

G:ENESIS



**A regulatory review of formal and informal
funeral insurance markets in South Africa**

A market review and regulatory proposal prepared
for Finmark Trust
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FOREWORD

The need to provide for funerals is one of the key drivers of financial behaviour for many South Africans and has led to a relatively sophisticated and widely accessed informal financial sector. It is estimated that over 6 million people currently belong to burial societies where an estimated R6 billion is invested every year- in addition to the wide usage of stokvels (or savings clubs). These informal groups play an extremely important role in mitigating the risks of poor households and, interestingly, are often complemented or supported by formal providers - as can be seen in the Financial Diaries project¹.

However it was evident from the scoping study FinMark Trust completed on *making insurance markets work for the poor*², that the existing legislative and regulatory environment was especially inhibitive to the potential graduation of the so-called 'informal mutual assistance (common bond) organisations' ability to become insurers in their own right.

At the same time, however, there is a heated debate about the extent of abuse in both the informal and formal funeral insurance market.

In light of the above, the following report sheds light on the operations of this key market (from formal to informal), assesses the extent of the abuse and current regulatory environment and proposes some amendments to the current regulatory regime. One of the key aims of the recommendations is to balance the often-contradictory objectives of consumer protection against the clear societal need for access to appropriate financial services. We would welcome feedback on the regulatory proposals, which we will be discussing with the respective authorities.

We commend this report to all those interested in the provision of funeral cover, as well as those practitioners working on financial regulation. The report therefore is of significance to both a domestic and international audience.

Jeremy Leach

Executive Director
FinMark Trust
April 2005

¹ The Financial Diaries project is a year-long household survey that examines financial management in poor households. For further information see www.financialdiaries.com.

² Genesis Analytics, 2004, Making insurance markets work for the poor in South Africa - scoping study. www.finmarktrust.org.za.

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EXECUTIVE SUMMARY

The provision of funeral cover is, if informal provision is included, both one of the most widely used financial services in South Africa and one of the most neglected. Recently, concern has grown about possible abuses in the provision of funeral cover, with several submissions made to the Parliamentary Committee on Finance in December 2003 suggesting wide scale abuse and fraudulent practices in the sector. Funeral cover in South Africa is a product targeted at lower-income households, a segment of the population characterised by low levels of financial literacy and thus vulnerable to abuse. In addition, a large proportion of provision of funeral cover is effectively unregulated, including the ubiquitous burial societies and funeral parlours.

This report was commissioned to analyse the market dynamics, ascertain the nature and extent of the abuses and recommend an appropriate regulatory framework. Our focus was particularly on Black consumers, as they comprise the bulk of the clients in this market. We found that the demand for funeral insurance and related services is driven by a deeply felt need in Black society for the deceased to be accorded a dignified funeral. Unlike most other insurance products, funeral insurance is bought, not sold. In fact, urban clients often contract with multiple providers to ensure a funeral of an appropriate standard.

Four broad categories of market players have evolved to meet the need for funeral-related financial services:

Burial societies, of which there are between 80 000 and 100 000 in the country, are community-based, member governed, not for profit voluntary associations whose primary role is to offer emotional and physical support to members in times of bereavement and to pay a cash benefit to members or their families to provide for the funeral expenses. These benefits are not guaranteed and burial societies therefore do not offer formal insurance, but rather a form of cash flow management or risk pooling. Burial societies do, on behalf of their members, enter into agreements with funeral parlours to pre-pay for funerals. Some also purchase insurance from either funeral parlours or formal insurers. We found limited instances of abuse amongst burial societies, mostly of a fraudulent or criminal nature.

Funeral parlours are primarily providers of funeral services. However, in an attempt to secure a market for their services, most of them have added a number of

financial services to their portfolio. These include insurance (legal and illegal), credit (mostly in rural areas) and savings (pre-paid funerals). People enter into financial agreements with funeral parlours, because they do not want to look for one when a death occurs. This places the funeral parlour in a very strong position once the death occurs. We found several abusive practices prevalent in this market. For example, the existing requirement of the Long-term Insurance Act that policyholders be given the option of a monetary benefit instead of a benefit in kind is not adhered to at all, leaving the client to take what he or she gets. The result is a lack of competition in a market with relatively opaque products. Combine this with low levels of regulatory enforcement and the incidence of abuse is understandable.

We also found that *administrators*, who typically provide intermediary services in other insurance markets, often assume the role of product providers themselves in the funeral insurance market. The administrator would effectively own the client, and sometimes only insure part of his book with a formal insurer. They also self-insure. The difficulties arise when they move their book from one formal insurer to another without full disclosure to either the clients or the insurer. Yet, they provide services at very competitive prices.

A number of *formal insurers* are active in the market, with some holding assistance business licenses only, whereas others provide funeral benefits linked to life cover. What is interesting though, is that there is great similarity between the risk management practices of formal and informal insurers in the funeral insurance market. All of them effectively utilise short term insurance risk management practices, i.e. policies are for terms no longer than 12 months – often monthly – and premiums are adjusted based on the payout history. This obviates the need for the type of actuarial treatment required by the Long-term Insurance Act.

Under the current statutory regime burial societies and funeral parlours which provide insurance have to register under the Friendly Societies Act, while all other bodies providing funeral cover of more than R5000 must register under the Long-term Insurance Act. The provision of financial advisory and intermediary services are regulated under the newly promulgated Financial Advisory and Intermediary Services Act and the Codes of Conduct issued under that Act.

We found that the current registration requirements imposed by the Long-term Act, for example a minimum capital of R10 million, are unduly restrictive and hampers the development of the market. We therefore recommend the creation of a dedicated funeral insurance licence, available to all players in this market, with reduced entry and compliance requirements. We also found that the applicability of

the Friendly Societies Act to this market is tenuous, given the fact that it only applies to institutions that provide insurance. We therefore recommend that burial societies and funeral parlours be removed from the operation of the Friendly Societies Act.

The risk pooling activities of burial societies should remain essentially unregulated since they are self-adjusting in the current HIV/Aids environment and offer very limited opportunities for abuse. However, burial societies should be included in the draft Co-operatives Bill currently being finalised. The co-operative form is more in line with the character of burial societies. However, registration should only be compulsory once the direct governance by members is replaced by more distant management. Moreover, the functional regulation and supervision of financial services rendered by large burial societies should remain with the FSB.

There is a strongly felt need for effective enforcement measures within this market. We recommend that various enforcement agencies responsible for this market co-operate and exchange information to protect consumers.

Due to the complexity of the insurance environment and the risk of creating further distortions through inappropriate regulation, it is recommended that the impact of the proposed changes should be carefully assessed before embarking on a process of legislative changes. At minimum the following three checks are proposed:

- Test the proposed dedicated funeral insurance licence with the regulator for regulatory consistency and actuarial soundness of the principles proposed;
- Interact with key insurance and actuarial experts to operationalize the design of the dedicated licence within the broader insurance regulation framework and test the implications for the existing market and players; and
- Test the attractiveness and implications of the proposed regulatory changes for potential takers of the licence.

If the above checks indicate in favour of the proposed changes, the process of drafting the revised legislation can commence.

We further recommend that the drafters of the Co-operatives Bill consider the findings and recommendations of this report and its implications for the Bill.

1. INTRODUCTION AND BACKGROUND

The provision of funeral cover is, if informal provision is included, both one of the most widely used financial services in South Africa and one of the most neglected. Recently, concern has grown about possible abuses in the provision of funeral cover, with several submissions made to the Parliamentary Committee on Finance (PCOF) in December 2003 suggesting wide scale abuse and fraudulent practices in the sector. Funeral cover in South Africa is a product targeted at lower-income households, a segment of the population characterised by low levels of financial literacy and thus vulnerable to abuse. In addition, a large proportion of provision of funeral cover is effectively unregulated, including the ubiquitous burial societies and funeral parlours.

But concerns regarding market abuse are not the only motivation for looking more closely at funeral cover. Funerals are a pivotal social event in indigenous African societies, that reaffirm family ties and obligations, reinforce a sense of community, and confirm each attendee's place in the social fabric of faith and tradition. The burial society is a voluntary and autonomous institution of trust and self-reliance that survived decades of institutionalised racism, and for eight million South Africans, membership of these societies is part of their weekly routine. For millions more, funeral cover purchased from funeral parlours and formal insurers is an important financial asset and obligation.

The assistance business market is made up of a complex combination of services, providers and market dynamics. The providers of funeral insurance can be broadly categorised into four categories, namely burial societies, funeral parlours, administrators and formal insurers. Of these, only formal insurers are regulated in practice. Funeral parlours and administrators are usually considered to be intermediaries rather than providers of insurance, but research presented in this document will illustrate that, in practice, they often assume the position of a product provider. To date very little research has been undertaken on the funeral parlour and administrator market, and this study paid particular attention to shedding light on the dynamics in these segments of the market.

This study was commissioned with the bold (if somewhat ambitious) mandate of reviewing the operation and regulation of the assistance business market and investigating possible solutions to its challenges. The analysis starts by defining a framework within which to consider the possible role of regulation in this area. A discussion of the current market structure is then undertaken, with a focus on the operation of market mechanisms and the nature of the players and clients in the market. This is followed by a review of current regulation applicable to assistance business, and potential regulatory changes that could improve the functioning of the market. Relevant international precedents on the regulation of mutual self-help institutions and self-regulation are reviewed in order to benchmark the proposed regulatory changes for South Africa. The study concludes with a diagnosis of the market and recommendations for action.

1.1.

APPROACH

Given the dearth of research available on the assistance business market, the first step was to provide a detailed review of the market, covering all the various categories of providers, intermediaries and clients. The focus of this was to provide a systematic understanding of the market, in a framework that can be used to describe and analyse why certain components of the market are more or less prone to abuse. The intention, therefore, was not to survey every single institution, player and client in the market, but to gain an understanding of the different components by engaging with samples of institutions from each proposed category.

