

**Presentation to the Portfolio  
Committee on Finance: Hearing on  
Funeral Benefits Schemes  
6 September 2005**

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FinMark Trust

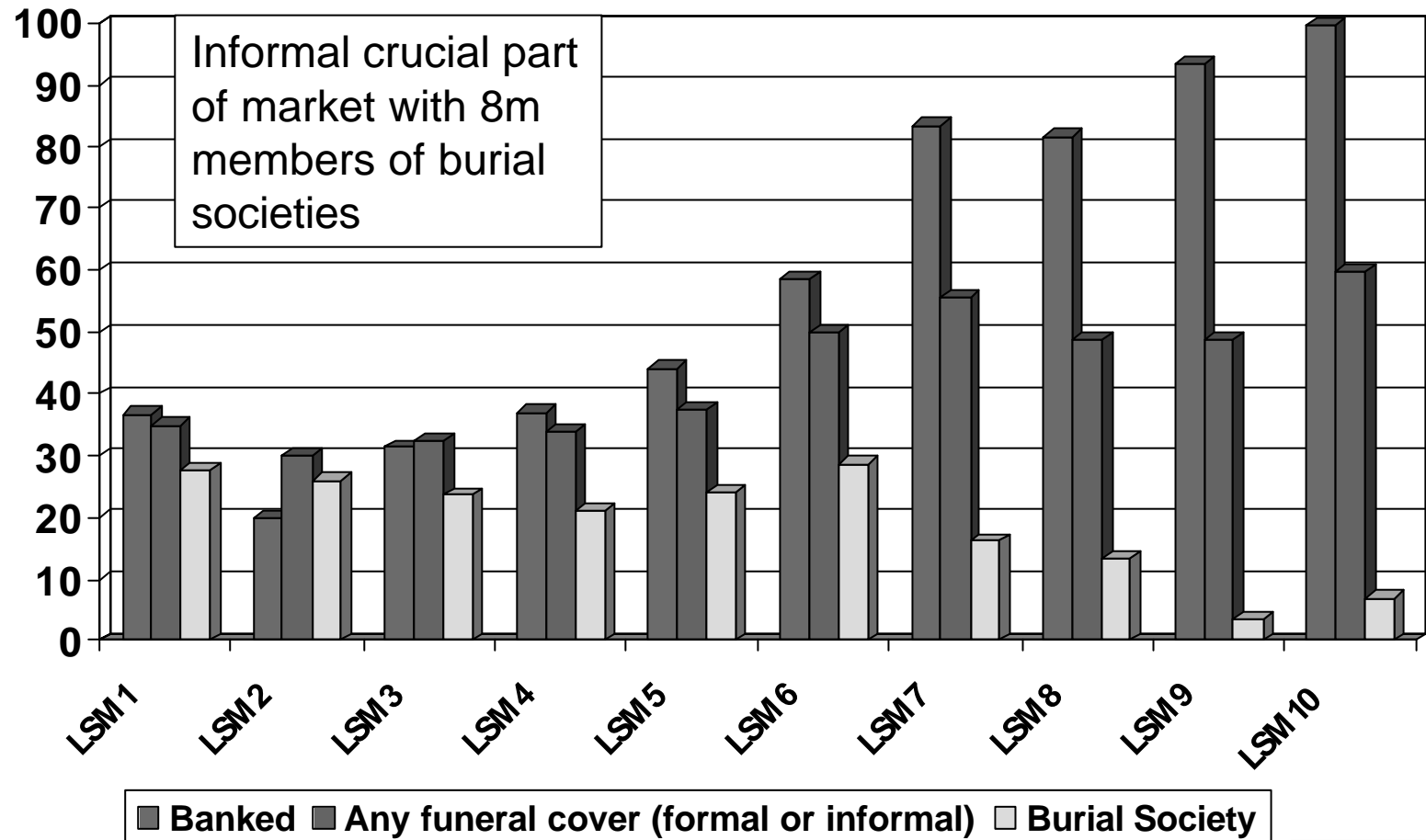


- Independent trust formed in April 2002
- Initial funding from UK's DFID
- Mission of *“Making Financial Markets Work for the Poor”*
- Facilitating and catalysing the next generation of development around access to financial services.
- Further information available at [www.finmarktrust.org.za](http://www.finmarktrust.org.za)



