short?

12.6. The respondents differed in their assessment of the ideal time period.⁴⁸ 12.7 Given that it is not unreasonable for an insurer to insist that a claim should be initiated within a prescribed time limit, shorter than the prescription period laid down by law, the Panel's recommendation is that this issue be left to the dedicated committee referred to earlier to determine the appropriate period, fair to both the insurers and potential claimants, for each separate product line. Special provision may have to be made for death and disability claims.

13. CONFLICTS OF INTEREST

13.1. A number of parties can be involved in the CCI distribution chain – the life insured, the product supplier, the credit provider, the administrator, the intermediary (as defined in the two Insurance Acts) and, finally, the insurer.

13.2. Except for the life insured there may be close commercial links between some of them. This may give rise not only to conflicts of interest to the detriment of the consumer⁴⁹ but also to confusion on the part of the consumer.⁵⁰ As it was put on behalf of **Capital Alliance** in its initial written submission: “*To minimise the risk of such*

Relyant: *In our particular sector of the business, time barring is generally not a problem as, within a virtually short period, the retailer becomes aware of non-payment of a credit agreement which may then elicit a response of an asset lost, destroyed or a death which then leads to the enactment of processes to fulfil the policy conditions ie replacement of the goods or settlement of the outstanding debt in the event of a death. In being generous however, we believe that we could extend a time barring provision to 12 months. On a practical level however, we become aware of the issues well before this timespan.*

Wesbank: *Yes, often the credit provider is unaware that a policy exists and a valid claim may exist and be repudiated because of late notification.*

⁴⁸ **Clientèle:** *c) Again, this is an area for competition. 90 days is common, but many offer 120 days. Our own experience is that very few claims are repudiated on this ground alone*

Nedlife: *Nedgroup Life feel that the time barring periods are fair but that death claims should be differentiated from disability claims as the insurer needs access the relevant medical information timeously to adequately assess a disability claim.*

Pinnafrica: *Yes. 90 to 120 days would be preferable.*

Relyant: *We have suggested that time barring periods for the LSM groups impacting the furniture retailing sector, could be extended to 12 months.*

⁴⁹ See chapter 6

⁵⁰ As it was put by the office of the Long-term Insurance Ombudsman in its written submission: “*An added complication can be a multiplicity of parties in the transaction. There could be a credit provider, an insurer, an administrator and the seller of the item for which credit was granted. This causes confusion for the complainant and complications for our office.*”

conflicts, without jeopardising legitimate business and consumer benefits that can arise from these inter-relationships, it is important that the business models are carefully scrutinised and that meaningful disclosure takes place.”

- 13.3. The business models giving rise to the possibilities of conflicts of interest are discussed in chapter 9.
- 13.4. The issue of confusion is discussed above.
- 13.5. It is recommended that the dedicated committee referred to earlier should implement a practice that the policy or the accompanying documentation should make it plain to the consumer
- (i) who the parties in the distribution chain are and
 - (ii) what the capacity of each is.

14. SINGLE PREMIUM MALPRACTICES

- 14.1. Both the NCW⁵¹ and Personal Finance⁵² criticized the practice of insurers capitalising monthly premiums upfront in a single amount as part of the principal debt. Interest was thus charged on the capitalised premiums. On the lapsing of the policy dealers continued to recover premiums as part of the instalments due. No refund was made of the premiums and no credit was passed if and when the policy was eventually reinstated.
- 14.2. Single premium payments have, however, been outlawed by the NCA and is now hopefully an aberration of the past.⁵³
- 14.3. To counteract the decrease in commission to dealers, so the Panel was told, the concept of “factoring commissions” (up to 30 months) has been developed. The insurer agrees to pay the dealer a factored “term” commission for selling policies.⁵⁴

⁵¹ In its press release of 31 August 2007.

⁵² In its reports in July 2007.

⁵³ See chapter 3 section 1.4.23.

⁵⁴ Mr Shaw said in evidence: *“What some of the retailers are now doing, they have a monthly policy with the insured client but in fact have agreed to pay a full premium over to the insurance company so that they don't have this problem and they become the banker in that sense. The old days you would add that principle amount to the principle debt and get interest on it, now you can't. So the retailer is becoming a banker without obtaining any interest on the funds so advanced but they find it, in terms of their own management processes, it works a lot better to do that.”*

And again: *“But the complexity nowadays is that the monthly premium has to be collected and if it's not collected and an event occurs, there's a loss, then there's a problem in a sense. So what the retailer is saying is we don't want this reputational problem with our client. We know we have to have a monthly policy which they've got in place. What we're going to do, we will become the bankers to the client and pay that full premium over to the insurance company. Previously we could charge interest on that action,*

14.4. It is recommended that the NCR should look into and review this practice to determine whether it can have potentially negative implications for consumers inasmuch as the product offered may be priced more expensively to compensate for the factoring.

15. **PREMIUM COLLECTION**

There was no suggestion in the submissions received or the evidence tendered of irregularities occurring in the collection of premiums for CCI.

16. **DISTRIBUTION CHANNELS**

16.1. In response to the follow-up questionnaire all the respondents confirmed that their products are being distributed through FAIS authorised entities.

16.2. In the case of furniture outlets only a tick-box facility is available at the point of sale. No advice is given. Any request for advice is diverted to a FAIS qualified call centre located elsewhere.⁵⁵

these days we can't, and that's just our problem."

⁵⁵ See section 2 above and appendix 15.

CHAPTER 13

PRODUCT VALUE PROPOSITION

1. VALUE FOR MONEY?

1.1. The Terms of Reference require the Panel

“...to consider the product value proposition, with particular focus on the fairness of the terms of the products, taking into account the scope of cover provided, the use of exclusions and other underwriting practices, the levels of repudiations, the claim notification periods, disclosure and information provided both pre- and post-sale, and the overall value provided to the client. This is not intended to be a pricing enquiry”.

1.2. “Product value proposition” is industry jargon for assessing whether CCI is worth it, whether the premium paid is, for the consumer, fair value for the potential benefits promised and, for the insurer, fair profit for the effort required and the risk assumed.

1.3. Based on the evidence provided at the hearings and in the written submissions received, there can be little doubt that CCI is a key and integral element of the credit provision industry. CCI can in many respects be regarded as the enabler of the credit transaction without which the transaction would not be possible.¹ There are many risks in a credit transaction for both the provider and the recipient of credit which can only be mitigated through the use of insurance. Without such risk mitigation access to credit would simply not be feasible. To this one may add the relative ease with which CCI can be arranged, without medical underwriting or undue delay.

1.4. Next to funeral insurance, CCI, especially warranty insurance, is often the first encounter of low-income consumers with insurance as such. In its valuable submission to the Panel, dealing comprehensively with a number of issues relating to CCI and which deserves to be read in its entirety, **FinMark Trust** said,²: *“Most lower-income South Africans, especially those that reside in townships, have difficulty obtaining household insurance due to the high risk profiles associated with these areas. If they are indeed able to obtain the insurance, premiums are high. Because of an inability to obtain credit insurance through the normal channels, the customer is then “forced” to buy the insurance from the retailer.”*

¹ See chapter 3 section 3.

² **FinMark Trust** submission, paragraph 26, appendix 16 to this report.

- 1.5. In their responses to the initial questionnaire referred to in chapter 1, insurers were without exception enthusiastic about the benefits of CCI for consumers. They emphasised the security and peace of mind such insurance brings to consumers, who would otherwise have to face the legal consequences of an indebtedness they have incurred and may now, due to a variety of unanticipated but foreseeable circumstances, not be able to meet. So too, for their dependants or executors who are relieved of the burden of the financial strain of finding the funds to pay the debt.
- 1.6. What follows is a representative sample of reasons given why CCI in all its forms is seen to be valuable to consumers:
- it enables many consumers to obtain credit which might not otherwise be available to them;
 - it resolves a possible financial embarrassment to the consumer or his or her estate, by settling the remainder of the debt in the event of the consumer's unanticipated death, critical illness, permanent or temporary disability, or retrenchment;
 - it ensures that the consumer does not have to relinquish assets purchased which would otherwise be repossessed;
 - it ensures that the consumer does not remain liable for the debt incurred in purchasing the asset even if the asset has in the meantime been lost, destroyed or damaged beyond repair;
 - it provides cover against sudden and unforeseen mechanical breakdown of vehicles;
 - it is tailored to consumers' specific needs and benefit options;
 - it is convenient, easy to obtain and understand, automatically accepted and free of medical underwriting;
 - it is affordable and its risk rates are generally lower than pure voluntary business.³
- 1.7. It is of course true that CCI has many benefits for consumers (receiving cover against a prolonged indebtedness on the occurrence of the insured event which may affect the consumer's ability to meet the debt), for insurers (receiving business that is almost without fail profitable, either for itself or within the group to which it belongs) and, in particular, for credit providers (receiving security for a debt which might otherwise

³ But see section 1.8 below.

have turned into a bad debt and, at the same time, both as credit providers and as intermediaries, receiving business that is profitable, either for themselves or within the group to which they belong).

- 1.8. But the enthusiasm for CCI is not necessarily unanimous or universal. The primary beneficiary of CCI, after all, is not the consumer but the credit provider, who sees CCI, according to what was stated in evidence, as simply “*a risk mitigant*”, apart from being, according to the evidence, a most profitable source of revenue. Nor is CCI necessarily the most economical form of insurance for the consumer. Term life insurance or disability cover to clear the outstanding debit balance and which is priced for the individual concerned at his or her own instance and against his or her own risk profile, rather than at the instance of the credit provider and across the board on a group basis, may be a more economical form of insurance.⁴ Thus there was evidence that in the upper economic echelons borrowers tend to make their own financial arrangements to secure their debts in preference to the CCI that may be offered to them.⁵
- 1.9. CCI, as stated above, is often a consumer’s first exposure to insurance in any form. This section of the market accordingly has a particular responsibility to the insurance industry as a whole to provide products that are affordable and that not only promise but also deliver genuine value. The question in this chapter is whether that ideal has been achieved.