Sources of information. Due to the complexity of the problem and the multitude of parties involved in the market, a number of approaches were pursued:

- *Literature review:* the study commenced with a review of existing literature relevant to the market. It quickly became clear that not much literature exists on this market or this topic, both locally and internationally.
- *Interviews:* a large number of meetings (in person and by telephone) were held with a broad spectrum of parties relevant to or involved in the market³. In the area of *regulation*, meetings were held with:
 - Individuals in the FSB, National Treasury, Department of Trade and Industry, Ministry of Health, Provincial and Municipal Health Departments, as well as other parties involved in the review and management of the market to date.
 - International experts on regulation and micro-insurance.
 - International regulators from a number of countries, including India, Chile, Taiwan, Japan, Botswana and Zimbabwe.

On the *supply-side*, a number of meetings were held with representatives of formal insurers, administrators, funeral parlours, burial societies and other parties serving the market (such as financial management consultants: see Appendix A for details). In addition, a number of *industry associations* of the various categories of providers and intermediaries were interviewed:

- Formal insurers and intermediaries: LOA, SAFSIA, IBCA
- Administrators: GAF
- Funeral parlours: NFDA, PFDA, IFDA, GFUA, SAFPA, FFSA
- Burial societies: SAFOBS and NABSSA

On the demand-side, two main approaches were taken:

- *Surveys:* brief product surveys (telephone and doorstep) were done in order to gain an understanding of the products offered and the manner in which they are offered. The surveys covered 40 funeral parlours and

³ See list of meetings in Appendix A.

14 formal insurers (through interviews with brokers, agents and representative offices).

- *Focus groups*: eight focus groups were held in order to obtain a detailed understanding of lower-income African households' views on products and providers of financial provision for funeral expenses, the decision-making framework applied in deciding between the various product options, and possible drivers of vulnerability. Details of the focus groups are provided in Appendix C. The focus groups proved to be extremely useful in understanding the intricacies of the market, and were particularly useful in understanding traditional and cultural needs and views with regards to burials.
- *Stakeholder workshop*: the preliminary findings from the above processes were presented at a stakeholder workshop on 29 September 2004⁴. The feedback received at the workshop was incorporated in the analysis where relevant to the report.

A focus on the indigenous African population. From the FinScope results and the research conducted for this analysis, it is clear that the indigenous African population is by far the largest consumers of financial and other services related to funerals⁵. This is largely due to the dominance of the African population relative to the other population groups, but also due to the particular importance and definition of dignified funerals in African culture. The African population employs the services of all providers in the market, from burial and other informal societies through legal and illegal funeral parlour schemes, to formal insurance providers. For various historic reasons, the African population furthermore comprises the vast majority of lower-income households and, therefore, forms a large proportion of FinMark's target market in extending access to financial services. It is for these reasons that this segment of the population is the focus for this analysis.

In addition, African consumers are the primary users of informal and funeral parlour insurance, both of which are subjects of concern from a market abuse perspective. This does not negate the fact that other population groups are also users of financial and funeral products, but suggests that the issues relevant to the other population groups will be sufficiently dealt with by looking only at the experience of the African population.

⁴ See Appendix B for attendance list.

⁵ See Appendix B for an overview of the FinScope data on burial society membership and formal funeral policy use.

2. THE MARKET: AN OVERVIEW

It is important to distinguish between the market for *funeral services* and the market for *financial assistance* for funerals, including funeral cover.

2.1. THE FUNERAL SERVICES MARKET

The demand for financial services for funeral expenses is ultimately driven by the number of deaths per year. Very little data is available on the size of the market, particularly on the unregistered/informal component. What is known is the approximate number of deaths per year, and the number of members of funeral parlour industry associations. Together with an estimate of the price charged by parlours, this allows the rough calculation of ranges of potential market size and financial flows. This is shown in Table 1. According to the ASSA 2002 model⁶, 826 406 people were projected to die in 2004 from AIDS and other reasons. If it is assumed that the average cost of a funeral is roughly R4 000, Table 1 shows an estimated gross funeral parlour income of about R3.3bn, and gross client spending on funerals of R5.0bn per year.

	Scenarios	
	15% unregistered market share	25% unregistered market share
Projected deaths: 2004	826 406	826 406
Estimated gross client spend on funerals	R4 958 436 000	R4 958 436 000
Estimated gross funeral parlour income: Total market	R3 305 624 000	R3 305 624 000
Registered	R2 809 780 400	R2 479 218 000
Unregistered	R495 843 600	R826 406 000
Estimated number of registered funeral parlours	1 500	1 500
Estimated number of unregistered funeral parlours	1 500	2 500
Estimated gross funeral parlour income: per parlour		
Registered	R1 873 187	R1 652 812
Unregistered	R330 562	R330 562
Implied funerals per year		
Registered	468	413
Unregistered	110	110
Implied funerals per week		
Registered	9	8
Unregistered	2	2
Assumptions		
Assumed cost of funeral for unregistered parlour relative to registered parlour		75%
Estimated average cost per funeral (direct cost paid to funeral parlour)		R4 000
Estimated average total cost of funeral to client		R6 000

Table 1. Estimated market for funeral parlour services in South Africa

Source: Genesis calculations based on industry conversations and ASSA2002 mortality model

⁶Actuarial Society of South Africa, www.assa.org.za

The analysis in Table 1 considers two components of the market. The first is the registered or formal component, which comprises funeral parlours that are members of industry associations and are almost invariably registered with the health authorities⁷. The second component is the unregistered or informal sector of the market, which comprises funeral parlours which are not members of an industry association and will not be registered with the health authorities. It is assumed that most of the players in this category are small, including informal and so-called 'suitcase' parlours which do not have their own mortuary facilities.

In terms of the registered component, approximately 1 200 funeral parlours are registered members of one of the four industry bodies (see discussion in section 4.5). Assuming that there are an additional 300 formally registered funeral parlours (in terms of health regulations) that are not members of industry associations, this brings the total estimated number of registered funeral parlours to 1 500. Assuming in addition that there are an equal number of *unregistered* funeral parlours⁸ in operation, this brings the total number of registered and unregistered operations to 3 000. If it is furthermore assumed that the unregistered category makes up 15% of gross industry income, and charges less per funeral than the formal category (we assume a charge rate of 75% of that of formal players), the expected gross annual income from funeral services for the registered and unregistered components of the market can be estimated as R1.9m and R330 562 respectively. This translates into an estimated nine funerals per week for the registered parlour and two for the unregistered. Different assumptions result in a sharply higher estimate for unregistered providers.

The numbers are sensitive to assumptions, but our calculations and industry conversations both suggest some 3 000 - 5 000 *providers* in all. This view should be tested against the database of funeral parlours captured through the FAIS registration process.

2.2. THE MARKET FOR FINANCIAL SERVICES RELATED TO FUNERAL PROVISION

A range of financial services for funeral expenses are offered:

- *Credit*: in the absence of funeral insurance or savings, households often obtain credit to cover the cost of funerals. This can be provided by formal financial institutions, microlenders or even the funeral parlour in some cases. This report will only examine credit provided by funeral parlours and burial societies.
- *Savings*: households can provide for funeral expenses by saving with any of a number of formal and informal players, including a funeral parlour. This report will discuss the savings services provided by funeral parlours and burial societies, but stop short of an extensive analysis of the savings market.

⁷ This is not strictly correct as it is known that not all members of industry associations are necessarily registered with the health authorities.

⁸ No formal data exists on this market and the estimates here are based on conversations with industry players and the components of data that do exist (mostly for the formal market).

- *Insurance*: insurance services are extensively used as a means of providing for funeral expenses. This includes formal and informal (including illegal) insurance services that are provided by formal insurers and funeral parlours, as well as some burial societies.
- *Cash flow management and risk pooling*: a distinction must be made between insurance, on the one hand, and cash flow management and/or risk pooling, on the other. In this analysis it is argued that burial societies do not offer insurance services per se, but rather a probability-based cash flow management system. This is not pure savings, as access to the member's benefits in a burial society is determined by a probability event (the death of member or dependent). At the same time it is not considered to be insurance as the benefits are not contractually guaranteed. Whether called insurance or not, burial societies do, however, offer a risk pooling mechanism. The distinction from traditional insurance is that the risk is not passed to a third party, which profits from managing the risk pool. In a burial society the risk is simply shared equally amongst members.
- *Non-financial benefits*: the definition of 'financial services' with regards to funeral provision does not only cover those products that provide a monetary pay-out. It also covers those products where, in return for a premium, a provider agrees to pay other non-financial benefits. In the case of funeral parlours, this may be a funeral package to which a nominal value is attached, but also extends to the emotional support and 'helping hands' services provided in return for a burial society contribution.

2.3.

WHAT DRIVES DEMAND FOR FUNERAL SERVICES AND RELATED FINANCIAL SERVICES?⁹

Two main factors drive demand for funeral services and related financial services:

- **The social and psychological presence of death.** A surprising result from the focus groups was the presence and importance of death in the mind of respondents. When asked about their spending priorities, participants often cited funerals, burial societies and death before spending on education or day to day expenses like food, water and basic services. It should be noted that this was in response to a general question about spending habits to participants who did not know what the focus of the discussion was going to be. This impression is confirmed by the FinScope data, which identified the death of a wage earner as one of the primary risks faced by households and one of the most likely to occur¹⁰. Had the FinScope questionnaire listed funeral

⁹ The findings in this section and the rest of this chapter are based on interviews with clients and providers, discussions with industry players, FinScope 2003 survey results and in particular focus group discussions conducted with individuals from lower-income African households. The focus groups were held to obtain a better understanding of the factors driving the choice of funeral cover providers and the relationship between client and provider. The results from an earlier ILO study (Thrivikraman, 2003) on the impact of HIV/AIDS on informal insurers will also be included in the discussion. The focus group results bear quite close resemblance to the findings of an ILO study on the impact of HIV/AIDS on informal insurers (Thrivikraman, 2003). This study was done in the area surrounding Vryheid (30 minute driving time radius around the town including two townships and several rural areas), Kwazulu-Natal, which was chosen due to its particularly high HIV/AIDS prevalence rates.