**FinMark Trust**

Funeral cover is one of the most important markets in South Africa – 3  
10m clients with some form of funeral cover vs 13m banked



## Backdrop to the review 1



- ‘Making Insurance Markets Work for the Poor’ scoping study completed in 2004 by Genesis Analytics. Report identified key problems in assistance business, to include:
  - Regulatory environment (a) inhibited graduation of informal mutual assistance organisations and (b) prevented effective formal – informal linkages.
  - Concerns expressed around abuse in the market (as per submissions to PCOF) but not clear whether fully representative.
- Genesis Analytics commissioned to investigate legislative and regulatory environment and make recommendations with an eye to making (informal and formal) funeral insurance markets work for the poor.



## Backdrop to the review 2



- The goal of financial policy is to create and sustain healthy financial markets for the benefit of the economy and society – with society being key.
- Tricky trade offs to be considered between traditional regulatory objectives (to include stability, market efficiency and consumer protection) and new objectives of consumer education and enabling effective access to appropriate financial services.
- Choices ahead are key - wrong choice could stifle the market and crowd out innovators from one of South Africa's most important financial markets.
- With an appropriate framework and consumer education policies in place, the Financial Sector Charter offers an opportunity to allow the Financial Sector to take the strain.
- Welcome constructive approach of the NT and FSB in taking time to understand the market – formal and informal.

## **Legislators and regulators dilemma**



# G:GENESIS

- 2<sup>nd</sup> tier insurance: A review of the operation and regulation of the assistance business market in South Africa
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6 September 2005

Doubell Chamberlain

Engagement manager – Genesis Analytics



## Overview of presentation

- Market analysis
- Current regulatory framework
- Recommendations
  - Suggested regulatory framework
  - Enforcement
  - Consumer education and recourse



## Market analysis

### Large vulnerable market

- Large market with substantial low-income exposure
  - 3,000-5,000 funeral parlours
  - 80,000 – 100,000 burial societies
  - 6.2m African members of burial societies contribute R4.5bn per annum
  - 4.2m holders of formal funeral policies
  - Estimated R5bn spent on funerals per year



## Market analysis

### Large vulnerable market

- Social and psychological presence of death
  - “...my dad caught us by surprise. When he died we had problems, the undertaker did not bring his body the day before he was buried and after that he would not leave before he got paid, so three of us had to go back to our banks and ask for money. I even asked my wife to help us there because we were in a situation. After that we called a meeting...and we had the very same problem. So last year we decided to all come together, in May we formed the team of 11 people and we paid R100 each...”
- Importance of dignified funeral
  - “I shall rather live without electricity for a month”

## Market analysis

### Large vulnerable market

- Cultural drivers slowly changing but entrenched by current market behaviour
  - “If you don’t slaughter, they think you don’t have money”
  - “I don’t see why a whole cow has to be slaughtered. We don’t have to buy all these vegetables. Half a cow and rice or samp will do just fine. Nothing fancy...my uncle wouldn’t even hear of it. A whole cow had to be brought down. I think it’s a trend and it’s all about ‘what other people say?’...Where does it all come from? [From] the parents, the elderly”
  - “...but sometimes we African people tend to have so many expenses. I mean, why do we have to go through such extreme measures...but it’s our culture anyway. A funeral is something so expensive and we are so used to that anyway. Imagine, slaughter a cow, hire buses, you know. I just don’t get it. My mother told me the same thing, it’s culture but when I sit down and think about it, it doesn’t make sense.”