2. THE PUBLIC PERCEPTION OF CONSUMER CREDIT INSURANCE IN SOUTH AFRICA

- 2.1. Speak to ordinary members of the public and one soon realises that CCI in South Africa has a bad name and is seen by many as “*a scam*” or “*a rip-off*” of consumers. This impression is confirmed by responses from consumer representatives⁶ and comments

⁴ But see chapter 4 section 12.2.

⁵ See chapter 8 section 2.2.3.

⁶ In a response to the follow-up questionnaire **Consumerwatch** described credit insurance as “*a shameful situation. Mostly serves to fleece unsuspecting, poorly educated consumers to immoral degrees.*”

in the general and financial media whenever another instance of over-reaching is reported.⁷

2.2. This poor reputation is doubtless due to a number of factors:

- (i) the number of “add-ons” of which CCI forms a major part and which, firstly, are often only disclosed, if at all, post-sale and are, secondly, disproportionate to the basic product price and, as far as the insurance is concerned, can also be disproportionate to the risk profiles of consumers;⁸
- (ii) the significant profit margins which are generally believed to be recovered along the distribution chain by product providers, credit providers, intermediaries and insurers, all of them often belonging to the same inter-company group, and all at the ultimate expense of the consumer;
- (iii) the perceived low claims ratio compared to insurance generally;
- (iv) the technical defences on which some insurers sometimes rely to escape liability, and which only become apparent at claim stage, especially limitations to the extent of cover, exclusion clauses and time bars.

2.3. Not all of these perceptions are necessarily valid. It is always necessary to distinguish between different insurers and different insurance products. What is true for motor vehicle warranties is not necessarily true for, say, credit life insurance covering mortgage bonds. The NCA has gone some way to address some of the aspects mentioned above. So too, there was evidence that on the furniture side insurers “*want to pay the claim, if there is a claim, because we don’t want a reputational issue. We want the client to come back... if they don’t pay the claim, it becomes a bad debt, it becomes a reputational issue, it becomes an upset client.*”⁹

2.4. The fact remains that CCI has huge value to both the provider and the receiver of credit. In effect it creates a platform without which access to credit would be limited – restricted largely to those who have a lesser need for credit. A viable, sustainable CCI

⁷ Compare, for instance, the reaction in the media to the publication in late January 2008 by the FAIS Ombud of his determination in the matter of *Gumede vs JDG Trading (Pty) Ltd*, case FOC3097/06, discussed in chapter 12 section 2..

⁸ The *Gumede* matter, supra, is a prime example. See further chapter 12 section 2 where the determination is discussed in greater detail.

⁹ Mr **Shaw** in evidence at the hearings. See too section 6 below. The counter-argument is that the risk of bad claims being paid is accounted for in higher premiums. In effect, so it can be argued, honest premium payers are subsidizing dishonest ones.

underpin is therefore essential for a sustainable credit industry which in itself feeds economic growth.

3. PRICING

3.1. While a “pricing exercise” is not envisaged in this enquiry, an assessment of the value proposition would not be possible without some comment on the price the consumer of credit is paying for the CCI embedded in or allied to the underlying transaction. If the price of the CCI is exorbitant, the value proposition is destroyed, regardless of any other inherent value the insurance may provide.

3.2. Several participants to the enquiry expressed the opinion that consumers were paying excessive premiums for certain CCI products, thereby unduly benefiting the insurers underwriting the products and other parties involved along the value chain, such as intermediaries and administrators.¹⁰ So, for example, it was said by the **FinMark Trust**:¹¹ *“Furthermore, as will be explained, the high price levels of credit or credit life insurance offered by furniture retailers have often simply extorted money from the client rather than offering real value.”*

And again: *“Due to the opaque nature of the credit agreement and disclosure, many customers do not realise that they have the option of buying insurance from other providers. This created a captive market, allowing the insurance company of the retailer to charge higher premiums and add a number of riders to the insurance policy.”*¹²

3.3. The Panel attempted in the follow-up questionnaire to obtain answers from respondents firstly on whether margins for retailers and dealers operating successfully as sellers, credit providers and intermediaries for CCI and secondly premiums were regarded as excessively high. The response to these questions was often that the respondent had too little information to be able to comment meaningfully.

3.4. The first question was:

6.7 Do you or do you not believe, and why, that the profit margin for retailers and dealers operating successively as sellers, credit providers and intermediaries for credit insurance is too high?

¹⁰ Compare chapter 4 sections 11 and 12.

¹¹ Submission par 2.

¹² Submission par 26.

A number of respondents were non-committal but some did respond.¹³

3.5. The second question was:

6.8 Do or do you not believe, and why, that premiums for credit insurance are on average too costly considering insurers' risk experience for this type of cover?

A sample of the replies received is given below.¹⁴

¹³ **Centriq:** *Motor dealers operate in a highly competitive market and any windfall profits would immediately attract new entrants into the market.*

Guardrisk: *Based on the input received from one of our major clients, they are of the opinion that profit margins are not excessive in relation to all the other value added products that they offer their clients.*

Hollard: *No, they are the distribution channel facilitating access to the market and convenience for the consumer. However, customers need to understand their involvement and interest in the transaction and that they have a choice as to product and product supplier.*

Liberty: *While Liberty cannot comment specifically on margins experienced by the industry, we do believe that it is reasonable and commercially sensible that the benefits of aggregation of the various components of a value chain should accrue to either customers (by way of a cheaper price) and to the aggregator of the value chain. It is not appropriate that regulation should provide for structurally different fee structures or profit margins, dependent on whether these services are provided by single or multiple providers.*

Metropolitan: *Under the group schemes model employed by Metropolitan where regulated commission is paid to the intermediary / credit provider, we do not believe that the profit margin, after allowing for the cost administration by the intermediary / credit provider is excessive.*

Pinnafrica: *There are frequent examples of retailer and dealer insolvencies. Also, there are many examples of very successful retailers and dealers. Profitability is affected by many factors. Generally, credit insurance is profitable. Profitability will remain high in the absence of normal market forces and competition.*

Relyant: *We do not believe that the profit margin for retailers, in particular, operating in the white and brown good sector, is too high. Regrettably, insufficient cognisance is taken of the cost structures insofar as it relates to insurance products sold to buyers of furniture and household items of this nature. Generally speaking, the premium is collected monthly on a manual basis. Very often the premium is not paid on time and in time. This leads to additional administrative costs of following up the payment from the consumer. The Rand value of such costs is, in itself, very high. There is generally no 'first world' collection of monthly premiums by debit order. The premium often so collected is lower than many costs levied by banks for financial services provided. Certain of these have been commented upon below.*

The cost component of the premium for administration, premium collection, claims handling and other ancillary expenses of policy wordings, statutory compliance costs etc consume around 43 – 47% of the monthly premium.

Wesbank: *No, provided that consumers are aware of how their premium is determined and what proportion is allocated towards the various commissions and fees.*

¹⁴ **Absa:** *We believe it is difficult and even unfair to draw comparisons on the costliness or otherwise of premiums between a low-premium-high-volume environment (such as most credit life product lines) and other products with higher premiums. Certain actions (selling, administration, claims handling, policyholder services, etc) demand the same input (time, costs, etc), whether the premium is big or small. In the low premium environment, expenses will therefore be a far greater portion of premium. The risk in certain product areas is also higher (more uncertain claims and lapse patterns), which demands a bigger profit margin to compensate. Finally, market forces should ultimately force premiums down if they are unacceptably high. We would argue that there is plenty of evidence that there is price competition between suppliers. For example, in packaged / composite solutions the total price matters very much.*

Centriq: *Our experience is that losses on motor warranties tend to run off at around 85% of risk premiums. The deductions on motor warranties also appear to be unusually high because the cost of the pre-delivery service and repair charge is factored into the deductions. Also, administration fees are consistent with other sectors in the insurance market.*

Guardrisk: *Claims ratios on credit insurance are generally lower when compared to other types of personal insurance, which means that this business tends to be more profitable for insurers.*

Hollard: *There are instances where the customer is clearly paying too much but on the whole credit insurance premiums are affordable. The monthly premium is a relatively low amount in monetary terms, and generally more affordable than stand-alone insurance products. It may be worth promoting consumer awareness by publishing product and commission comparisons.*

- 3.6. A meaningful conclusion regarding the overall reasonableness and affordability of the pricing of CCI products would not, however, be possible without a thorough and comprehensive actuarial investigation. In the Panel's view it would be presumptuous

Liberty: *Although there are anecdotal incidents where Liberty is aware of very high premium rates are being charged, it is difficult to make a general statement in this regard. Although the mortality experience (and consequently profit margin) of Liberty's book has varied over time, Liberty is comfortable that its premium rates in respect of credit insurance business are fair and reasonable.*

Metropolitan: *Where the interests of the intermediary and client are aligned, as is the case where only regulated commission is on offer, then we do not believe premiums are too costly relative to the risk taken onboard by the insurer. Premiums are generally low in comparison with what individual life cover would cost.*

Momentum: *We take this question to relate to the dealers' and retailers' share in credit life profits. As a starting point, there is no upper limit on profits in a free market economy. One never regulates "profits" explicitly. This principle is subject to the proper functioning of the market mechanism in the underlying transactions.*

The real question is therefore what the insurance regulations on commission are intended to achieve. Is the object to promote competition and enhance the functioning of the market mechanism in credit insurance transactions, or is it merely to cap the amount that may be paid to a particular intermediary in a transaction, with the intention of implicitly protecting the consumer against this cost component by so doing? If it is the latter, and the profits are made after complying with the regulations, then the profits can never be too high.

If there is such a problem as "too high" profits, we do not believe that the correction of that problem is best (or at all) achieved by capping commission levels in the insurance regulations and believe it should be addressed differently, for instance through proper disclosure.

Any policy decision in this area requires the careful assessment and application of economic principles in the light of the prevailing practices. It is in this context that we believe that the market conduct of the participants could be a bigger issue than the level of commission.

In the South African institutional landscape the responsibility to oversee the functioning of the market mechanism resides with the Competition Commission, which is in a position to employ existing measures to deal with the matter if anything is amiss. Generally speaking the Competition Commission functions so as to enable the market mechanism to function efficiently.