¹⁰ 34% of Black respondents indicated that the death of a wage earner is one of the factors that could impact on their financial situation. Together with the loss of job for the main income earner (also at 34%), these were the highest

expenses as one of the financial risks from which respondents could select, the response may have been even more indicative of the importance of these factors.

- **The value of a dignified funeral.** A common theme reiterated by virtually all focus group respondents was the high value placed by all on being able to bury loved ones with dignity. Expectations of what constitutes a dignified funeral differ substantially across cultural and racial groups.

Funerals in African culture: indigenous African culture places a much higher premium on the funeral process and accompanying activities than is the case for other South African cultures. In traditional African culture, death is a significant event that is treated with the utmost respect. It is often believed that ancestors have a profound impact on the lives of those who are still alive. Thus, when someone dies, it is important to ensure that they are buried with much extravagance and festivity to keep them happy in the afterlife.¹¹ Furthermore, a funeral is an opportunity to strengthen family ties and to affirm the family's standing in the community. A social premium is attached to the number of people attending the funeral service. This may prompt the bereaved to go to great lengths to provide food and care to people attending prayers and the funeral itself. The value attached in some communities to a dignified funeral is deeply ingrained: one focus group participant commented that he "would rather live without electricity for a month" than not provide a dignified funeral for himself and his dependents.

Varying costs across population groups: culture and/or religious beliefs result in substantially different average costs for funerals across population groups. Conversations with industry players in the Johannesburg area suggest that whites spend on average R4 000 per funeral, Africans R8 000 and Indians less than R3 000¹². The relatively high cost of African funerals, combined with high poverty levels, explains why providing for funeral expenses is such a high priority for these households and, consequently, why they are over-represented in the sample of funeral insurance users.

Processes and elements: Figure 1 provides a picture of the general processes around death and funerals. During the process, the services of different providers are required by the family. These providers range from burial societies to funeral parlours to formal insurers and administrators. The following elements are typically offered by funeral parlours: storage of the body, preparation of the body, provision of the coffin, hearse services (if the transport is non-local the client has to pay for this), family car/s (including possibly rental of a limousine), flowers (coffin spray and wreaths), church decoration, a cross or grave stone, trolley and screen, tent

responses received across the various risks listed. The same two risks were also considered to be the most likely to occur.

¹¹ In an article written by Michael Wines (2004), illustrating the impact of AIDS on cemeteries in South Africa, a quote highlights the importance of laying dead family members to rest in the correct manner. The person speaking is referring to cemeteries that are at capacity and are having to bury people on top of each other. As a result, the ancestors are not happy: "some survivors claim that the departed speak to them in dreams, complaining, for instance, that their bunkmates have pushed them so close to the surface that they get wet when it rains."

¹² These costs may be high due to the urban setting. Costs in rural areas will be substantially lower, but the same variation between population groups is expected to exist.

and chairs, toilets, programmes, glasses and plates, catering, video and a bus for mourners.

In general the grave fee and money to purchase a cow (required under certain circumstances) are not included in the package and must be paid for separately by the family. The slaughter of a cow can be an important element. As a focus group respondent remarked, "If you don't slaughter, they think you don't have money".

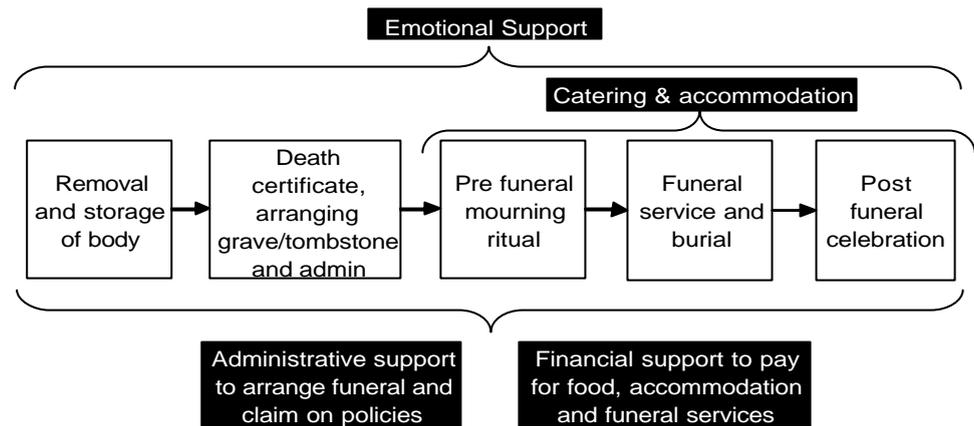


Figure 1. The African funeral process and needs arising from it

Source: Genesis Analytics

Expenses create financial need and risk: the expense of each item typically serves to increase the perceived dignity of the funeral. For example, the more lavish the coffin, the more impressive the grave stone or the more generous the catering, the greater the perceived dignity of the funeral in indigenous African culture. All of this translates into a very expensive and lengthy event which may leave families in a position of debt, unless they have provided for the expense. From a young age people are expected to start providing financially for death, so that they can provide adequately for their own funeral and those of their dependents.

Are social mores changing? The need to provide a dignified funeral has to a large extent been driven by indigenous African culture and what is expected by other people (particularly the elderly) in the family and community. One group of younger respondents admitted that funerals are becoming more and more difficult to afford, but were unable to cut back on costs because older family members insisted on maintaining the cultural traditions. One focus group participant said about his uncle's funeral:

"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 and 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 will other people say?'...Where does it all come from? [From] the parents, the elderly".

And another:

“...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, its culture but when I sit down and think about it, it doesn’t make sense.”

However, it would be an exaggeration to claim that a change in social mores with respect to funeral expenses is visible. And market players, of course, have an interest in perpetuating the substantial expenditure on funerals. This is particularly true in the funeral parlour market where market behaviour prevents competition and rationalisation of expenses (see Section 4).

2.4.

FUNERAL INSURANCE IS ‘BOUGHT’, NOT SOLD

According to the old adage, “insurance is sold, not bought”, suggesting that it is a grudge purchase requiring the persuasive energies of a salesman. However, this is not the case in the funeral cover market, where providing for death is generally a pro-active decision by the consumer who actively approaches providers of such services. One focus group respondent explained why he had obtained funeral insurance as follows:

“What happened to us at home is that 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 the 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 but then we came up with an idea that we must invite people maybe from Old Mutual who will come and present to us.”

From the focus group discussions it is clear that the decision to provide for death is, generally, made with the consent and knowledge of the whole household.¹³ In some instances female family members would be the member of the burial society, while male family members would be included as dependents and would provide the money for premiums.

¹³ Although in certain situations where men take out a substantial life policy, this is kept secret from their wives. This is done to ensure that the wife receives a surprise pay -out when the husband dies and also to prevent any temptation for the wife to hasten the demise of the husband in order to claim the money. As one respondent put it, “people die mysteriously for money.” Where funeral benefits are involved the spouse is usually informed as he/she needs to know of the policy in order to ensure funding of a dignified funeral.

2.5. MULTIPLE FORMS OF COVER AND PROVIDERS PER CLIENT

The social importance and expense of funerals may explain the prevalence of individuals holding multiple forms of funeral insurance. Most focus group participants used more than one policy from more than one provider of funeral cover. Thrivikraman (2003) also found that 70% of individuals in her study had multiple policies.

People choose multiple cover because, (i) there is a large gap between what is expected of a dignified funeral and what most lower-income people can afford on a cash basis and, (ii) several aspects have to be provided for in order to ensure a dignified funeral and a single provider may not cover all of these. According to one focus group participant:

“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 undertakers who will take care of the funeral. The money from the insurance company takes time to pay out so whenever that money comes, you can settle all your outstanding bills, so it is worth it. It’s for peace of mind in a way.”

A respondent quoted by Thrivikraman (2003) made a similar point, saying “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”. The focus groups pointed out that each type of provision plays an important and often complementary role. This view is summarised in Figure 2. In short, then, multiple policies may be *rational*, but are unlikely to be *optimal*, particularly if multiple intermediaries need to be rewarded.

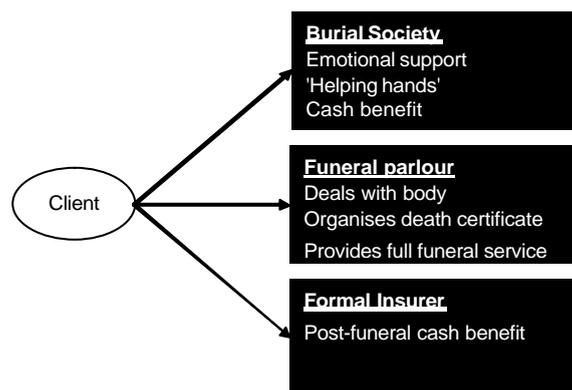


Figure 2. Client perspective on role of different providers of funeral cover

Source: Genesis Analytics

2.6. INSENSITIVITY TO PRICES

A surprising observation from the urban focus group discussions was the relative insensitivity towards the *price* of funeral cover and, indeed, to the higher costs of providing for death associated with using more than one insurance provider.

This is illustrated by one respondent who mentioned that, in addition to having a formal insurance policy, he is paying R350 per month to a funeral parlour that covers himself, his father, his brother and his child. He justifies such a high monthly premium by the fact that he has been assured that he will receive a very fancy coffin and the best service as part of the package. In his words this fancy coffin will ensure “a dignified funeral”. This is someone whose monthly household income is between R3 000 and R5 000.

Respondents were also asked about the details of their current policies. In most cases, the premiums of the policies used by various respondents would differ substantially, but this information was never met with concern and did not lead to them questioning the value of their own policies. This was the case, for example, in one group where two respondents indicated in conversation that they paid R30 and R70 per month respectively for policies providing the same cover but did not question the difference in premium.