## Market analysis

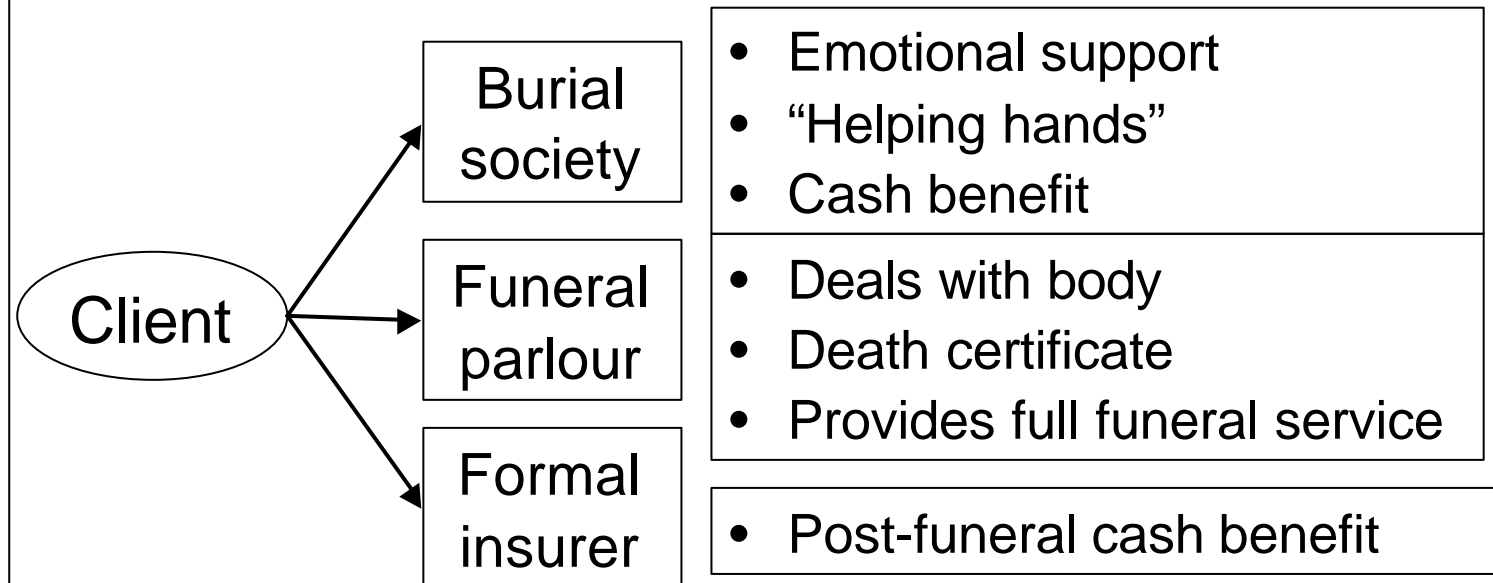
### Large vulnerable market

- Insensitivity to prices
- Multiple cover from multiple providers
  - “I know if I die, that first one will do everything. The second to give my children after funeral to have something to eat. Also, the third one the same”
  - “As a person you have needs, there is a hierarchy of needs. Socially you need to have money should something happen – so you need the burial society, and then you need the undertaker who will take care of the funeral. The money from the insurance company takes time to pay out so whenever the money comes, you can settle all your outstanding bills, so it is worth it. It’s for peace of mind in a way.”