Pinnafrica: *It is commonly known that credit insurance products are profitable.*

Regent Insurance: *No. Premiums are calculated taking into account, loss experience, expenses and cost of capital.*

Relyant: *We have replied in part to this question in 6.7 above. However, the total cost component of the risk premium of a standard credit insurance policy for a furniture retailing client is in the order of R30.50 per month or around 56% of the pure risk premium.*

Observers of the furniture retail market consider only the incurred loss ratios for such business and pay no attention to the cost components of the very difficult collection of premium and the ancillary expenses of managing the insurance portfolio. It is accepted that the incurred loss ratios are generally lower than the norm in the Personal Lines insurance market in South Africa. When one removes the motor component of the Personal Lines market and considers the higher expense costs, then the business rationale for such premiums is apparent.

A study of the 'first world' banking costs in comparison with the costs of credit insurance related to furniture retailers, highlights the very real and unfair perceptions in which the retailers find themselves. We have not detailed the actual comparative costs below but are prepared to provide this information in a detailed comparative study if so requested.

*Simultaneously various long term insurers in the marketplace will advise that the costs of maintaining a life policy which has been in existence for many years where no premium collection problems and other administrative issues occur in the form of unpaid debit orders etc and would suggest that the average monthly **expense cost** of such a policy is greater than R58.50 per month. This, in itself, is nowhere near the costs of a credit insurance policy for a furniture retailing client.*

Wesbank: *No, premiums are actuarially determined by the insurer.*

for it to attempt to draw sweeping conclusions from the sporadic evidence on this topic that was given during the hearings and in response to the questionnaires.

- 3.7. Two factors in particular make it difficult if not impossible to draw firm conclusions from the evidence the Panel received. Firstly, one is not dealing with a product providing for one single need. To use credit life insurance as an example, the product offerings vary from a simple straightforward provision of an amount payable on the death of the person who had acquired credit, through to products providing cover for different types of disability, critical illness and retrenchment. A simple comparison of premium rates can clearly not provide a scientific basis for arriving at a definite conclusion.
- 3.8. Secondly, the nature of credit transactions and the circumstances under which they are concluded differ drastically. On the one hand the insurance concerned may involve large transactions with amounts running into hundreds of thousands of rands, where there is the opportunity to individually underwrite the credit life insurance involved and where it is possible to administer the insurance policy by using the infrastructure used for the insurer's normal business. Under such circumstances the premium rates for the credit life insurance should not differ materially from the insurer's normal products providing similar benefits. On the other hand, there is the micro-lending and furniture retailing environments where it is impractical and cost-ineffective to attempt any form of underwriting; where the amounts insured are in the low thousands if not hundreds; and where the normal administration of insurers would be wholly inappropriate.¹⁵ Examples were quoted to the Panel of premium collection being done in the townships by individual premium collectors.¹⁶ Those circumstances would

¹⁵ Compare the **FinMark Trust** submission, paragraph 26.

¹⁶ Thus it was stated by **Relyant**, in response to item 6.7 of the follow-up questionnaire, also referred to below: *“Generally speaking, the premium is collected monthly on a manual basis. Very often the premium is not paid on time and in time. This leads to additional administrative costs of following up the payment from the consumer. The Rand value of such costs is, in itself, very high. There is generally no ‘first world’ collection of monthly premiums by debit order. The premium often so collected is lower than many costs levied by banks for financial services provided. Certain of these have been commented upon below.*

The cost component of the premium for administration, premium collection, claims handling and other ancillary expenses of policy wordings, statutory compliance costs etc consume around 43 – 47% of the monthly premium.”

So too, it was said by Mr **Shaw** in evidence:

“There's a view that there's a huge profit to be made. Practically if you consider claims to premium, it looks like it but in reality you're collecting a monthly premium and instalment sale in cash every month and with the impact of the National Credit Act now it's become much more complex because previously the full premium was added to the principal debt, paid upfront by the retailer,

- inevitably lead to significantly higher proportionate premium rates for the insurance products concerned.¹⁷
- 3.9. The widely differing responses received to the follow-up questionnaire make it difficult to reconcile the price differentials encountered in the follow-up questionnaire.¹⁸
- 3.10. The following life premium rates obtained by the Panel from outside sources were used as a benchmark:

passed on to the insurance company, which was an in-house structure and if there was any problem that might occur, the claim was fully indemnified.

Now the problem is that you've got to collect the monthly premium on a continuing basis. If the client doesn't pay the premium he has no cover. And on average if you do a study of the retailing industry you'll find that a 24-month instalment sale is paid on average between 31 and 33 months. And that's a mindset in the retailing industry, that if a person at Christmas time or whatever, stops one or two instalments, they don't regard it as a bad debt, they continue to pursue and push and collect over a period of time. The NCA has made it a lot more complex and of course a concern too is that if there is no insurance cover then who loses?"

And again:

"The problem with the premium is it's not a first world collection mechanism, bank debit order and that type of thing, it's collective, the premium and the instalment is collected every month on a continuing basis and there's lots of follow-through, lots of administration, just to make that process work effectively and properly.

It's become more complex with the introduction of the National Credit Act because you've now got to make sure that you collect the premium monthly. Previously you could add the full amount to the instalment sale and add interest on it. You don't get the interest anymore and you've got to do it on a monthly basis. So it's become a lot more complex, time consuming.

If you were collecting R87.00 every month in cash from an individual and he doesn't turn up to pay, you've got to be in touch with him about that, you've got to phone him, you've got to send him a telegram, that type of thing to get him to come in next month to pay. Next month he doesn't come in and then thereafter he comes in to pay and you try and collect as much as you can because sometimes he says: I can't pay the R87.00 times 3 anymore, I can only pay one instalment. Fine, well please come back next month and pay your instalment. So it's a very complex, time-consuming administrative burden that the retailers themselves carry on a continuing basis."

¹⁷ In the **FinMark Trust** submission, footnote 20, it is said: "Given the low administrative burden of selling credit insurance policies bundled with credit purchases, the contribution of administrative costs to the premium is expected to be low. This assumption may, therefore, not be too far removed from reality."

¹⁸ Compare the **FinMark Trust** submission, paragraph 29: "Given the bundled nature of the product, it is difficult to assess the overall value of cover relative to the premium charged. However, as noted, the overlapping nature of cover means that the total cover for all the insurance elements is limited to the maximum value of the outstanding loan or the funeral benefit. The effective cost to cover ratio is not improved by the multiple riders included and questions can be raised about the value for lower-income customers. At R807.20 for the year, the insurance charge is almost 25% of the purchase value of the product (including value added tax). If for simplicity, the full amount is assumed to go towards the risk charge¹⁸, this suggests that up to one in four clients is expected to claim on this policy. Industry information, however, suggests that claims are fewer than 2 per 100 policies sold in practice.

In the example shown in Box 1, the cover to cost ratio was 6.2¹⁸ (or stated differently the premium equates to R160.80 per R1,000 insured per annum). This is significantly more expensive than other credit life products available with cover to cost ratios in excess of 20¹⁸ (i.e. costing less than R40 per R1,000 insured per annum). (For the footnotes, consult the full text at Appendix 16.)

Johannesburg hearings. It is self-evident that insurers would not be focusing on this area of the market for growth opportunities were it not significantly profitable.

- 3.14. In the light of the foregoing, the Panel recommends that the NCR initiates a comprehensive review of the price at which CCI products are being offered to consumers to determine whether, for the purpose of section 106(2) of the NCA, such prices are, by and large, reasonable or not.

4. CONSUMER AWARENESS

- 4.1. The **FinMark Trust** submission rightly stresses the extent to which many consumers remain unaware that they had taken out CCI. The following comment²² from that submission summarises their conclusion:

“In 2005, less than 0.5% of individuals in LSM 1-5 indicated that they use credit insurance, while 25% said that they had bought large appliances or furniture and paid for these goods in instalments (FinScope 2005). Most (if not all) of these credit purchases would have included credit insurance as consumers are generally required to take credit insurance (especially where they do not have life or household content insurance) for credit purchases of appliances and furniture. As a result, we must conclude that people in LSM 1-5 are generally not aware that credit insurance is added to their credit agreement. This brings into question the value of the cover to the consumer and is at least one factor in explaining the low claims rates generally experienced on this category of insurance.”

- 4.2. So too: *“Due to the opaque nature of the credit agreement and disclosure, many customers do not realise that they have the option of buying insurance from other providers. This created a captive market, allowing the insurance company of the retailer to charge higher premiums and add a number of riders to the insurance policy.”*²³

And again:

*“The ‘tick-of-the-box’ method employed in the selling of the policy also creates a distinct possibility that many customers will not be aware of the fact that they actually own a policy covering a specific contingency.”*²⁴

- 4.3. A low claims ratio will also serve as an indicator of the lack of awareness on the part of consumers that they have CCI. CCI attracting premiums but of which the

²² Paragraph 10. See too paragraphs 23 and 25 quoted above.

²³ Paragraph 26.

²⁴ Paragraph 27.

consumer or his or her family is unaware represents pure profit for all except the consumer. The panel itself does not have its own statistics on this issue but **FinMark Trust**'s market research revealed that at least for one particular retailer:

*"...for every 100 individuals that actually bought a credit/credit life insurance policy during 2004/05, only 1.28 claims were received. It is easy to interpret this claims ratio as indicative of the fact that customers are not befallen by the contingencies covered by the policy. However, the South African context of high crime rates and high mortality due to HIV/AIDS begs another interpretation of the claims ratio. The most obvious interpretation is that very few customers actually know that they purchased an insurance policy and therefore are not submitting claims."*²⁵

- 4.4. In the submission the hope is expressed that the situation will change for the better once the NCA is fully enforced. It is essentially a disclosure issue, which was addressed at some length in chapter 12.