However, this may be an urban phenomenon. The ILO study (Thrivikraman, 2003) focusing on a rural area in Kwazulu Natal indicated high price sensitivity and an inability to cope with increases in contributions. The rural focus groups unfortunately did not explore the issue of price sensitivity sufficiently to provide further insight.

FinScope only collected information on behaviour patterns as regards contributions to burial societies, which is likely to differ substantially from contributions to formal policies. Interestingly, the contributions to burial societies do show systematic variation across income categories, suggesting price sensitivity (see Appendix B for more details). What this may suggest is that relative income levels do play a role in determining what is considered to be affordable, but that the need to ensure a dignified funeral tends to override price concerns. It should be noted that compared to higher-income households, lower-income households contribute a substantially larger proportion of their income to funeral provision.¹⁴

2.7. DIFFERENCES BETWEEN URBAN AND RURAL USERS

Two major differences emerged in the focus groups between rural and urban consumers of funeral cover.¹⁵

¹⁴ The variation in contributions to burial societies (the only provider for which contribution levels were captured) across LSM categories is explored in Appendix B.

¹⁵ It must be noted that the urban focus groups consisted of respondents from the greater Johannesburg area and the rural focus groups consisted of respondents from the rural area of Dikebu (in the Northern Province, about 30 km from Moretele). It is, therefore, not possible to generalise this to all rural households in South Africa.

- None of the respondents from the rural areas owned a formal insurance product or had a direct relationship with a funeral parlour. Instead, the relationship was one where the individual had joined a burial society, and through the society had access to a funeral parlour (see Figure 6). Urban respondents seemed to join a society in addition to holding a policy directly with a funeral parlour and/or a formal insurer.
- Rural burial societies seem to have savings relationships with funeral parlours, as opposed to urban burial societies where the relationship is a mixture of insurance and savings (see Section 7.1.2). In addition, rural parlours in some cases still extend funerals on credit based on their relationship with the society. This is no longer the case for urban parlours.

Interestingly, FinScope results show that take-up of burial society membership by African households is quite similar for rural (31.4%) and urban areas (32.5%), whereas formal funeral policy ownership is substantially higher in urban and particularly metropolitan areas (with a take-up rate of 15.7%), as compared to rural areas (7.7%). In addition, it showed that as a percentage of household income, rural households contribute slightly more than urban households, but the difference is not significant.¹⁶

¹⁶ See Appendix B for more details.

3. BURIAL SOCIETIES

Whilst the primary purpose of burial societies is to provide funeral support services to their members, the services offered are typically not explicitly or contractually determined, but are determined by the members themselves when the death occurs. The services offered are primarily financial benefits and emotional and physical support in the preparations and management of the funeral. As the financial benefit is not guaranteed and no third party profits from risk management, burial societies do not offer insurance, but rather a form of cash flow management or risk pooling service. All of these support services are, however, offered in return for a premium and are therefore considered to be financial services.

3.1. PURPOSE AND ROLE

From the focus group responses, people seem to join burial societies for four main reasons:

- The society and its members offer emotional and physical support when death occurs. This is often termed 'helping hands', with society members coming to the home of the deceased to help the family prepare for the funeral (by peeling vegetables, cutting wood, slaughtering the cow, and so on).
- The society normally offers a cash benefit, sometimes known as bereavement money. This amount helps with the purchase of additional items (such as groceries, vegetables and the cow) for the funeral that are not, in general, provided by the funeral parlour.
- Society membership is often inherited. This is not reflected in the FinScope responses (see Table 2) where only 1.6% of Black respondents indicated the reason for membership being that it was inherited from a parent. However, this may only reflect the fact that inheritance was not the primary reason for joining and that the member sees several other benefits from membership.
- Dealing with the society is easy. When death occurs, only the chair-person needs to be informed and everything else is promptly taken care of.

Reason for belonging to a burial society	Proportion of Black respondents
To help me make the funeral arrangements	82.5%
To help when there is a death in the family	54.3%
To provide the kind of funerals my family deserves	23.5%
To provide for the family	21.6%
To help when there is an emergency	12.6%
Because I don't qualify for a funeral policy through a big organisation	12.6%
To provide comfort and support when I need it	11.8%
For people to help each other/build each other up/ubuntu	11.0%
It makes me feel safe	10.8%
There are many people who will die who depend on me	8.0%
Because I could not get money or help anywhere else	7.1%
To socialise/like going to meetings	4.5%
To keep money safe	3.0%
Because I know and trust the members	2.2%
Because I inherited the position from my parent	1.6%
For self-discipline and commitment	0.8%
To borrow money	0.5%
To increase the benefits I get	0.3%
Other	0.3%

Table 2. Reasons for belonging to a burial society (Base: Black members of burial societies)

Source: FinScope 2003

3.2.

DESCRIPTION AND TYPES

Burial societies are generally formed by people who know each other,¹⁷ such as family or friends. An archetypal burial society¹⁸ is characterised by member governance, is not for profit, meets at least once every month and usually has, at the branch (primary society) level, no more than 300 to 500 members (and usually far fewer – the average membership ranging between 50 and 80). As a result, societies are based on trust and operate on a common understanding between members. In general, they are highly organised, with procedures, financial reporting and, in some cases, a written constitution to control operations. Like co-operatives, burial societies can develop into larger structures through a system of branches (primary societies), secondary societies (usually area or regional) and federations or apex bodies.¹⁹

The research for this study confirmed that there are a number of different types of burial societies, as shown in Table 3. Existing research on burial societies suggests

¹⁷ Strangers are accepted into a society, but only with the consent of an existing member.

¹⁸ As opposed to those funeral plans that are called burial societies by funeral parlours and certain formal institutions.

¹⁹ Burial societies are structured in a clear hierarchical manner that reflects and maintains its member-governance nature. A secondary society has primary societies as its members and a federation has secondary societies as its members. The same principles of member governance apply and decisions taken are governed by representatives of the member societies, which, in turn, are governed by their members. Industry associations such as SAFOBS and NABSSA would be defined as federations. SAFOBS, in turn, belongs to NCASA, which is the apex body for co-operatives in South Africa.

that most are *contributing* societies. The *collection* societies (mostly the block system) seem to be less organised, as contributions are voluntary and it is therefore not predictable how much will be collected. *Contributing societies* require all members to contribute the same amount on a periodic (mostly monthly) basis. These societies sometimes develop into hybrid burial societies, which are linked with either a funeral parlour or a formal insurer who carries the risk and provides benefits. Societies can also be linked or combined with a *stokvel*, in which case the benefit is a combination of periodically receiving the *stokvel* pool of funds (as a rotating savings scheme) and a benefit paid on death of member or dependent. The premiums for the *stokvel* and burial components are usually separated (Thrivikraman, 2003).

Within this rough classification of burial societies there are a number of variations, including societies who offer loans to members as part of their investment strategy, and a few who have advanced to investing in equities or other assets.

Types	Categories ²⁰	Regulatory risk character
Collection Collection from members only when death occurs, and no pool of funds is built up	<i>Block system</i> : membership is often a natural consequence of living in a particular neighbourhood (“block”) and is seen as an additional collection system to help with costs.	No insurance risk. No contractual liabilities. No fiduciary risk. Some fraud risk due to theft by collectors of contributions, which is possible due to the absence of member governance.
	<i>Defined society</i> : people who know each other and form a society, which collects an unspecified amount (i.e. contributions may vary amongst members) from each member on the death of a member.	No insurance risk. No contractual liabilities. No fiduciary risk. Member governance limits fraud risk.
Contributing Members contribute every month to a pool of funds that are accessed when death occurs	<i>Standalone</i> : these societies may have a bank account, but do not have explicit links with funeral parlours or other funeral cover providers. All members contribute the same amount of money. The benefit is not contractually guaranteed and may vary based on the size of the fund. In most cases, the benefit does not cover the full cost of the funeral.	No insurance risk (benefits not guaranteed). No fiduciary risk as members’ funds are managed by members. Fraud risk where society control mechanisms are not in place.
	<i>Service agreement with funeral parlour</i> : the burial society acts as a bargaining group to negotiate discounts with the funeral parlour on a preferred supplier basis. These societies may or may not pre-pay for funerals (i.e. save with the funeral parlour). All members contribute the same amount of money. The benefit is not contractually guaranteed and may vary based on the size of the fund. Although the society may pay a cash benefit that can be applied to the cost of the funeral, the society usually does not cover the full funeral cost.	No insurance risk (benefits not guaranteed). Potential fiduciary risk as members’ funds (or part thereof) is saved with funeral parlour. Fraud risk where society control mechanisms are not in place.
	<i>Hybrid: contractual insurance agreement with funeral parlour (self-insured)</i> : these societies pay a monthly premium to the funeral parlour in return for which a contractually defined funeral service is provided to its members. This is different to the pre-paid funeral in that the funeral parlour carries the risk. The benefit is defined as a funeral service and in most cases, there is no option of a monetary/cash benefit. In some cases, the society may charge a higher premium to members than is paid to the insurer, with the difference kept in a bank account to tide over defaults by members and to pay for aspects of the funeral not covered by the formal policy.	Unhedged or managed insurance risk (parlour illegally underwrites and guarantees benefits). Potential fiduciary risk as members’ funds (or part thereof) are saved with the funeral parlour. Fraud risk where society control mechanisms are not in place.
	<i>Hybrid: contractual insurance agreement with insurance provider or intermediary</i> : these societies pay a monthly premium to the insurance provider (in some cases through an intermediary), in return for which a contractually defined monetary benefit is provided to members. In some cases, the society may charge a higher premium to members than is paid to the insurer, with the difference kept in a bank account to tide over defaults by members and to pay for aspects of the funeral not covered by the formal policy.	Hedged/managed insurance risk (contractual liability, but insurer complies with prudential regulation). Potential fiduciary risk as members’ funds (or part thereof) are managed by intermediaries. Fraud risk where society control mechanisms are not in place and if the point of intermediation is not monitored and controlled.