## Market analysis

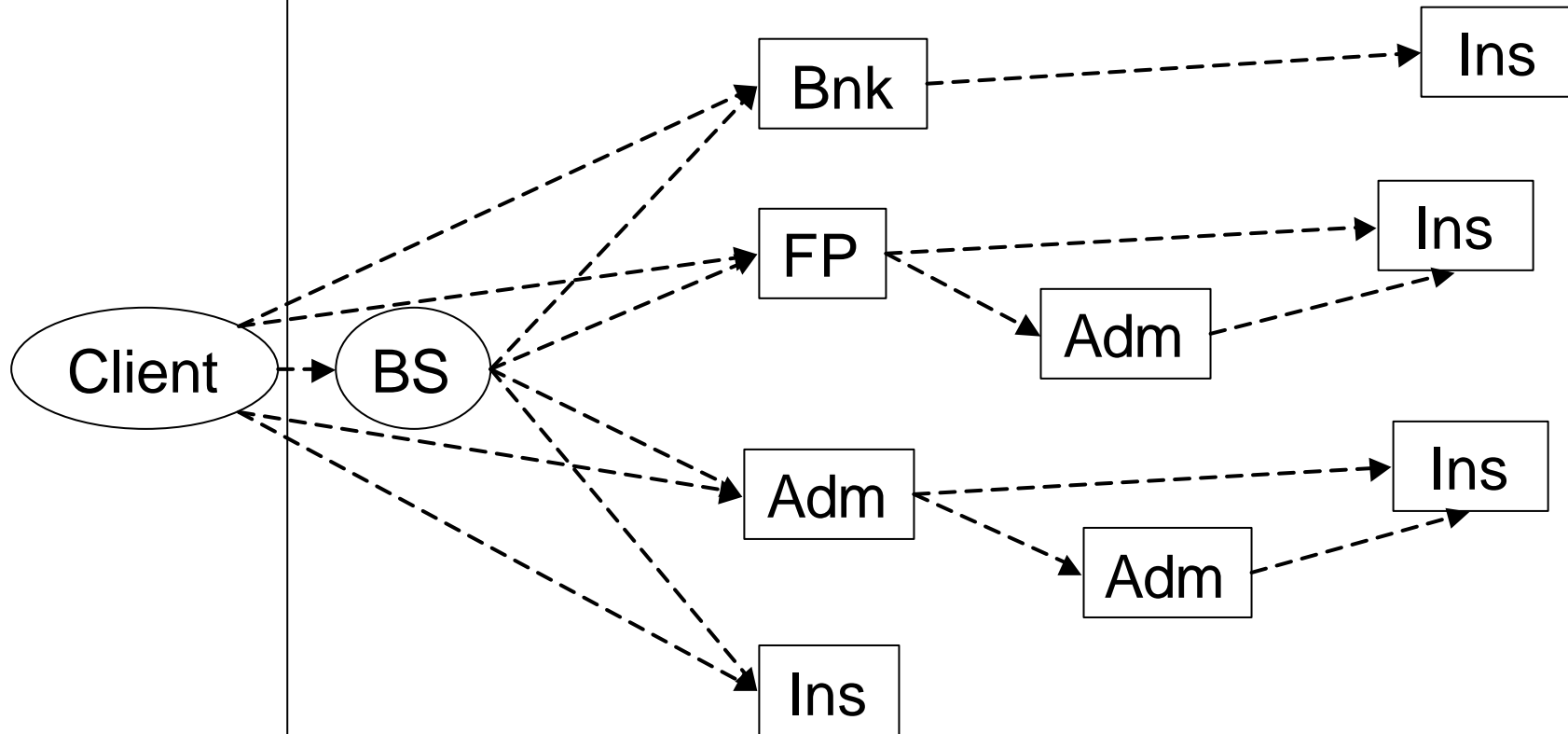
### Large vulnerable market

- Multiple cover from multiple providers (cont.)