5. LEVELS OF REPUDIATION

- 5.1. High repudiation levels would tend to indicate either a lack of value in the policies or a lack of integrity of consumers.
- 5.2. In the initial questionnaire respondents were asked to provide details of the percentage of claims repudiated and the main reasons for the repudiations. Examples of the responses received are:

ABSA	32%
Channel Life	32%
Clientèle Life	15%
Guardrisk	20 – 30% (warranty business)
Hollard	13%
Liberty	12%
McLife	5%
Metlife	6%
Momentum	38%
Monarch Life	15%
Pinnafrica	10%

²⁵ In the *Gumede* determination, discussed in chapter 12 section 2 the conclusion was that the consumer was not aware of the existence of the credit insurance cover.

Regent Life 25%

Relyant Life 5%.

- 5.3. These responses indicate, notwithstanding the oral evidence given, that it is the preference of furniture retailers to pay claims,²⁶ whilst there are meaningful levels of repudiations by their associated insurers.
- 5.4. The main reasons given for repudiations were suicide, pre-existing conditions, waiting periods and misrepresentation.
- 5.5. From the above it can be concluded not only that the overall levels of repudiations can be significant in themselves but also that they vary significantly between different insurers. While repudiations are clearly prejudicial to consumers, it is nevertheless difficult to arrive at a firm conclusion as to whether the levels of repudiations are unfair since the problem cannot be viewed in isolation but must be assessed together with the nature of the product, the degree of underwriting and the premiums charged.
- 5.6. What was significant was the approach which appears to be generally followed in the furniture industry namely, that claims are as a rule not declined or repudiated. The following response from **Relyant** to question 11.2 on pre-existing conditions in the follow-up questionnaire was insightful:

“Generally speaking pre-existing conditions are waived in the furniture industry. The objective is to pay a valid claim and an uninformed consumer cannot be held to ransom in such instances having legitimately paid a premium. The cover is wide.

As we do not test for pre-existing conditions, we hold the view that, other than in extreme and obvious circumstances, the said conditions in the furniture retailing insurance sector should not form part of any policy conditions. We do not believe that this approach could apply the credit insurance market particularly when dealing with informed consumers where the policy sums assured are substantial. The low sums insured applicable in our sector are more easily handled.”²⁷

- 5.7. The furniture industry appears to be different from other forms of CCI in this respect. As it is said in the **FinMark Trust** submission,²⁸

“Furniture retailers in South Africa have an extensive distribution network that reaches into even remote rural areas. It therefore has the potential to sell insurance to individuals in areas not

²⁶ See section 2.3 above and 6.5 below.

²⁷ See too, footnote 8.

²⁸ Paragraph 30.

traditionally (or easily) served by insurance agents and brokers. However, a number of practices employed by these retailers have (at least until now) prevented the credit/credit life insurance products offered being considered appropriate to the needs of low-income clients.”

- 5.8. It is of course also true that most of the insurers operating in this sector of the industry are wholly owned companies of the furniture group. Effectively one has a “zero sum” situation where if a claim were to be rejected by the insurer (because, say, of a pre-existing condition or the non-payment of premiums) the credit provider’s loss in cover would be compensated by the insurer’s resultant gain in profit.

6. THE SCOPE OF COVER

- 6.1. The Terms of Reference require the Panel, in considering the product value proposition, to focus on the fairness of the terms of the product taking into account a list of factors, the first of which is the scope of cover.
- 6.2. As stated earlier it is essential to differentiate between different sectors of the market, different products and different insurers.
- 6.3. Dealing first with credit life insurance, credit providers have access to a wide range of benefits on offer, depending on the nature of the transaction and the circumstances of the consumer. Based on the evidence and in particular the responses to the follow-up questionnaire, it is apparent that the whole range of available benefits are utilized in putting together insurance packages mitigating the risks inherent in the credit transactions. Thus, for example, retrenchment benefits are included in the insurance provided to consumers with an exposure to this type of risk. Life, disability and critical illness benefits are usually included in most packages offered to consumers. Little substantive evidence was furnished to the Panel of an “over provision” requiring consumers to take coverage which has no or little relevance to the credit transaction or the circumstances of the consumer.²⁹

²⁹ An example is quoted in the **FinMark Trust** submission, paragraph 28: *“Within the South African context of low financial and legal literacy amongst lower-income groups, very few customers that purchase the specific credit insurance policy will, firstly, be aware of their rights with respect to the purchased policy and will, secondly, be able to comply with all the requirements. This is particularly problematic for policy riders such as insurance providing anti-retroviral treatment only on accidental exposure to HIV. The burden would be on the policyholder to prove that the virus was contracted due to accidental exposure.”*

- 6.4. The same can generally be said of short-term insurance where both the asset - house/car or brown/white goods – and the underlying credit transaction are insured.³⁰
- 6.5. There was anecdotal evidence in respect of warranty insurance that the scope of cover was so limited due to the many exclusions that, as the previous Ombudsman for Short Term Insurance said in evidence: *“As one auditor said to me, his son took out a policy like this and he said: ‘It’s a licence to print money!’”*³¹
- 6.6. Based on the information submitted to the Panel, particularly in response to the follow-up questionnaire, it is standard practice for policies to contain extensive exclusions, particularly when there is no individual underwriting. Without commenting on whether such exclusions are always imperative,³² it is self-evident that in effect they do significantly limit the cover, in certain cases even to an extent that would in some cases not be within the expectations of fairness of the normal purchaser of such insurance.

7. THE USE OF EXCLUSIONS AND OTHER UNDERWRITING PRACTICES

- 7.1. Once again it is necessary to deal separately with credit life insurance and short-term insurance. There is an overlap with the previous section.
- 7.2. Generally the conduct of life insurance (other than e.g. group life insurance associated with retirement funds) is based on the premise that sufficient information will be provided by the applicant to enable the insurer, in underwriting an application for insurance, to assess the risk and price it appropriately. Such a process can be both time-consuming and expensive. Clearly in the case of credit life insurance where for example in the retail environment the amounts of credit (and therefore also the insurance) are small, and there is a need to conclude the transaction at the time and point of sale, the normal processes followed in concluding insurance are not appropriate. Insurers have to avail themselves of other means in order to be able to grant cover, but in such a way that the applicant does not have an unlimited ability to select against the insurer. Typically this will be done by the use of exclusion clauses.

³⁰ See too, the **FinMark Trust** submission paragraph 30.

³¹ Respondents were canvassed on this statement in the follow-up questionnaire. All of them dismissed it as a gross exaggeration but some conceded that it contained a grain of truth. See too chapter 12.

³² The topic is discussed in chapter 12.

- 7.3. A common exclusion clause is the so-called suicide clause which limits the insurers' obligation

*"... in respect of any condition or event arising directly or indirectly from or traceable to
(i) Intentionally self-inflicted injury, suicide or suicide attempt, within 2 (two) years of the signing of the proposal."*

This clause is in general use in insurance policies and is not limited to credit life insurance. In the evidence submitted to the Panel there were interesting extensions to the suicide clause such as *"I/we further understand that no benefit will be payable if the case is due to my/our own action within two years."* This is a significant broadening of the scope of the "suicide clause" and one is inevitably left to speculate as to the interpretation of "own actions" in the above exclusions.

- 7.4. In the case of credit life insurance where, as indicated, the opportunity to underwrite, both medically and otherwise, is limited, it is also common practice to make use of the so-called "pre-existing condition" exclusions. A typical example of such an exclusion clause is the following:

"No benefit payment will be considered for any claim arising directly or indirectly from a pre-existing condition in the first 24 (twenty-four) months of commencement, or reinstatement of cover.

A pre-existing condition means an injury or medical condition:

(a) From which the Insured Person...and/or...suffered or was treated for, or...for in the 24 (twenty-four) months immediately before the Insured Person signed the application form, or reinstated the cover, or

(b) For which the Insured Person should have sought treatment, or where the symptoms displayed could have lead to the diagnosis of a condition in the 24 (twenty-four) months immediately before the Insured Person signed the application form, or reinstated cover.

This exclusion applies only in the first twenty-four months of cover. Thereafter the Insured Person will have full cover."

- 7.5. The intention of the type of exclusion is clear and could generally be regarded as being fair.³³ The submissions to the Panel in response to the follow-up questionnaire,³⁴ were

³³ Once again the question of interpretation arises, particularly for example in the case of (b) above. Will all applicants for insurance (or in the case of credit life, for credit and an ancillary product credit life insurance) have the same understanding of what the conditions are referred to in (b), would this agree with the

consistent, namely that from the insurers' perspective such insurance without such exclusions would simply not be viable. The respondents indicated that without such exclusions they would either have to withdraw from the market or increase their premium rates to the level where the insurance would become unaffordable.³⁵

- 7.6. The hearings and submissions focused to a lesser extent on short term insurance (specifically asset insurance providing cover against damage or loss of the asset) and from the evidence presented it was evident that, as there are not the same considerations as there are with life insurance as to the possibility of anti-selection against the insurer, the exclusions were largely the same as apply in respect of short term insurance generally.
- 7.7. Warranty insurance and the use of exclusions have been referred to above.³⁶ There is extensive use of exclusions in the conduct of this business. Some exclusions are of a highly technical nature. In particular the exclusion dealing with the matter of "consequential loss" was highlighted during the hearings as leading to a significant limiting of the scope and nature of cover provided.³⁷ Generally speaking, the use of exclusions is unavoidably inherent in the conduct of CCI, both life and short-term but

interpretation of the insurer and will the person helping to complete the application form (often the same person completing the credit application and purchase agreement) be in a position to explain b) satisfactorily?

³⁴ Discussed in chapter 12.

³⁵ See chapter 12 section 9.4.

³⁶ See chapter 3 section 2. The matter is also discussed in chapter 12.