Table 3 Types of burial societies and their risk character

Source: Genesis Analytics

Membership. There are between 80 000 to 100 000 burial societies in South Africa, to which 6.2 million African members contributed an estimated R4.5 billion in 2003 (FinScope 2003). As mentioned, a burial society is the result of the need in lower-income communities to cope with the cost and shared responsibility of death. Therefore some 80% of African burial society members are in LSM 1 to 5. Membership does however extend into higher income levels, which may indicate that the cultural importance of such societies extends beyond their immediate financial role. Figure 3 illustrates how membership of burial societies and formal insurance usage varies across LSM categories, illustrating consistent membership

²⁰ See section 7 for a discussion of linkages amongst various institutions

of burial societies even for the higher LSMs and a very different penetration profile to that of the formal funeral insurers.

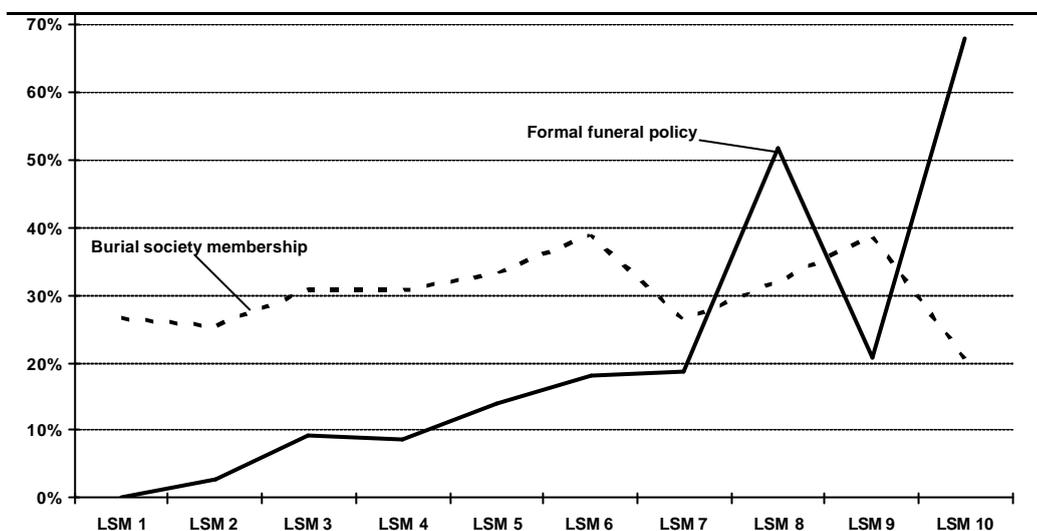


Figure 3. African membership of burial societies and use of formal funeral insurance across LSM categories

Source: FinScope 2003

New members. New members are encouraged to join at any time, but will usually be either a dependent of a main member, who has passed away, or a friend or relation of an existing member. Generally, new members need to be introduced by existing members if they are not known to other members of the society. Both founding members and new members are expected to pay a joining fee, which seems to range between R100 to R1500. The joining fee is paid by founding members to get the society pool started, and by new members to demonstrate commitment to the society.²¹ In addition, societies often own assets (such as pots, pans, tents and so forth) which have been accumulated over time. The joining fee paid by a new member is a contribution in lieu of the purchase of these assets. In conjunction with the joining fee, a new member has to go through a waiting period before benefits can be claimed on death. This waiting period is normally three months and helps to assess the commitment of the person to the society. Members are expected to attend monthly meetings and are fined if they fail to do so.

3.3.

MANAGEMENT AND GOVERNANCE

Burial societies are member-governed, non-profit in nature and, from an institutional identity point of view, take the form of a co-operative. Elaborate systems have evolved over time to ensure effective member governance.

Executive committee. An executive committee (normally a chairperson, secretary and treasurer) is selected each year to manage the funds of the society. The executive committee is replaced annually in order to reduce the level of control any

²¹ This is also a way of reducing moral hazard, as it decreases the risk that new entrants will immediately require benefits that have not been covered by contributions, and then switch to another society.

given individual has over the society, spread responsibility and reduce the risk of corruption. The committee is responsible for collecting monthly premiums and banking money collected, either in a bank or with a funeral parlour or both. The procedure is tightly controlled and records are kept in a bank book or contributions register, which is shown to all members at meetings, and is open to inspection by all members. As an additional measure, the bank book or card is normally kept by a non-executive member who does not have signing rights to withdraw money. The system effectively ensures member control and is usually quite strictly kept to. Thirivikraman (2003), for example, found that several of the rural burial societies interviewed in the ILO study could produce records of payments for the last ten years. The executive committee is also responsible for authorising and paying out benefits. When money is withdrawn, at least two of the executive members have to be signatories, to prevent the possible abuse of funds.

Contributions. Premiums are the same for every member and do not vary according to age, medical condition or the length of society membership. Premiums may, however, vary from time to time according to the claims experience of the society. These changes are managed carefully and must pass a democratic vote by the members. A member will be liable for a fine if a payment is missed, but will be allowed to remain in the society if he/she is able to make up any missed payments. In general, a member will be asked to leave a society if three consecutive monthly payments are missed. This member may reapply to join the society at a later stage, but the application will be treated as a new membership, and the joining fee and waiting period will re-apply.

Benefits. A burial society will pay benefits on the death of the main member and a defined list of dependents, which may include the spouse, children, extended family²² and other designated dependents. The names of dependents are usually listed, together with their ID numbers. If a dependent dies, the main member can, in some societies, substitute their place with someone else. Benefits provided by the society can be split into two categories. On the one hand there is *emotional and physical support ('helping hands')*²³ from the members of the society and on the other hand there is a *cash benefit* (often called '*bereavement money*'). The cash benefit may also be split into a component that is paid before the funeral and a smaller payment after the funeral. The value of the benefit varies based on the size and well-being of the society, but the focus group discussions suggest that it is typically less than R3 000.²⁴ It is important to note that payment of the cash benefit is immediate (normally paid within two days of the chairperson being notified), and that people can relocate and still receive benefits. Other benefits are also offered: some societies own assets that can be used for the funeral and which reduce costs; furthermore, the burial society sometimes offers the benefit of contracting on behalf of members with funeral parlours (see Section 7.1.2).

²² Parents and in-laws

²³ This seems to be the primary reason for joining a society and explains why a burial society will continue to exist even if HIV/AIDS wipes out the financial benefit

²⁴ One reportedly paid as much as R16,000.

3.4.

MARKET FAILURES AND ABUSES

Consumer issues Common law crimes such as theft (e.g. where the treasurer runs off with the society's money) and fraud at burial societies are some of the problems that were raised by the focus groups, as well as in FinScope 2003. In general, however, member-governance seems to be an effective control mechanism, as the incidence of such problems is remarkably low given the informality of organisational structure and the large number of burial societies.

Figure 4 shows the FinScope results on problems experienced with burial societies. Incidences of money lost from an outside party or committee members seem remarkably low given the informal nature of governance. The main concern is that members default on their contributions (burial societies typically allow members to miss one or two payments, and repay at a later stage. This is useful to informally employed members who have erratic incomes).

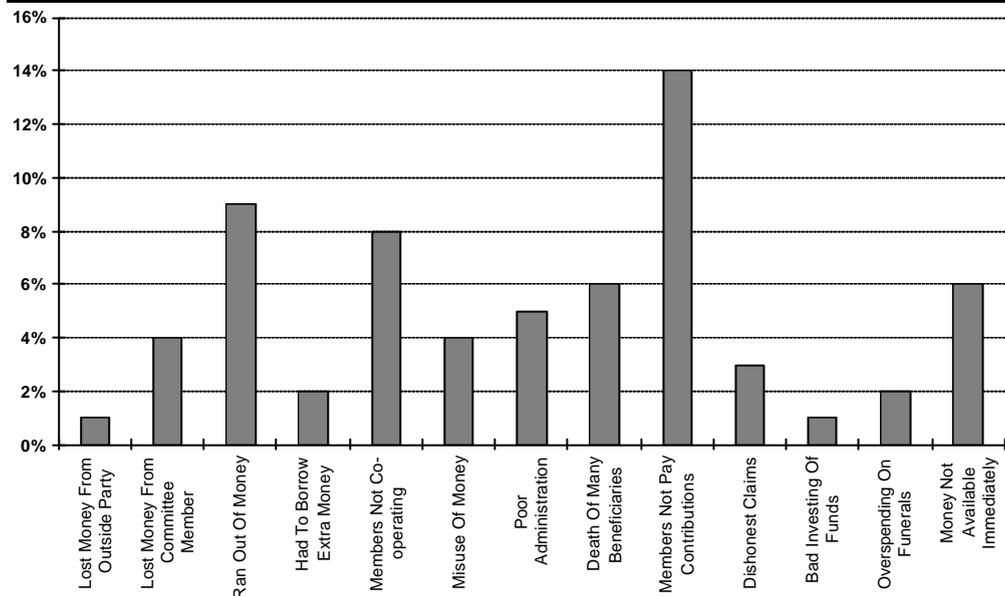


Figure 4. Problems experienced with burial societies (base: members of burial societies)

Source: FinScope 2003

HIV/AIDS. The effect of HIV/AIDS on burial societies is of concern, as the epidemic is likely to increase claim pressure. However, focus group participants did not report that HIV/AIDS had had a major impact on the viability of their societies, and none reported dramatic increases in their claims to date. This is not to say that it is not a problem, but simply that the societies sampled have not experienced this or are coping. In contrast, the individuals interviewed in the ILO study (Thrivikraman, 2003), indicated that they had been substantially impacted by increased mortality rates (ascribed to HIV/AIDS). Nine out of the twenty three burial societies reviewed in the ILO study indicated that they no longer accept new members, due to uncertainty over whether new members have HIV/AIDS (recognising the risk of adverse selection), and the fact that existing members are struggling to keep up payments (partially due to HIV/AIDS). This illustrates the fact that HIV/AIDS not

only affects the mortality experience of the group, but also disposable income and therefore the ability to contribute to such a society.