Rational but not optimal

# Market analysis Market structure



## Market analysis

### Market failures

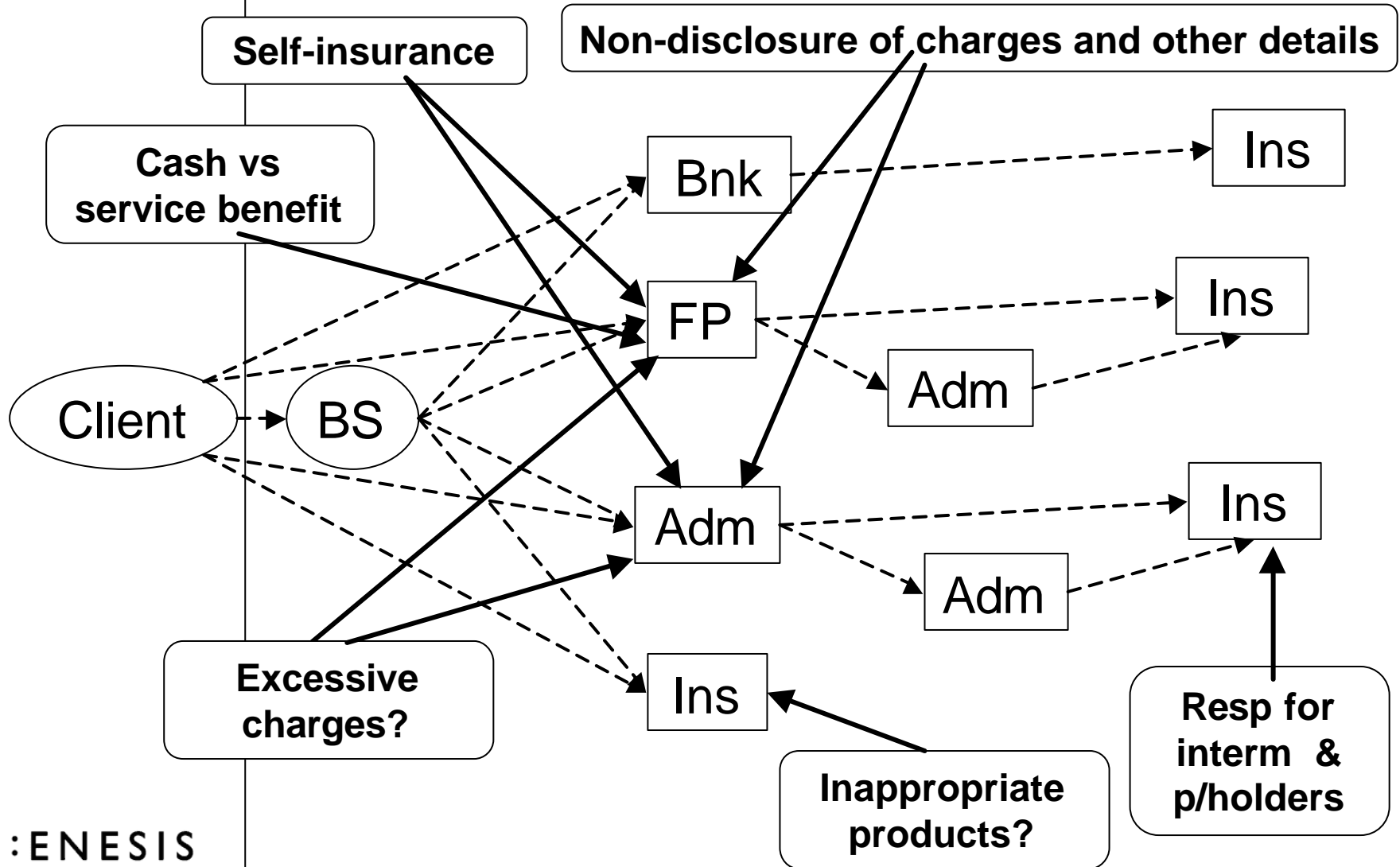
- Combination of funeral cover and services results in market failures
  - Price behaviour and funeral package
  - Non-enforcement of monetary benefit option
  - Lack of competition and choice in service provider
  - Failure in funeral services complicates regulation and functioning of market for funeral cover

## Market analysis

### Market failures

- Enforcement vacuum creates ‘soft middle’
  - Lack of control over administrators and funeral parlours results in self-insurance and potentially excessive charges
- Appropriateness of formal products
  - Dealing with extended illness before death (HIV/AIDS)
  - Bundling funeral cover with credit life
  - Policy period
  - ST or LT risk?

# Market analysis Market failures





## Market analysis

### Inefficient and burdensome regulation

- Current regulation does not provide adequate protection
  - Not enforced on funeral parlours and administrators
- AND overly onerous requirements do not facilitate development
  - Similar capital requirements to LT insurance but with limited risk
  - Actuarial assessments on product managed as ST insurance
  - Extensive reporting requirements
- Insurance regulation tied to health regulation
- Burial societies
  - Absence of clear legal identity hampers recourse to protection offered by legal system
  - Do not facilitate institutional development

## Market analysis

### Inefficient and burdensome regulation

Example: Great North Burial Society

- Registered friendly society
- 15,000 to 20,000 members
- Structure: primary, secondary and apex
- Until 2000:
  - Managed risk under FS Act
  - Contractually guaranteed benefits
  - Employed own actuary
- 2000 evaluation report suggested that risk pool was insufficient
- Advised to obtain underwriting from formal insurer
- Underwriting from New Era in 2000 did not match
  - Different premium revision frequencies
  - Lapses treated differently (FS Act > 6m)
- Result: substantial losses to GNB and uncertain regulatory position

# Current regulatory framework

## The landscape

- Institutional vs functional regulation
- What is insurance:
  1. The payment of a premium
  2. In return for an agreed (guaranteed benefit)
  3. On the occurrence of a certain event
  4. In which insured has insurable interest
- LT Act and Friendly Societies Act
- LT Act requires option of monetary benefit

## Current regulatory framework LT Insurance Act: Requirements

- Public company
- R10m minimum capital – FSB
- Every policy “actuarially sound”
- Capital Adequacy Requirement (CAR): Higher of R10m or 13 weeks operating expenses
- Prudential requirements do not differentiate between different types of insurance business