³⁷ An example of "Extended and Deposit Cover" provided to the Panel in response to the follow-up questionnaire, had the following under "General Exceptions":

"We shall NOT be liable for:

5. Consequential loss of any nature whatsoever".

Nowhere in the policy document is the concept of "consequential loss" defined and the question arises what the interpretation of the average purchaser of a motor vehicle would be and whether he/she would regard these as being fair. Mr **Viljoen** of the Short-term Ombudsman office gave the following example:

"Insurers attempt to further limit benefits by relying on principles such as betterment and consequential loss. Betterment is usually applied where the insurer, in the process of indemnification, places the insured in a better position than what he/she was in prior to the loss. Our office would ask the insurer for proof that the value of the entire vehicle (as opposed to the specific part replaced) has been enhanced before we would allow betterment. Consequential loss in terms of case law, refers to a separate financial loss suffered by the insured as a result of the insured event e.g. loss of income because the insured could not earn a living whilst the vehicle was in for repairs. Warranty insurers however, often attempt to apply this principle in a far more direct way. An example of this was a recent case handled by the office where the turbo exploded causing damage to inter alia the engine. The insurer contended that the damage to the engine would be a consequential loss."

there are instances where exclusion are worded in a way which could lead to a variety of interpretations.³⁸

- 7.8. The crux of the issue, the Panel believes, is whether insurers resort to ambiguous exclusions as a means of resisting claims when it suits them to do so. Two further questions arise. Are exclusions wider than they ought to be to adequately contain the risk and protect the insurer against anti-selection? And are exclusions and limitations properly explained to the consumer at the point of sale, given the possible lack of sophistication of the consumer concerned? These questions were also discussed below and in chapter 12 above.

8. **DISCLOSURE**

- 8.1. What became quite clear from the responses to the questionnaires and the evidence given at the hearings, is that the NCA has had, and will in future increasingly continue to have, a significant effect on the nature and level of disclosure that takes place both pre- and post-sale. It was also evident from a discussion with the NCR that this is an area that will be receiving a great deal of attention from his office. In particular the format of the disclosure that is required, will very clearly demonstrate the effect of the insurance and financing costs on the overall cost of the transaction.
- 8.2. To a large extent it is difficult to come to any firm conclusions regarding the disclosure of information in the CCI industry as there is currently an element of transition subsequent to the NCA becoming effective. There were however a number of questions posed in the follow-up questionnaire and the responses to these are of interest.
- 8.3. There was a mixed response to the desirability of a follow-up letter to the policyholder shortly after the insurance becomes effective.³⁹ A number of insurers already follow this practice while others thought this could be a worthwhile practice. Yet others felt that such a letter was not appropriate and in some cases unnecessary, the notion being that, given the nature and level of communication before the sale, further post-sale communication would add little if no value.

³⁸ This is not, of course, typical of credit insurance alone. One has only to read the annual reports of the Long-term and Short-term Ombudsmen to appreciate how many complaints turn on the interpretation of policy provisions.

³⁹ This topic is also discussed in chapter 12.

- 8.4. Regarding the question of standardizing communication and disclosure, there was once again a mixed response.⁴⁰ Some respondents felt that some form of standardization could be desirable and could potentially be accommodated in SAIA and LOA Codes of Conduct. Yet others were strongly of the view that standardizing was not only impractical due to differences in product offerings but also undesirable. In particular it was felt that it would be inappropriate for industry bodies to get involved in this area.
- 8.5. Lastly, the follow-up questionnaire asked respondents to indicate which of a long list of items should be disclosed.⁴¹ There was overwhelming consensus that all the mentioned items should be disclosed excepting three items being all the components of the premium, the insurer's claims ratio per product line and the insurer's ratio of rejection of claims per number of claims made per product line. A typical response regarding disclosure of all the components of the premium was the reply by **Absa**:
"...it is our view that not all components need to be disclosed, other than the commission being received by the intermediary, ... The allocation of internal costs of the business ... a proprietary business secret and disclosing this to the public at large would violate the company's right to secrecy in this regard, while disclosure to this level would not benefit the consumer. Furthermore, one does not find other non-insurance industries having to disclose all details of how their pricing is made up".
- 8.6. Regarding the actual disclosure of claims ratios and rejection ratios by insurers to consumers it was generally regarded that this information, apart from being of a proprietary nature, was so technical as to be meaningless, in the absence of a detailed and informed explanation, to most consumers.

9. CLAIM NOTIFICATION PERIODS

- 9.1. From the responses to the follow-up questionnaire it is evident that it is general practice for insurers to have a claim notification or time-barring period.⁴² From a practical point of view a situation where an insured could institute a claim a couple of years after the event would clearly be chaotic. On the other hand the insured (or his or

⁴⁰ This topic is also discussed in chapter 12.

⁴¹ This topic is also discussed in chapter 12.

⁴² The topic is further discussed in chapter 12. The Panel believes the industry should strive for a uniform period of notice throughout the industry that would allow sufficient time to the complainant to initiate the claim without being so long that the evidence has become stale for the insurer. A period of 180 days may fulfil those requirements.

her estate) should be given a reasonable time to do whatever is required to institute a claim. There was a general feeling that such a period should be fair and reasonable for both parties. While there appear to be a number of insurers that have a 90 day period, there was also a sentiment that a year may be more appropriate.

9.2. The following comment from **Hollard** to item 12.3 of the follow-up:

“We believe that a time-barring provision is necessary and we would support a period of 12 months in the event of death and total disablement as ordinary prescription periods may be too long. Unlimited periods compromise the insurer’s ability to assess a claim in terms of the policy conditions. It is also not in the interest of the insurer’s financial soundness to have to keep reserves for too long on claims that require a full pay-out. It also means that claims are not finalised, which means that the claim is left pending for long periods of time, which can facilitate fraud”.

10. CONCLUSIONS

10.1. We end this chapter as we began it with the proposition that CCI fulfils a definite insurance need for consumers and as such is a worthwhile expedient for credit providers, intermediaries, and insurers but above all for consumers. CCI has become a fact of life. But there are potential deficiencies in the system lending themselves to the exploitation of consumers by practitioners more intent on profit than service. Such deficiencies if not neutralized can and do substantially detract from the value proposition. The correct response is not an outright and self-righteous condemnation of CCI as such but the recognition and the effective and consistent elimination, in so far as it is practically and economically feasible to do so, of its potential abuses.

10.2. In the chapters above⁴³ the Panel has sought to make recommendations relating to various undesirable practices and potential abuses. If these are left unattended by the industry itself and by the various regulators concerned with it, CCI will continue to add to its current somewhat unsavoury reputation, and operate in practice to the ultimate detriment of at least some consumers.

10.3. It is put thus by **FinMark Trust** in its submission:⁴⁴

“In South Africa and internationally, credit or credit life insurance is often a low-income individual’s first encounter with insurance. If correctly structured and explained to the client, the product has the

⁴³ Particularly chapter 12.

⁴⁴ Paragraph 2.

ability to not only educate the client about insurance about the workings of insurance, but also offer real value to him or her. However, the value of this product to the client has been drawn into question because of the low consumer awareness at purchase.”

- 10.4. The Panel agrees. The short answer to the question posed, whether CCI in South Africa has a sustainable value proposition, is accordingly “yes, but”.

CHAPTER 14

CONSUMER AWARENESS AND EDUCATION ABOUT CONSUMER CREDIT INSURANCE

1. SOME INTRODUCTORY REMARKS

- 1.1. “Consumer education” is a broad concept comprising the process whereby knowledge and skills are imparted to consumers, generally as well as individually, resulting in such consumers being more alert and better equipped to make informed decisions and take appropriate action on matters affecting them as consumers.
- 1.2. The Financial Services Board Act, 1990 (FSB Act¹), as amended, provides for consumer education in promoting
“programmes and initiatives by financial services institutions and bodies representing the financial services industry to inform and educate users and potential users of financial products and services.”
- 1.3. The Financial Sector Charter of 2003 makes provision for mandatory consumer education by the financial services industry and for guidelines for the implementation thereof.
- 1.4. These initiatives deal with consumer education in general and not, of course, with consumer education in respect to CCI in particular.

2. PROVIDERS OF FINANCIAL LITERACY PROGRAMMES IN SOUTH AFRICA

- 2.1. The FSB has embarked on a consumer education strategy, in line with the FSB Act, aimed to provide a framework for the industry-wide development and implementation of consumer education initiatives. A dedicated consumer education department has been established which led, amongst other things, to the registration of an independent Consumer Education Foundation with its own trustees. The trust has been registered as a Public Benefit Organisation with concomitant tax benefits.
 - 2.2.1. SAIA has a consumer education initiative called “SAIA FSC Consumer Initiative.” This programme is being implemented with 0.2% after tax profits levied from its members, an amount that is contributed in terms of the Financial Sector Charter.

¹ Act 97 of 1990.

2.2.2. Three projects were approved for implementation by SAIA in partnership with the FSB, namely:

- teacher training, a joint project with FSB, the Department of Education and Training and Enviroteach to include financial literacy in various subjects in the curriculum of Grades 10 to 12 on a provincial and national level, with support material and workshops to empower teachers to teach financial literacy in the further education and training phase;
- financial literacy community workshops. These were aimed at specific communities in the LSM 1-5 bracket;
- a Comutanet project which is a joint SAIA/FSB consumer financial education project aimed at commuters who are users of taxis, trains and buses. This project is aimed at reaching 17.1 million commuters daily.

2.3.1. The LOA receives 0.2% of post-operating profits from its members which is earmarked exclusively for consumer education.

2.3.2. The LOA initiatives include:

- a consumer education programme for government employees. The consumer education will take public servants through financial well-being projects such as budgeting, borrowing and saving;
- a joint venture with SAIA to implement community based consumer education workshops with the support of labour and community constituencies in the financial service sector. The joint project is known as “Inzala” which aims to educate 35,000 people in the communities in all nine provinces. Low income earners will be taught basic principles of financial well-being, including budgeting and being responsible when buying goods on credit;
- a media-based consumer education programme targeting the low income earners. This programme is done through radio and newspapers. Topics to be covered include facts about life insurance, disability insurance, funeral cover and CCI.