Management of HIV/AIDS risk: the flexible, member-governed nature of burial society operation may facilitate their ability to cope with HIV/AIDS. Most burial societies (particularly the smaller ones) do not contractually guarantee benefits. It is understood by members that the benefits paid are dependent on the available funds and may vary. In addition, burial societies reported on in the focus groups (also see Thrivikraman, 2003) indicated that, in the event of a depletion of funds, they would increase payments, reduce benefits or have additional collections from members to boost the fund. The ability of societies to manage their pool by varying or increasing the contributions is, however, limited by the fact that many burial society members are from poorer households, where income is low and unemployment high. Increasing premiums may result in people withdrawing from the society as they cannot afford the premiums (confirmed by Thrivikraman, 2003).

Even if the pool of funds is completely drained, it is to be doubted that the societies will disappear as the need for emotional and physical support still remains. Indications from members suggest that societies may, in such cases, simply revert to collection societies, as the burden of death will be lighter even if shared amongst substantially poorer members (and in the absence of a fund).

3.5. INDUSTRY ASSOCIATIONS

There are two major national burial society associations: the National Association of Burial Societies of South Africa (NABSSA), with about 4 000 members, and the South African Federation of Burial Societies (SAFOBS), with about 600 members. Considering that there are 80 000 to 100 000 burial societies in South Africa, the membership base of the national associations is very low. However, they are making a concerted attempt to expand their base. NABSSA and SAFOBS are currently in an advanced stage of negotiations around the possibility of merging. Both associations see broader membership of burial societies in their associations as a first step to establishing a self-regulatory regime for the burial society industry.

SAFOBS is part of the National Co-operative Association of South Africa (NCASA). Based on its co-operative roots, SAFOBS is of the view that burial societies operate in much the same way as co-operatives and, as a result, would like to see burial societies categorised and regulated as financial co-operatives. They see the new Co-operatives Bill as an appropriate regulatory framework, and want burial societies to be moved from the Friendly Society Act to the Co-operatives Bill. This bill also provides for the establishment of self-regulatory bodies and SAFOBS sees itself becoming such a body.

In addition to representing their members' interests to government, SAFOBS and NABSSA negotiate with formal insurers on behalf of their members, communicate best practice amongst members and offer financial education and structural support.

Box 1. An example of burial society evolution: Great North Burial Society

Burial societies are about the sharing of risk amongst a group of people who share a common bond and usually take responsibility for each other anyway. In the nature of co-operative structures, risk sharing beyond this core group is possible through the establishment of secondary co-operatives or federations, which is consistent with the co-operative model applied by burial societies in South Africa. If the expanded pool is still insufficient, prices can be adjusted or re-insurance can be arranged with formal insurers or re-insurers.

An example of such a development was seen with one of the larger burial societies, Great North Burial Society (GNBS). This society has been in existence for a substantial period of time and covers between 15 000 and 20 000 lives. It comprises several primary burial societies, which, through regional bodies, form part of GNBS - a registered Friendly Society.

Until 2000, Great North managed its risk under the Friendly Societies Act without the involvement of formal insurers. GNBS contractually guaranteed benefits to members and risk was managed from a central pool to which all members contributed. They employed their own actuary, were required to submit three yearly actuarial evaluations to the FSB, and their books were audited. In its 2000 evaluation, the actuarial report suggested that the risk pool was not sustainable and, based on this, the FSB advised GNBS to obtain underwriting from a formal insurer. This was an interesting recommendation as the insurer would either apply similar evaluation models and simply increase the premium or re-insure some of the risk. Both of these options were also available to GNBS, and did not require the involvement of a formal insurer. In retrospect, it may have been better for them to consider re-insurance or possibly even becoming a full insurer.

Following this recommendation, GNBS obtained underwriting from New Era in 2000. Although the system worked reasonably well, there were two major concerns:

- New Era revised premiums twice yearly, whereas GNBS could only do this on a yearly basis at annual general meetings. Any increases in the interim would, therefore, have to be carried by the society until the next general meeting.
- Lapses were treated differently by GNBS and New Era. GNBS was bound by the Friendly Societies Act, stipulating that individuals who have been members for more than 5 years are allowed to miss six payments before the policy lapses. The contract with New Era, however, stipulated that policies will lapse if two payments are missed. This resulted in GNBS remaining liable for benefits to members who lapsed according to New Era, but were still within GNBS's grace period. It seems that GNBS understood the agreement with the insurer to replace that under the Friendly Societies Act, while members insisted on the terms as stipulated in the Act. In total, this cost GNBS between R600 000 and R700 000, which was paid by liquidating some of their investments.

Ironically it seems that the evaluation leading to the underwriting agreement was based on incorrect information. GNBS has since exited the agreement with New Era and has requested a temporary moratorium on underwriting from the FSB, in order to reconsider its options.

This case study illustrates the potential for burial societies to develop into formal institutions and the possibility of even becoming insurers in their own right.

4. FUNERAL PARLOURS

4.1. PURPOSE AND ROLE

Funeral parlours are primarily in the business of providing funeral services. However, in an attempt to secure a market for these services, many have added a number of financial services to their portfolio. These include insurance (legal and illegal), credit (mostly in rural areas) and savings (pre-paid funerals).

People take out an insurance policy or pre-pay a funeral with a funeral parlour because they do not want to have the burden of looking for a parlour at the time of death. The funeral parlour will take care of the body, arrange the death certificate and provide the full funeral service according to what has been specified. In addition, the funeral parlour is often more convenient to work with than a big financial institution (for example, a death certificate is required by the latter but not by the former). The perception expressed by the focus group respondents was that a parlour treats one with respect, empathy and understanding. A funeral parlour is often chosen based on past experience of relatives or friends. Respondents did not seem to be concerned with whether a parlour was underwritten or not, but with their reputation in the community and the quality of service offered. A parlour is normally an integral part of the community and can build a reputation of trust as long as a dignified service is provided.

Number. Due to the general non-enforcement of both health regulations and the requirement to register funeral parlours, it is difficult to say how many funeral parlours are operating in South Africa. The estimation done in section 2.1 suggests that the figure is between 3 000 and 5 000, which correlates broadly with the guestimates provided by industry players. These parlours may vary from informal 'suitcase' operators to branches of large funeral parlour groups and some may offer financial services to provide for the cost of a funeral (savings, insurance or credit).

4.2. DESCRIPTION AND TYPES

Funeral parlours differ profoundly from burial societies in that they render mostly non-financial services, are not member governed, operate as a business for profit and, in general, offer funeral cover to a much larger pool of clients. Parlours take a variety of institutional forms, and vary from informal one man operations to close corporations to public companies, of which some are listed on the stock exchange. Parlours can be independent, associated with other parlours or insurers, or owned by formal insurers (branch structure).

The definition of what actually constitutes being a funeral parlour, however, is not clear. Current health regulations seem to focus on the regulation of a mortuary rather than the services provided around a funeral. Funeral parlours have, however, evolved to be more than just mortuaries and provide a number of additional services, including transport, catering, administration and so forth. In

fact, some providers of these services do not even have their own mortuary and may rent space from other state or private mortuaries (often referred to as 'suitcase' parlours). The absence of a clear and comprehensive definition makes enforcement of health (and, thereby, financial) regulation difficult and creates an environment conducive to fly-by-night operators. In this analysis, the definition of funeral parlours will include all operations dealing with the preparation, storage and burial of the body. The focus will, however, be on parlours which also provide financial services. Where necessary to provide context, however, the discussion will extend beyond this to include those who do not offer financial services (including suitcase and full-service parlours).

There are, consequently, a number of different categories of funeral parlours in operation. The main distinction for financial regulation purposes is between those who provide funeral services only (i.e. collecting and storing the body, preparing the body for the funeral and co-ordinating the funeral) and those who provide funeral services as well as some form of funeral insurance or pre-paid policy. Funeral parlours can offer two distinct financial products to provide for death. The first is an insurance policy,²⁵ where a defined benefit is paid in the event of death irrespective of the value of premiums already paid. The second option is where a person pre-pays for a funeral.

Insurance Funeral parlours offer insurance in three ways:

- **Illegal insurance:** the parlour sells their own insurance products, which are not underwritten by an insurer. From a survey²⁶ of funeral parlours and discussions with people in the parlour market, more than 90% of those interviewed offer some form of funeral insurance product and indications are that a large proportion of these are fully or partly self-insured.²⁷
- **Underwritten insurance:** the parlour sells their own products, and the risk pool is underwritten by an insurer (effectively acting as an administrator).
- **Intermediary:** the parlour acts as an intermediary and sells the products of an administrator or an insurer.

Although this study focuses on funeral insurance, the impact of the low enforcement of health regulations (see Box 2 Health regulations: funeral parlours) on the overall market is substantial and will be noted because of its relevance to the overall regulatory environment and recommendations.

²⁵ As discussed, this may be offered illegally, underwritten by an insurer, or a product of an insurer

²⁶ This survey was conducted by telephone and through a number of on-site visits - 30 to 40 parlours were surveyed. These parlours were mainly in the greater Johannesburg area and the Limpopo province. However, a number of parlours were also contacted in other parts of the country.

²⁷ Respondents were reluctant to disclose this information in the telephone survey.

Box 2. Health regulations: funeral parlours

Certificate of competence

In order to handle, store or prepare dead bodies and operate as a funeral parlour, a certificate of competence²⁸ is required. Certified parlours must be inspected by health and building inspectors from the local municipality. Once clearance is given, the local municipality submits the application and a report to Environmental Health Services in the National Department of Health. It is then the responsibility of the Director-General to grant approval for the funeral parlour to operate,²⁹ in the form of a certificate of competence.

However, according to conversations with the Environmental Health Services, there is at present a backlog of applications for a certificate of competence, to the extent that numerous funeral parlours have started doing business without an authorised certificate of competence. According to an industry source, only 10% to 20% of funeral parlours are currently registered.³⁰ Unfortunately, the Environmental Health Services is short staffed and are unable to police³¹ or change this situation in the short-term.