## Current regulatory framework

### FS Act: Requirements

- Mutual assistance organisations – members share common bond
- Definition: “association of persons established for any of the objects in s.2”
- Sec 2: “insurance of sum/benefit to be provided towards expenses in connection with death/funeral of a member”
- Annual income <R100k: not required to register
- If benefit >R5000: must register under LT Act
- Upon registration: FS becomes body corporate
- Compliance rules, eg valuator’s certificate

# Current regulatory framework

## Position of burial societies

### Institutional form:

- Legal personality: Conferred by common law
- If non-profit: Separate legal personality as *universitas* under common law (law of voluntary association)
- *Universitas* must:
  1. Enjoy perpetual succession
  2. Be non-profit
  3. Founded on mutual agreement
- Practice: BSs can open bank accounts and enter into contracts
- Profit motive:
  - < 20 members – partnership
  - > 20 members – must register under Companies Act
- Does not qualify as co-operative under current Co-operatives

## Current regulatory framework

### Position of burial societies

#### Financial services:

- Do not offer insurance, but form of cash flow management or risk pooling if they do not guarantee benefits or take third party profits
- Thus: do not qualify as either friendly societies or long-term insurers
- When benefits guaranteed:
  - Benefits < R5000 and income > R100 000 – friendly society
  - Benefits > R5000 – long-term insurer

#### Intermediary services:

- Not intermediary. Act on behalf of members

## Current regulatory framework

### Position of funeral parlours

Institutional form: Various

- one person business
- public and private companies
- closed corporations

Financial services: 3 types

- Insurance
- Savings
- Credit

If insurance: must register under LT Act

Intermediary services: Must comply with FAIS



## Current regulatory framework

### Position of administrators

#### Institutional form:

- Similar to funeral parlours

#### Financial services:

- Insurance -must register under LT Act

Intermediary services: Must comply with FAIS

## Current regulatory framework

### Position of formal insurers

Institutional form:

- Public companies

Financial services:

- Insurance -must register under LT Act

Intermediary services: Must comply with FAIS

## Recommendations

### Three areas of recommendations

- Suggested regulatory framework
  - Dedicated funeral insurance licence
  - Appropriate regulatory regime for burial societies
- Enforcement and coordination
- Consumer education and recourse

# Suggested regulatory framework

## Dedicated funeral insurance licence

### Why?

- Different risk character: Assistance business written on ST basis
- Formalise the informal
- Can manage HIV risk
- Will facilitate development of financial services market

### Implementation:

- Apply to funeral insurance only
- Appropriate capital, risk management and reporting requirements
- Do not create bifurcated market between large and small players: Open to burial societies, funeral parlours and administrators
- Form: Amendment to LT Act/Stand-alone legislation (amendment to ST Act?)
- Subject to Financial Charter CAT (Charges, Access Terms) standards

## Suggested regulatory framework

### Appropriate regulatory regime for societies

1. Do not regulate risk pooling by burial societies, provided member governance in place
2. Remove societies that provide insurance from Friendly Societies Act
3. Place corporate governance under new co-operatives legislation:
  - Registration only when member governance replaced by distant management
  - Functional regulation remains with financial regulator
  - Test specific terms of Co-op Bill against reality of burial society phenomenon
  - Allows for evolution of burial society

## Enforcement and coordination

- Enforce regulation on ‘soft middle’
  - Note position of funeral parlours re FS Act
  - Enforce FAIS
  - Enforce right to monetary benefit
  - Close in on unregulated insurance
  - Close in on movement of insurance pools by administrators (New PPR rules)
- Facilitate closer cooperation between regulatory bodies
  - FSB
  - Health, including local government
  - SARS
  - SAPS

## Consumer education and recourse

- Extension of insurance products to lower-income households requires education (e.g. pre-pay vs insurance)
- Current recourse mechanisms not visible or accessible to consumers concerned
- Problematic to inform on monetary benefit without recourse
- Should review current mechanism to ensure that it address needs of funeral insurance market