2.4. The Ombudsman for Short Term Insurance

- is engaged in promoting consumer awareness about the existence and functions of his office through media, publications, exhibitions and workshops;
- is a member of SAIA Consumer Education committee;

- issues an electronic quarterly “Ombudsman’s Briefcase” newsletter which is also intended as a service to consumers.
- 2.5. The office of the Ombudsman for Long Term Insurance
- has broadened its attempt to create consumer awareness of the service provided by his office to consumers and insurers;
 - has commenced a programme of addressing small groups of consumers at advice centres and individuals at shopping malls about its activities;
 - makes use of a centralized help line to reach consumers. The volume of calls dealt with by this help line has increased on average from 15 per day at the inception of the help line to 175 per day on average.
- 2.6. Most non-profit organisations focus on financial literacy programmes. There is no monitoring mechanism in place monitoring the effectiveness of their projects. Funding is also a problem. Consumer education is not their main concern.
- 2.7. Some private insurance companies provide their own consumer insurance education programmes. Here again, there is no monitoring mechanism of the content and effectiveness of their consumer awareness programmes. It is, however, assumed that their education is in line with financial services charter guidelines for Consumer Education.
- 2.8. Certain government departments such as the Department of Trade and Industry and the Department of Education and Labour have their own education programmes. Such government department cover mostly financial literacy issues in the learning area on management and economic sciences. The main objectives of these programmes are to empower consumers to manage their own finances.

3. **ALLOCATIONS FOR CONSUMER EDUCATION FUNDS**

- 3.1. The FSB’s Consumer Education Foundation has an allocation of R5 790, 235 for 2007 and 2008 and a consumer education print material and research allocation of R2 731,543. Its Consumer Education Department’s operating costs were R21 520,221 for the past seven years, raised from FSB levies.
- 3.2. SAIA received 0.2% after tax profits from its members. This funding is to be used only for consumer education. An amount of R8 455,976 was received from its

members during 2007. The aggregate spent during the past four years was in excess of R27 million.

- 3.3. The LOA received 0.2% after tax profits from its members, to be used only for consumer education. An amount of R9 998,234 was allocated in 2007.
- 3.4. The Ombudsman for Short Term Insurance did not have a budget for consumer education during 2007.
- 3.5. The Ombudsman for Long Term Insurance allocated R200,000 for consumer education.

4. **CONSUMER EDUCATION IN RESPECT OF CONSUMER CREDIT INSURANCE**

- 4.1. From what has been said above it is evident that consumer education within the financial service sector at large is fragmented and largely uncoordinated.
- 4.2. By the same token there is no central monitoring mechanism to prevent wasteful duplication and to ensure the most efficient strategies for the deployment of available funds.
- 4.3. Moreover, only a section of the population is being targeted and presumably reached.
- 4.4. By far the largest part of available funding is directed at financial literacy in general and not at insurance or CCI in particular.
- 4.5. CCI is admittedly a subset of insurance in general. Such consumer education as may be directed at insurance as a topic would at best mention CCI only in passing. But for the reasons mentioned in earlier chapters CCI is characterised by a number of unique features requiring it to be treated and regulated either as a category on its own or, at the very least, as a subset of credit. For the same reasons it deserves to be treated separately from other insurance products for the purpose of consumer education.
- 4.6. There are three aspects of CCI deserving of special mention in consumer education:
 - an explanation of the different products;
 - their value for consumers;
 - the potential pitfalls for the unwary.
- 4.7. CCI products straddle both long-term and short-term insurance. Both sectors of the insurance industry should therefore be untiring in concerted campaigns to explain CCI

products to the general consuming public so as to promote its value and caution against its shortcomings.

- 4.8. The largest portion of the budget is normally allocated to financial literacy in general. It is the recommendation of the Panel that a specific portion thereof be allocated and dedicated to CCI literacy in particular.

5. THE FOLLOW-UP QUESTIONNAIRE

- 5.1. Insurers, long-term and short term, were asked to respond to this question:

13.3 What do you suggest should be recommended by the panel to make consumers in general more aware of both the significance and the value for them of credit and credit life insurance?

- 5.2. Most respondents regarded adequate disclosure at the point of sale to be sufficient to ensure consumer awareness. But several of them made a number of sensible additional suggestions, a sample of which is given in the footnotes.²

² **Centriq:** *Perhaps the associations should coordinate a consumer awareness campaign through the various media sponsored by the industry.*

Channel: *opinion, under certain circumstances, The panel can discuss the apparent lack of monitoring and enforcement of the disclosure requirements and commission regulations with the FSB/Regulators and insist that they enforce the legislation. There will always be parties who find new ways to breach the legislation and in doing so it makes it difficult for those parties who comply with legislation as they are prejudiced when it comes to sourcing business. In our business gets placed with insurers that pay the highest commission, rather than service, brand and best rates for the ultimate consumer.*

Clientèle

Include it as part of the general educational press releases / training activities now being undertaken by the LOA and FSB. Arrange for an LOA document / pamphlet on the subject to be included with every finance agreement entered into.

Guardrisk: *Credit providers should ensure in their advertising campaigns that consumers are made aware of the need for credit insurance.*

In addition, specific consumer education campaigns for this business can be launched by the industry associations in conjunction with the different retail industries that participate in the distribution of these products.

Hollard: *We recommend consumer education - both by the industry and consumer organisations and perhaps even in literature distributed by the Ombudsmen's offices - aimed specifically at these issues, rather than being about insurance in general. We also recommend more detailed and relevant disclosures to prospective policyholders. Banks and other credit providers should be obliged to inform the insured's next of kin of the existence of credit cover in the event of his death or total disablement. The risks of not having the cover in place should be highlighted. Details of the insured's next of kin should be registered with the bank or credit provider and against the policy. Any consumer education material and all documentation provided to the consumer should be simple and comprehensible.*

In addition to the comments and consumer education initiatives outlined in 13.2, we suggest that the industry could sponsor a television/radio ad creating consumer awareness of the risks of not having this cover in place. Use could also be made of Commutanet, a SALA/FSB consumer education project educating consumers financially through rank television ads, and financial literacy messages in taxis and trains and on buses. There could also be education around these issues in high schools.

Liberty: *(a)Improved disclosure necessary; (b)Insurers and credit providers should make reasonable efforts to create awareness and demonstrate the value of the product and the need to inform beneficiaries while the insured is alive. It is difficult to find beneficiaries after the claim event, particularly when the sum assured is very small*

6. RECOMMENDATIONS

The Panel recommends:

- 6.1. that CCI be treated, for the purpose of consumer education, in conjunction with, but as a topic separate and distinct from, other forms of insurance;
- 6.2. that the composite subcommittee of the LOA and SAIA, referred to in chapter 12 section 6.8, operate as a permanent standing committee;
- 6.3. that the said committee be required, in addition to its other duties:
 - to promote consumer education in respect of insurance in general and CCI in particular;
 - to ask for a separate budget allocation from the LOA and SAIA which is to be devoted specifically to consumer education in respect of CCI;
 - to co-ordinate current consumer education initiatives of the LOA and SAIA;
 - to devise new strategies for the enhancement of consumer education, if needs be in conjunction with, but as a separate item from, other forms of insurance;
 - to liaise and co-operate with the FSB and in particular the Consumer Education Department of the FSB, with the NCR and the Credit Information Ombud, as

Metropolitan: *The crux of the situation that the Credit Life market finds itself in is the fact that different practices through different distribution and legal channels is prevalent and therefore there is no standardisation. Until we are all brought into line under the same rules then there is very little that you can tell the consumer without creating confusion in one way or another. The solution must come from the application of the law and through the Industry.*

Momentum: *Disclosure and consumer education will rectify this in the longer term. It is unlikely that a practical and effective regulatory intervention can be designed to assist an unsophisticated insured. It may be that the selling process could place greater emphasis on the insurance dimension.*

Nedlife *Nedgroup Life are of the opinion that current legislation sufficiently meets the consumer awareness expectation, however if the Regulator's attention is drawn to specific areas of abuse then those cases should be treated directly rather than attempting to change behaviour through the implementation of new regulations.*

Nedgroup Life is of the opinion that this is not the responsibility of the panel to raise awareness as the industry bodies are already involved in awareness initiatives. It is our view that the responsibility rests with individual life offices and other industry players to promote the value and sustainability of the credit life market.

There also needs to be an element of responsibility placed on consumers for financial products that they purchase.

Pinnafrica: *A consumer education program, as currently being contemplated by the LOA.*

Regent Insurance: *Advertising in the media, as well as ongoing consumer education programmes. Regulations must be actively enforced by the Financial Services Board.*

Wesbank: *Full disclosure to be given by the intermediary, to the consumer at point of sale. Thereafter, the insurer should provide the consumer with a policy document, containing full disclosure and the insurer should inform the credit provider that their interest has been noted.*

Standardise information on Credit Life schedules and credit insurance policies, highlighting policy benefits to the consumer.

well as with any other governmental and non-governmental agencies active in the fields of CCI and consumer education;

- to agitate for the co-ordination of the allocation of funds for specific projects and strategies;
- to seek to co-ordinate and integrate a consumer awareness campaign with all or some of the bodies mentioned above and directed at:
 - explaining and simplifying various CCI products;
 - highlighting the relative advantages and shortcomings of such products;
 - devising specific consumer education strategies relating to CCI, such as, for instance, canvassing consumer agencies and groups and community aid centres, multi-lingual radio and television broadcasts, road shows, school education programmes, and the like.

CHAPTER 15

CONCLUSIONS AND RECOMMENDATIONS

1. IN GENERAL

- 1.1. CCI has a bad name - and not only in South Africa. This perception may be due to a variety of factors. So, for example, it is generally believed that consumers are not always told, when purchasing goods on credit, that they are paying for CCI as well, and if they are so told, they are not told of the hidden limitations and exclusions in the policy, or that insurers are inclined to look for technical reasons to decline claims in the relatively rare cases when claims are made, or that they are paying over the odds for such insurance which they sometimes don't really need.¹
- 1.2. These assumptions are not necessarily valid. CCI comes in a variety of forms and is issued by a variety of insurers. What is true for second hand motor vehicle warranties is not necessarily true for, say, credit life insurance covering mortgage bonds. The fact is that CCI has value for both the provider and the receiver of credit. CCI is a key and integral element of the credit provision industry and can in many respects be regarded as the enabler of the credit transaction without which the transaction would not be possible. In effect it creates a platform without which access to credit would be limited – restricted largely to those who have a lesser need for credit. A viable, sustainable CCI underpin is therefore essential for a sustainable credit industry which in itself feeds economic growth.²
- 1.3. Insurers were canvassed by way of a questionnaire on whether CCI is worth the expense for consumers. They emphasised the security and peace of mind such insurance brings to consumers, who would otherwise have to face the legal consequences of an indebtedness they have incurred and which they may now, due to a variety of unanticipated although foreseeable circumstances, not be able to meet; so too, for their dependants or executors who are relieved of the burden of finding the funds to pay the debt.
- 1.4. But of course the reality is that CCI serves, in the first place, the interests of the credit provider. It is the credit provider which is often the primary beneficiary of the

¹ See, in general, chapter 12.