From 1 July 2004 it was intended that local municipalities would have greater authority in issuing the certificate of competence and more power to enforce the applicable regulations, without the process being referred to the Director-General. However, with the exception of Mogale City municipality, it is difficult to determine whether this has taken place.

Mogale City Municipality

In an effort to bring order to the funeral parlour business and the use of cemeteries in Mogale City, an attempt has been made by the municipality to register parlours and only allow registered parlours to perform funerals in cemeteries. In order to register as a funeral parlour, the municipality will issue a permit subject to the following conditions:

- i) A valid registration certificate from a recognised undertakers' association is produced.
- ii) A clearance certificate stating that all health regulations are adhered to is received from the municipality's health section
- iii) The funeral parlour signs a memorandum of agreement with the municipality.
- iv) The registration fee is paid in full.

As part of the memorandum of agreement, funeral parlours have to pay an annual registration fee to operate³² and a burial fee for each funeral conducted. In addition, a full list of the parlour's personnel, with contact numbers and addresses, needs to be submitted to the council. Before they are allowed to work, the personnel need to acquaint themselves with all the rules and regulations that apply to running a funeral parlour.

Separate cemetery by-laws have also been drawn up. The key by-laws pertaining to funeral

²⁸ See regulations relating to Funeral Undertakers' Premises, Government Notice No. 237 of 8 February 1985. This is a schedule relating to the Health Act of 1977 (Act No 63 of 1977).

²⁹ Apparently no list is kept by the Director General of those funeral parlours that are registered.

³⁰ Municipal cemeteries are only supposed to allow burials by funeral parlours with a certificate of competence. According to the department of cemeteries and crematoria at the Johannesburg municipality, only 112 funeral parlours are registered to conduct burials according to possession of a certificate of competence. However, industry sources have confirmed that about 500 to 1000 parlours operate in the greater Johannesburg area. Thus, parlours are still being allowed to conduct business without a certificate of competence.

³¹ Since 1996, only four funeral parlours have been closed down as a result of non-compliance with health regulations. It is believed that many more are not complying.

³² R1000 for Mogale City based undertakers and R1500 for external undertakers

parlours are that permission needs to be obtained from the manager of the cemetery to operate in the cemetery. Permission will only be granted if the parlour is registered with the municipality and has signed a memorandum of agreement.

The Mogale City municipality has taken important steps in trying to get a handle on those operating as funeral parlours. However, very little attention has been given to the insurance side of the business.

Impact on regulation of financial services

In addition to increased health risks, weak enforcement of health regulations has resulted in (i) the absence of a central record or registration database of funeral parlours, (ii) a general spirit of non-compliance, which spills over into areas such as tax and insurance, and (iii) an environment conducive to 'fly-by-night' operations. These factors complicate the regulation of provision of financial services through these institutions. From a survey³³ of funeral parlours and discussions with people in the parlour market, more than 90% of those interviewed offer some form of funeral insurance product and indications are that a large proportion of these are fully or partly self-insured³⁴.

Box 3. Example of a pre-paid funeral

One funeral parlour surveyed offers the option whereby members can save towards funerals by paying a minimum of R50 per month to the parlour. For each payment a coupon is issued to the member, which is inserted into a booklet. If the monthly coupon contribution had been paid for 20 months, then R1 000 worth of coupons would have been earned. If someone on the designated list were to die at the end of 20 months, and a funeral worth R7 000 was requested, then the family would have to pay in an additional R6 000 to cover the costs of the funeral.

Pre-paid. Money is paid to a funeral parlour at defined or undefined intervals. The funeral parlour keeps this money and may issue a coupon for each payment made. When death occurs, the funeral parlour assesses how much money has been paid. If sufficient money has been paid in for the funeral requested by the customer then the funeral parlour will conduct the funeral. However, if insufficient money has been paid, the customer will have to pay the balance to cover the cost of the funeral. Box 3 gives an example of a pre-paid funeral. Where such schemes are offered, 'policyholders' are usually free to 'withdraw' their savings at any time. No interest is earned on money pre-paid to a funeral parlour, but pre-paying normally secures a "discount" on the cost of the funeral. It also means that members have an existing relationship with a parlour and do not have to go through the process of finding a parlour in the event of a death in the family. Furthermore, the burial society sometimes offers the benefit of contracting on behalf of members with funeral parlours (see Section 7.1.2).

³³ This survey was conducted over the telephone and through on-site visits to 30 to 40 parlours. These parlours were mainly in the greater Johannesburg area and the Limpopo province. However, a number of parlours in other parts of the country were also contacted.

³⁴ Respondents were reluctant to disclose this information in the telephone survey.

The group of parlours that both conduct funeral services and offer some type of funeral insurance can be split into a number of sub-categories, as shown in Table 4. The combination of the non-enforcement of regulation (health and insurance) and the demand for funeral services have created an environment conducive to 'fly-by-night' and/or 'brief-case' operators, which require minimal capital to operate. Although formal figures are not available, indications are that a large number of these institutions are in operation. They often rent space from state mortuaries³⁵ or other private mortuaries and only collect the body the day before³⁶ or on the day of the funeral. As a result they are able to offer funeral services without the stipulated facilities and in contravention of the relevant health acts.

In the absence of enforced health regulations, it is often quite difficult to identify and control funeral parlours from the financial regulation point of view.

Types	Categories	Regulatory risk character
Funeral services only	<i>Suitcase parlour.</i> Provides funeral services but does not have its own mortuary and usually operates from someone's home or car.	No insurance risks as only funeral services are provided. Substantial health risks as most are not registered and absence of physical presence make it hard to regulate
	<i>Full-service parlour.</i> Provides funeral services and usually has a fixed office or 'shop' from where it operates. They may have relationships with formal insurers, burial societies or administrators, but this is limited to preferred supplier agreements.	No insurance risks as only funeral services are provided. Some health risk where health regulations are not enforced.
Providing mechanism for insuring or providing for funeral costs (May be independent or tied to formal insurer)	<i>Independent offering pre-paid funerals or administering member savings.</i> This is usually a full-service parlour that also offers a savings product to help clients pre-pay for their funerals.	No insurance risk. Substantial fiduciary risk as members' funds are not separated from business funds.
	<i>Independent and self-insured (fully or partly).</i> The same as the previous but offers an insurance product instead of (or in addition to) the savings product. The insurance product may not be underwritten by a formal insurer.	Substantial insurance risk as member contributions are re-invested into the business and benefits are paid out of cash flow. Some health risk where health regulations are not enforced
	<i>Independent but acting as intermediary for formal insurer.</i> Similar to the previous category, but instead of self-insuring, the parlour simply on-sells the product of a formal insurer on which it earns a commission.	No insurance risk if fully underwritten. Some health risk where health regulations are not enforced
	<i>Friendly Society.</i> In a few cases, parlours operate as Friendly Societies and are thereby allowed to write insurance business with benefit values of up to R5 000. This also requires that the parlour be owned by members and operated on a not-for-profit basis.	Insurance risk managed by requirements of the Friendly Society Act, but less regulated than formal insurers under the Long-term Insurance Act. Some health risk where health regulations are not enforced.
	<i>Owned by formal insurer.</i> These are full-service parlours that act as intermediaries for their parent insurance company. As they are fully owned by the insurance company, they effectively become tied agents.	No insurance risk as fully underwritten. Low health risk due to visibility of parlours and reputation risk to insurer.

Table 4: Types of funeral parlours and their risk character

Source: Genesis Analytics

³⁵ This is confirmed by the KwaZulu-Natal Environmental Health Department where, apparently, state mortuaries charge a nominal fee of about R12/month to keep the dead body once the family has identified the body. However, the Kwazulu-Natal Environmental Health Department confirmed that draft legislation is being drawn up that will change environmental health regulations. One of the main aims of the regulations is to standardise the treatment of, for example, funeral parlours in different municipalities. One goal is to discontinue the practice whereby funeral parlours operate without a mortuary. This is in light of the health hazard posed by dead bodies.

³⁶ In extreme cases, the body is not even stored in a mortuary but kept under a wet blanket in the family home.

Clients/membership. Funeral parlours serve a wide spectrum of clients which overlap with the burial society and formal insurance market across the different income categories. As FinScope 2003 did not require respondents to indicate membership of funeral parlour schemes, formal figures on membership are not available. From the focus groups and industry discussions, it is, however, clear that the market is concentrated in the lower-income categories, falling somewhere between burial societies and formal insurers in terms of income categories.

Insurance schemes: It is necessary to distinguish between funeral parlour schemes where the parlour is owned by an insurer (e.g. AVBOB), and those where the parlour is the intermediary of a formal insurer, or self-insures. In general, underwritten schemes (owned or intermediary) will penetrate to quite low income levels, but will also be used by higher income individuals. Self-insured schemes tend to be concentrated in the lowest income categories. One of the fundamental reasons for this is the absence (or perceived absence) of regulated alternatives for lower-income households in the area.

Membership is not explicitly restricted, but discussions with funeral parlours indicate that they are shrewd assessors of individual risk, know their communities well and do manage selection bias. Some of the ways in which this is done is through differentiated prices for age categories and generally longer waiting periods than burial societies (see Table 8).

Savings schemes: As parlours carry little risk from savings schemes, there are no restrictions on membership of such schemes. Once again, formal figures are not available, but indications from industry conversations suggest that most people in urban areas would prefer to insure with parlours rather than save. In rural areas, the relationship seems to be mostly one of savings, but it is not clear whether this can be generalised to all rural areas in South Africa. This service is often provided to burial societies and the parlour may also provide further administrative support in return for a preferred supplier arrangement (see section 7 for a discussion on linkages).

4.3. MANAGEMENT AND GOVERNANCE

Funeral parlours are profit-driven institutions. Once again, it is necessary to distinguish between management of funeral parlour schemes where the parlour is owned by an insurer, and those where it is the intermediary of a formal insurer or self-insures.