## Three critical checks

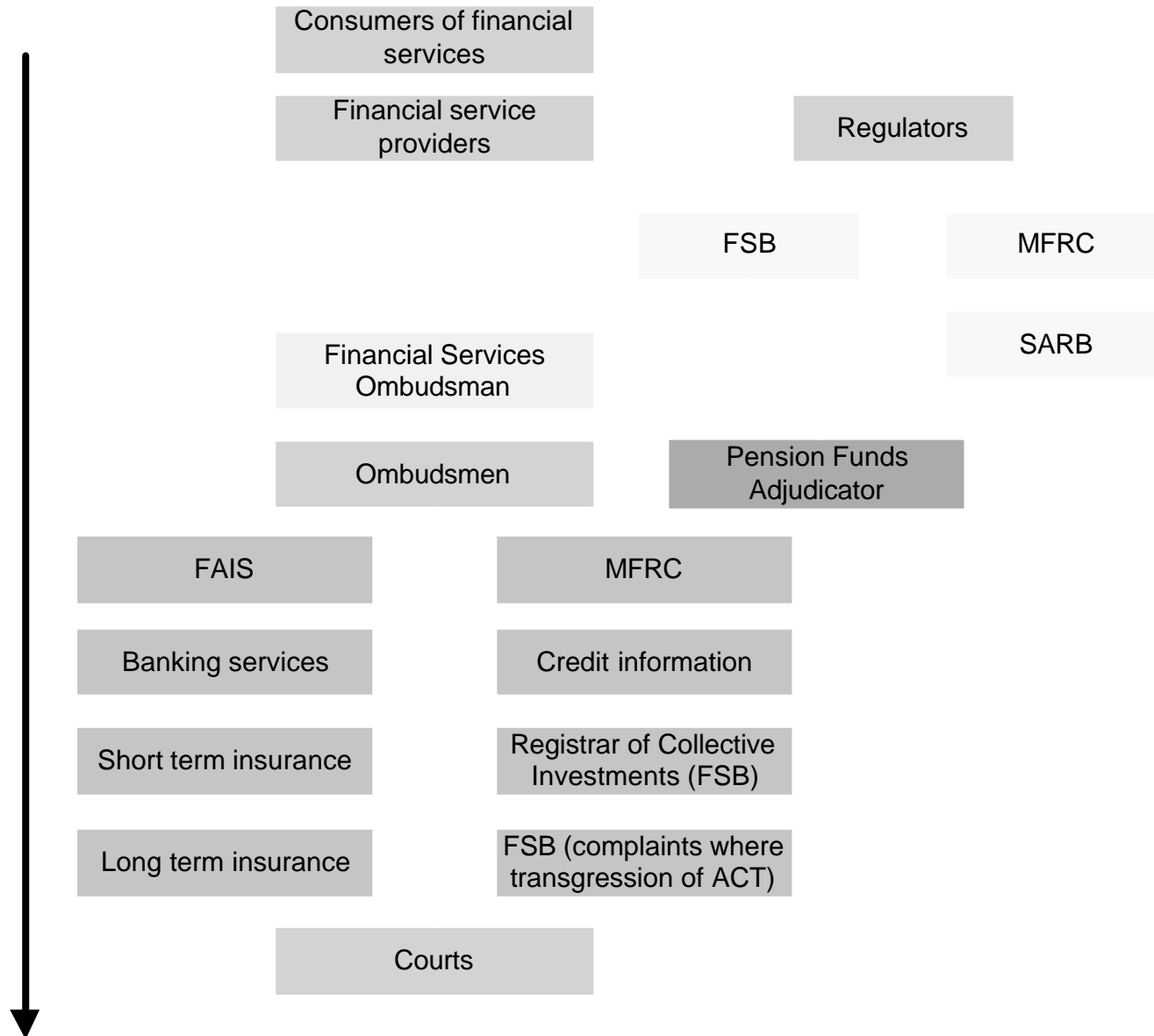
- Test regulatory consistency and actuarial soundness of principles proposed with regulator
- Test implications of proposed changes on existing market with key insurance and actuarial experts and operationalize design of dedicated licence
- Test attractiveness of proposed new framework with potential new licensees



- Encourage move to new regulatory regime to enable improved access – with appropriate safeguards in place.
- Capacitate Financial Services Consumer Education Foundation to play coordination role – not just funding, Could include setting ‘CAT’ standards for consumer education (akin to Mzansi standards).
- Need for clear and well publicised consumer recourse regime – with central contact point?

## **Conclusions and recommendations**





**In time of need - recourse**