² See, in general, chapter 13.

- insurance should the insured event occur, be it the death or disability or retrenchment of the life insured or the breakdown of the vehicle or the theft of the household goods.
- 1.5. The Panel investigated the question, in chapter 13 of its report, whether there is value in CCI for the consumer. It came to the conclusion that CCI does fulfil a real need. This is hardly a surprise since CCI has proved itself over many decades and in many jurisdictions. But that there are imperfections in the system needing to be addressed is also clear. The very fact that it was deemed necessary for the LOA and SAIA to commission this enquiry is proof thereof.
 - 1.6. The Panel sought to identify the shortcomings, in accordance with its Terms of Reference, and made recommendations on how the regulator and the industry should cope with them. Those are mere recommendations. The Panel has no powers of enforcement and it is for the LOA and SAIA to determine whether to support the recommendations and make representations to the authorities about their implementation.
 - 1.7. The Panel, as stated earlier in this report, has had the advantage of considerable interaction with the industry and the regulators, through questionnaires and evidence and interviews.³ What has become abundantly clear is that there are as many opinions on the many controversial matters mentioned in the report as there are commentators.
 - 1.8. The Panel received its mandate and its terms of reference from the LOA and SAIA. It had no power to subpoena or compel witnesses to give evidence. The submissions made to the Panel were all on a voluntary basis.
It was dependent on the LOA and SAIA to persuade its members for the good of the industry as a whole to participate in the enquiry. The evidence it received was mostly from insurers. In particular the Panel received no direct evidence from intermediaries themselves, either from broker organisations or from organisations representing intermediaries such as motor dealerships or furniture retailers. And the response from consumer organisations and members of the public was disappointing.⁴
 - 1.9. The two main issues dealt with in the report are
 - the regulation of intermediary remuneration; and

³ See, in general, chapter 1 and chapter 7.

⁴ See, in general, chapter 1.

- market conduct.

We deal with them in turn.

2. INTERMEDIARY REMUNERATION

- 2.1. On the issue of intermediary remuneration the Panel concluded:⁵
- 2.1.1. that the provisions of the STIA and the LTIA and the regulations issued relating to intermediary remuneration are complex and unclear; that this has given rise to some interpretative confusion in the industry; and that the legislation in this regard is in need of thorough revision;
- 2.1.2. that the principal uncertainties relate to the payment of remuneration by insurers to third parties for the outsourcing of intermediary services; and to payments additionally made pursuant to section 48(2) of the STIA.
- 2.2. On a proper interpretation of “*services as intermediary*” and “*independent intermediary*” in the two Insurance Acts and their regulations any outsourcing by the insurer to a third party of any of the functions the insurer is itself obliged to perform in terms of the policy would be subject, as far as the payment of remuneration for it is concerned, to intermediary remuneration regulation. That is because “intermediary” is defined in the regulations with reference to the type of service rendered.
- 2.3. Conversely, if the service rendered by the third party was not a contractual obligation in terms of the policy, the third party was for that purpose not an intermediary and the payment for such service would not have been subject to regulation (such as payment for the use of the third party’s data base or the payment of royalties for the use of its brand name, or IT assistance or pre-sale repair work to the asset that was sold), even though the third party also rendered intermediary services and was, for that purpose, an intermediary.
- 2.4. To this there is one caveat: the service rendered must not be a pretext for additional payment for what in truth is a service falling within the insurer’s contractual obligations in terms of the policy.
- 2.5. In the view of the Panel it matters not, when the work done does fall within the insurer’s contractual obligations, whether the third party is wholly independent of the insurer or forms part of the same group of companies. Separate legal entities are

⁵ See, in general, chapters 3, 8 and 10.

involved that are separately remunerated for such services. But what is true is that in the latter situation there is no prejudice to consumers, in like manner that there is no prejudice to consumers if the intermediary services are rendered by employees of the insurer, instead of by a separate company within the same group.⁶

- 2.6. As a result of, *inter alia*, the interpretation put on an interpretative note issued by the FSB, structures have been put in place by some insurers in terms of which intermediary services have been outsourced to third parties for additional remuneration.⁷ The third party concerned was sometimes within the same group of companies as the insurer and sometimes independent. Either way the structure, in the view of the Panel, was not in conformity with a correct interpretation of the regulations, if the result was that the aggregate of payments made for intermediary services exceeded the permitted maximum.
- 2.7. It was the view of the Panel that until such time as the regulations have been reviewed and revised the insurers affected should liaise with the FSB on how such matters should be dealt with in the interim.
- 2.8. As for section 48(2) of the STIA which is notoriously difficult to interpret and is in need of revision⁸ the Panel came to the conclusion firstly, that one independent intermediary may not be remunerated, both in full as a section 48(1) independent intermediary (regarding regulated commission) and as a section 48(2)(c) independent intermediary (regarding unregulated remuneration) in respect of the same policy; and secondly, that two independent intermediaries may be remunerated in respect of the same policy, the one receiving full regulated commission in terms of section 48(1) and the other unregulated remuneration as a section 48(2)(c) intermediary, but not if they are inter-related companies in the same group of companies.⁹
- 2.9. Since some companies did structure their business on this basis, acting on legal advice received, the Panel were of the view that such structures were also not in conformity with STIA regulation.

⁶ See, in general, chapter 6.

⁷ See chapter 6 section 2.11.

⁸ Any revision of section 48(2) will have to be aligned with revisions to section 48(1) of the STIA, as suggested in chapter 8.

⁹ See, chapter 9 section 8.

- 2.10. In accordance with the Terms of Reference several insurers were informed of what the Panel proposed to say about them. All of them responded and in a number of cases the Panel was persuaded that it was not necessary to refer to them in the report.
- 2.11. Some insurers were, however, mentioned by name in chapter 10 of the report but in not a single instance was it found necessary for the Panel to make a recommendation that any further action be taken against any insurer by the LOA or SAIA.
- 2.12. The Panel also found that there were occasions when, contrary to the regulations, gift vouchers and other incentives or rewards were given by insurers to intermediaries but these were all in the past and are unlikely to recur. The Panel recommended no further action in that regard.¹⁰

3. **REGULATION REVISION**

- 3.1. Of far greater importance are the recommendations the Panel makes about possible future changes to the regulatory regime.
- 3.2. This involves, in the first instance, a debate on matters of principle about a number of key issues:¹¹
 - 3.2.1. Should there be any regulation of intermediary remuneration in respect of CCI whatsoever?
 - 3.2.2. Should at least the introduction fee be regulated in order to prevent improper incentives from being paid by insurers to intermediaries to promote their business above that of their competitors?
 - 3.2.3. Should the servicing fee paid to an intermediary be regulated at all?
 - 3.2.4. Should there be a special dispensation in respect of CCI at the lower income end of the market and in particular a decapping of intermediary remuneration?
- 3.3. On the first two issues (whether there should be any intermediary regulation at all or at least in the case of the introduction fee), the Panel is divided, as indeed were the insurers who responded to the follow-up questionnaire.
 - 3.3.1. The one view is that market forces should determine the proper level of intermediary remuneration between competitors and that commission regulation is anti-competitive

¹⁰ See, in general, chapter 10.

¹¹ See, in general, chapters 8 and 10.

- and simply creates opportunities for commission regulation manipulation and contravention.
- 3.3.2. The other view is that, subject to what is said in section 3.5 below, the time for complete deregulation has not yet arrived and that deregulation may lead to an increase in premiums, at least in the short term, to the ultimate detriment of consumers. Moreover, absent any regulation of the introduction fee, there is no benchmark against which improper incentives can be measured.
 - 3.3.3. The members of the Panel favouring the retention of a limit on the introduction fee believe that it is the only effective means of foiling a recognised mischief, namely, the payment by insurers to intermediaries of improper incentives.
 - 3.3.4. Improper incentives, according to that view, should be condemned, preferably in express terms. Not only does this practice tend to increase the premiums since the cost is passed on to the consumer but it also means that the consumer does not necessarily get the best advice and hence the best service.
 - 3.3.5. The level at which the introduction fee should be pegged should be determined per product line by the various regulators in conjunction with the industry, represented by the LOA, SAIA and intermediary representatives.
 - 3.3.6. The entire issue of regulation or deregulation can only be determined as a matter of principle by discussion between the industry and the various regulators.
 - 3.4. On the third issue (should the servicing fee be regulated) there is no difference of opinion between Panel members. In the view of the Panel there is no basis in need or logic for the regulation of the servicing fee. Since the consumer's only commitment as far as the insurer is concerned is to pay the premium, the genuine outsourcing of administrative work to a third party by the insurer is not to the detriment of the consumer. (Of course, if the payment supposedly for intermediary services is in truth simply a pretext for an additional reward for the introduction of new business, the additional payment, judged according to its true tenor, would be a contravention.)
 - 3.5. On the fourth issue (commission regulation at the lower income end of the market) the Panel is also unanimous.
 - 3.5.1. The Panel was initially of the view that in those cases at least premiums should be regulated which would dispose of the need to regulate the commission. Having heard the views of the NCR, the Panel has been persuaded to support the opposite view of

no premium or indeed commission regulation at all at the lower income end of the market.

- 3.5.2. This is in line with the approach in the LTIA in the case of assistance business.
- 3.5.3. The benefit level below which no commission should be payable should be determined by the various regulators in conjunction with the industry, represented by the LOA and SAIA and intermediary representatives.
- 3.5.4. Those members of the Panel who support the regulation of the introduction fee above the predetermined benefit level are of the view that, as in the case of assistance business, the amounts involved are so low that the perils of improper incentives are commensurately diminished.
- 3.6. The views of the Panel on these issues can be summarised in tabular form as follows:

	REGULATION OF		
	PREMIUM	INTRODUCTION FEE	SERVICING FEE
UPPER INCOME END OF MARKET	NO	SOME: NO SOME: YES	NO
LOWER INCOME END OF MARKET	NO	NO	NO

- 3.7. The source of most of the problems is the attempt in the STIA and the LTIA to regulate the fee for administrative work outsourced to third parties. If that problem is removed, as the Panel recommends it should be, the difficulties with the regulations, even if commission regulation is to remain to a limited extent, will largely disappear.
- 3.8. It is a matter for comment that it is only in the case of credit life issued under the LTIA that administrative work is specifically regulated at 15% of the GWP and that

the Panel is unaware of any other instance anywhere else where it is thought necessary to regulate a fee corresponding to the servicing fee in South Africa.

4. **MARKET CONDUCT**

- 4.1. CCI is a subset of insurance. As such the ills that are typical of the practice of insurance in general, universally and in South Africa, apply in equal measure to CCI.¹² Insurer and intermediary conduct is subject to regulation. This is discussed in chapter 11. In comparison to market conduct regulation in other jurisdictions studied by the Panel, market conduct in South Africa, in the Panel's view, is more than adequately regulated.
- 4.2. The STIA, LTIA, the FAIS Act, the FAIS General Code of Conduct, the PPR and in particular the NCA have provisions in place that cover, amongst other things, the crucial issue of disclosure in general which as such applies to CCI as well.
- 4.3. But regulation alone is not necessarily the complete answer. What is demanded on paper does not always translate into corresponding action on the ground. A striking example is the "free choice rule" discussed in chapter 11. Another is the *Gumede* determination of the FAIS Ombud, discussed in chapter 12.
- 4.4. There is also the risk of "over-regulation". Over-regulation can be counter-productive and may reach the point where the burden of compliance detracts from the quality of delivery. A proper balance can only be struck if there is an ongoing process in place of consultation and co-operation between the regulators concerned and the industry represented by its various representative bodies.
- 4.5. Market misconduct is dealt with at some length in chapter 12. Topics discussed in that chapter include the recent determination by the FAIS Ombud in the *Gumede* matter, referred to earlier, the lack of proper disclosure (of costs and charges, of sensitive terms and conditions), pre-sale misselling by intermediaries, the sometimes lack of awareness by consumers that they have signed up for CCI, CCI policies being foisted on consumers, failure by intermediaries to explain the limitations and exclusions of cover, problems surrounding extended warranties, conflicts of interest, time bars and the like.

¹² See, in general, chapters 5, 11 and 12.

- 4.6. The evidence of actual market misconduct on the part of insurers was mostly general and anecdotal. It is the Panel's impression that individual insurers strive, by and large, to comply with market conduct regulation but that it is not always able to achieve the goal. One only has to read the Annual Reports of Ombudsman's organisations to realise that non-compliance with the standards of what is fair and appropriate conduct is far from rare. What is true for insurance in general is equally true for CCI.
- 4.7. In that respect South Africa is not uniquely placed. The parallels between market misconduct in South Africa and in countries like the UK, Australia and the USA are immediately apparent.¹³ So too, are the efforts to contain them by regulation. In that respect South Africa, in the view of the Panel, is no worse than others and better than some.
- 4.8. A key recommendation in the report is that the LOA and SAIA establish a composite permanent standing subcommittee dedicated to dealing specifically with CCI.
- 4.9. The duties of this subcommittee should include:
- 4.9.1. considering the implementation of the recommendations of the Panel regarding matters such as the best way of highlighting what is due *by* the consumer by way of premiums and *to* the consumer by way of benefits; of explaining any composite fees; explaining the various parties in the distribution chain and their capacities; the simplification and standardisation of policy terminology; the standardisation of limitations to cover, exclusion clauses and waiting and notification periods for different product lines; the highlighting of the health declaration; the introduction of an industry practice of a follow-up letter to every new policyholder highlighting the above matters, the need for the consumer to inform his or her family of the existence of the CCI, and the right of recourse to the relevant Ombudsman's office; and, in the case of direct marketing, to consider a template of core questions and answers for use by insurers;
- 4.9.2. taking cognisance of significant developments in the field of consumer protection in the case of CCI in other parts of the world, particularly the UK and Australia;
- 4.9.3. liaising with the various Ombudsman's organisations about examples of obscure policy language or unacceptable conduct on the part of members;

¹³ See, in general, chapter 5.

- 4.9.4. liaising with the FSB and the NCR about the implementation of the recommendations in this report and other matters that concern CCI in particular, including consumer education and awareness initiatives.
- 4.9.5. Regulation is only one part of consumer protection. The other part is enforcement. Without proper investigative, monitoring and enforcement measures regulation becomes a paper exercise. A crucial question is therefore which entity in South Africa would be best placed to monitor and enforce market conduct regulation. In the view of the Panel that entity is the NCR.

5. WHICH ENTITY SHOULD ADMINISTER CONSUMER CREDIT INSURANCE?

- 5.1. CCI is unique. It differs in fundamental respects from other forms of insurance.¹⁴ The main distinguishing feature is doubtless that CCI is contingent on credit having been granted to the insured by someone other than the insurer. As such the CCI contract is ancillary and subordinate to the loan or sales agreement between the lender and the borrower or the retailer/dealer and the purchaser. The primary beneficiary of CCI, more often than not, is the credit provider and not the consumer.
- 5.2. Because of its unique characteristics it follows that CCI should preferably be treated as a category separate and distinct from other forms of insurance, especially when it comes to the regulation of intermediary remuneration and the regulation of market conduct.
- 5.3. That raises the question which regulatory entity should assume responsibility for and control of CCI as a distinct category.
- 5.4. There can be no doubt that the prudential control of the CCI industry should remain with the FSB.
- 5.5. In the view of the Panel the entity exercising control over credit should logically and functionally also be the one to exercise control over CCI.
- 5.6. That entity is the NCR. Consumer credit, in terms of the NCA, extends to CCI. The NCR is obligated to assume responsibility for consumer protection, inclusive of CCI, and is thus par excellence the appropriate authority to whom the principal

¹⁴ See chapter 3 section 3, chapter 8 section 6.

- responsibility for regulating CCI ought to be assigned. Moreover, the NCR rather than the FSB has the infrastructure for the hands-on monitoring of CCI compliance
- 5.7. The NCA as it stands does not presume to supersede the provisions of the STIA, the LTIA or FAIS dealing with CCI as a sub-set of insurance generally. It merely expands on the protection for consumers already apparent in those Acts.
 - 5.8. The suggestion now made, which is developed in chapter 8 section 6, is that the NCA and the NCR should become the main focus for consumer protection in the field of CCI and that a model for doing so should be developed in conjunction with the LOA, SAIA, the FSB, National Treasury and in particular the NCR. Such control should extend to both intermediary remuneration, to the extent, if at all, that it is retained, as well as to the market conduct of insurers and intermediaries alike.

6. **THE MAIN RECOMMENDATIONS OF THE REPORT**

- 6.1. CCI should be seen as a unique insurance field with a variety of disparate products that are to be treated separately from other more customary forms of insurance.
- 6.2. The provisions of the LTIA, the STIA and their regulations relating to intermediary remuneration should be thoroughly reviewed and revised, in line with decisions taken on the matters of principle outlined above.
- 6.3. The LTIA, the STIA and the NCA should likewise be revised to allow for the NCR to assume market conduct control over CCI in conjunction with the control exercised by the NCR over credit generally.
- 6.4. The LOA and SAIA should appoint a permanent standing committee dedicated to CCI matters, as outlined above.
- 6.5. The standing committee should be the prime mover in co-ordinating and fostering consumer education and awareness of CCI. It should agitate for a separate budget allocation from the LOA and SAIA and liaise with the FSB and other governmental and non-governmental agencies active in the field of CCI and consumer education.

7. **END-NOTE**

- 7.1. The purpose of this enquiry by the Panel was two-fold: to report on what it has found about CCI in South Africa and to make recommendations for the future.

- 7.2. Those recommendations are in the first place made to the LOA and SAIA. It is for those bodies, as stated earlier, to decide whether to accept the recommendations and make representations to the regulatory authorities to implement the recommendations or some of them.
- 7.3. In its report the Panel sought to deal with numerous aspects of CCI that were raised in the course of the submissions made to it and the evidence given. In its discussion in the report the Panel ventured to express views on a number of more or less controversial topics. Regardless of whether the recommendations are accepted or not, the report will hopefully serve as a positive contribution to the debate on these matters.
- 7.4. Much valuable and interesting material about CCI in South Africa and elsewhere has been gathered in the course of canvassing the views of industry players. The quality of responses received from insurers is proof of a sophisticated appreciation of the intricacies of this type of insurance and of the complexities of the legislation and regulation governing it.
- 7.5. The Panel trusts that its report will also serve as a worthwhile compendium of the views of industry players on the many issues canvassed and that it will serve as source material on which regulators can if needs be draw in the future. One of the difficulties facing the Panel was to find a format that would do justice to the wide variety of views expressed by all those who made submissions and gave evidence before it. If the Panel failed to mention all the valuable points made by contributors, either in substance or by name, it tenders its apologies.
- 7.6. Finally, the Panel would like to take this opportunity of expressing its appreciation to the members of the LOA and SAIA for their co-operation in responding to two sets of questionnaires and in giving evidence at the hearings. In addition, the Panel would like to record its thanks and indebtedness to a number of outsiders who spent time and effort in assisting the Panel. The Panel has in mind Mr **Ketola** and Mr **Casserly**, Judge **Galgut** and Ms **Preiss** from the Office of the Ombudsman for Long-term Insurance, Mr **Viljoen** from the Office of the Short-term Insurance, Mr **Helm van Zijl**, the then recently retired Ombudsman for Short-term Insurance and finally Mr **Chamberlain** and Ms **Anja Smith** who prepared the **FinMark Trust** submission.

The Panel would also like to thank Webber Wentzel for hosting the hearings and several meetings of the Panel at their premises in Johannesburg.