- *Owned by insurer:* These parlours are generally well-governed by the parent company and compliant with formal institutional, tax and other legislation. Some of the issues with formal insurers will be discussed in section 6.
- *Intermediary:* These parlours are usually more formalised and will be registered as legal entities and for tax purposes. Prior to the introduction of FAIS, insurers did not have sufficient control over their intermediaries, and in several cases and for various reasons, insurers did not assume

responsibility for their intermediaries. Although the introduction of FAIS will require insurers (and may improve the ability of insurers to do so) to more actively manage their intermediaries, it is still early days and the result will depend on how it is implemented in practice (see discussion in section 9.6). In addition, the governance of intermediaries will benefit from the enforcement of general institutional, reporting and tax regulation.

- *Self-insured.* These parlours are typically not governed by members or by a parent company, and corporate governance is generally weak. It is unlikely that many of these parlours are registered as companies (particularly in the case of suitcase parlours), or for tax purposes. At the same time, a large part of the success of a funeral parlour seems to be in effective administration, which allows the parlour to manage its risks on a cash flow basis. The successful parlours therefore tend to have well-developed administration systems. Where self-insured insurance or savings products are offered, there is no clear separation of member accounts. The insurance business is used to provide cash flow to the overall business, but profits are mostly taken from funeral services and used to cross-subsidise the insurance business. It is for this reason that parlours are unwilling to provide the option of a monetary benefit, or to transparently price the components of a funeral, as this would prevent cross-subsidisation.

Contributions and benefits. The survey of funeral parlour and formal insurer products conducted as part of this analysis indicated that the benefit structures on funeral parlour policies (insured or self-insured) are quite similar to those of formal insurers, but that premiums are generally higher, resulting in a higher cost for cover ratio (see Table 8). This is exacerbated by the fact that both insured and self-insured parlours tend to express benefits in terms of services, rather than in terms of monetary value. If these services are valued at market rates for the components (which also tend to be overvalued, see section 4.4 below), the implied value to the client is much lower than the nominal value attached to the service.

Funeral parlours provide two broad benefit types:

- The most common are benefits in the form of funeral services. These funeral services can be specified either in terms of a cash value or in terms of actual services that would be delivered upon death³⁷. Added to the funeral services, some funeral parlours offer a cash component, which is intended for groceries or other expenses associated with the funeral, but not normally covered by the parlour.
- Some parlours allow the customer the option of a cash benefit (instead of the service), but usually deduct a certain percentage of the value (between 25% and 50%) as an 'administration fee'. However, with the possible exception of parlours linked with formal insurers and some larger independent operators,

³⁷ Focus group respondents indicated that benefits in the form of funeral services are sometimes beneficial, in that they eliminate the temptation to use the cash pay -out for other purposes besides the funeral.

the option of a cash benefit is fairly rare (the impact of this is discussed in section 4.4 below).

With the exception of national funeral parlours or those linked to formal insurers, funeral parlours generally do not provide services outside of their geographic area of coverage. If members move away or if dependents live far away, funeral parlours typically refuse to conduct the service or only agree to provide transportation (within limited distances). Where the option of a monetary benefit is not available (the majority of cases), the policyholder will therefore forfeit benefits.

4.4. MARKET FAILURES AND ABUSES

Several market failures and abuses in the funeral services market were identified.

- *Monetary benefits*: existing provisions in the Long-term Insurance Act require funeral insurers to offer policyholders the option of a monetary benefit. This is however not enforced, and evidence collected through focus groups and the survey of funeral parlours suggests that very few funeral parlours (with the general exception of parlours affiliated to formal insurers) offer clients the option of a monetary benefit. Where they do offer this option, it is not made clear to the client, or the package is structured in such a manner to make it seem better to take benefits in kind.
- *Price behaviour*: funeral parlours define their benefits in terms of the funeral service, to which a nominal value is attached. The value applies to the whole package and is not broken down by the separate items included in the package. This makes it very difficult for the consumer to know and compare the true value of offerings amongst the various potential providers.
- *Set funeral package*: at the time of death, individual components of the funeral package are not negotiable downward, and the client can only upgrade to more expensive options (usually at substantial cost). If unhappy with a particular component, the client cannot opt to exclude the component in question in favour of money. If the client wishes to replace a component with one that was bought elsewhere (e.g. a different coffin), they are allowed to do so, but the funeral parlour will not refund money on the coffin that will no longer be used.
- *Lack of competition*: the effect of the product structure and the absence of a monetary benefit option results in severely restricted competition in this market. Funeral parlours only compete in terms of how impressive the funeral display is, but not on the value or cost to the client. The way in which products are structured prevents consumers from reducing the cost of the funeral by a more careful selection of components, and marketing of products exploits cultural vulnerabilities with regard to the need for “dignified” funerals.

The combination of the above dynamics results in a substantial welfare loss to consumers and the maintenance of artificially high funeral costs.

- *Forfeiting of benefits*: in some cases market structure results in consumers simply forfeiting their benefits. For example, one focus group respondent

contributed to a funeral parlour in Carltonville for 20 years. When she left the area, the funeral parlour refused to continue covering her, as they would not do a funeral service outside of Carltonville. As a result, she was forced to forfeit the policy she had and find a new parlour. Another participant in the focus groups was covered under each of her three children's policies with separate funeral parlours. As the parlours only offered benefits in the form of services, two of the children's policies will be forfeited with no cash alternative.

- *Self-insurance*: interviews with market players suggest that funeral parlours may, in some cases, self-insure or only partially underwrite their insurance business. The underwritten portion is then shown to FSB inspectors as proof of legality on inspection. Such funeral parlours will generally pass on the worst risks to the insurer, while retaining the best risks for themselves. In this way they can manage their risk through 'screening', without turning people away. This behaviour by parlours will be difficult to control unless insurers take the responsibility of auditing the intermediaries they use. For funeral parlours to retain the best risks, it is important for them to prevent communication between the client and the insurer. In some cases (particularly in the initial agreements between insurers and parlours), the insurer only knows the number of lives underwritten. Due to the absence of appropriate risk management in both fully and partly self-insured schemes, the policyholder's funds are at substantial risk.

HIV/AIDS. In the absence of the backing of a properly managed insurance fund, a self-insuring funeral parlour faces substantial exposure to HIV/AIDS. This is particularly the case where adverse selection is not controlled for, and is believed to have led to the demise of even large parlours such as City Funerals. In terms of self-insuring funeral parlours' exposure to the HIV/AIDS risk, this is primarily managed through waiting periods. As parlours are also the providers of funeral services (which cost them substantially less than is charged to clients) their actual liability is much lower than the nominal value placed on the funeral. However, as proper reserve requirements and risk management are rarely observed, and risk is managed on a cash flow basis, these buffers will eventually be depleted as (due to the mixing of business models and cross-subsidisation) the parlour cannot monitor and accurately manage its risk.

4.5. INDUSTRY ASSOCIATIONS

The principal body in the funeral parlour market is the newly established Funeral Federation of South Africa (FFSA) which serves as the apex body for the funeral parlour industry, with the industry associations as its members. The National Funeral Directors Association (NFDA), the Independent Funeral Directors Association (IFDA) and the South African Funeral Practitioners Association (SAFPA) are currently members of the FFSA. The Private Funeral Directors Association (PFDA) has applied to join the FFSA, but was refused membership on the basis of concerns over the probity of the operations of its members. A number of organisational issues can be noted as regards the funeral parlour associations:

- The FFSA is a relatively new body and is yet to establish itself as representative of the industry. Despite democratic voting arrangements, there are concerns over dominance by larger parlours.
- The NFDA has about 200 members (about 440 branches in total) and is dominated by the bigger funeral parlour groups owned by AVBOB and HTG. The purpose of the NFDA is to act as a representative of its members to government, and to ensure that standards in the funeral parlour industry are maintained.
- The IFDA only has 13 members and was originally formed to allow its members to become assistant registrars and issue death certificates.³⁸ However, the legislation has changed and funeral parlours are no longer able to issue death certificates. Instead, individuals can now qualify to issue burial orders by writing an exam set by the Department of Home Affairs. These burial orders are then sent to the Department of Home Affairs, which issues the death certificate. As a result, the IFDA's original purpose has waned, but it continues to represent its members in wider forums. It focuses primarily on best practice as relates to the funeral services offered by members, and does not concern itself with issues on the insurance side of the business.
- SAFPA has about 450 members³⁹, all of which are African owned funeral parlours – a requirement set out in its constitution. SAFPA is trying to set best practice in relation to funeral services and also to improve the standard of insurance offered by its members. It has, for example, recently put out a tender to obtain underwriting for products offered through SAFPA members. SAFPA is also trying to use their combined membership to become a stronger player in the market and provide competition to large players.
- The PFDA has over 400 members and, although it has not been allowed access to the FFSA, is active as an association. It provides representation and a range of benefits (including FAIS registration support) to its members. In addition, Safrican has won the tender to provide products through PFDA members.

³⁸ Only funeral parlours who were members of a recognised industry association could act as assistant registrars and issue death certificates

³⁹ Their membership consists mostly of smaller independent operations and, therefore, the number of branches involved will be similar to the number of members.

5. ADMINISTRATORS

5.1. PURPOSE AND ROLE

The primary purpose of an administrator is to provide efficient and low-cost administration of policies. These services may include managing policyholder records, receiving premiums, payment of claims, and so forth. Although administrators are usually seen as intermediaries, it was found in this study that they often assume the role of product provider rather than intermediary. In some cases the administrator would structure the product and, although the risk is underwritten by an insurer, the administrator effectively owns the client base. In other cases, the administrator may illegally opt to fully or partly self-insure, in which case they also carry the risk of the pool.

Numbers. As with funeral parlours there is some uncertainty about the exact number of administrators in South Africa. The Group Administrators Forum (GAF) currently has 15 members, but this is not necessarily representative of the industry as a number of administrators have chosen not to join GAF (see section 5.5). Current information suggests that there are no more than 50 administrators in the country (if defined separately from brokers).

5.2. DESCRIPTION AND TYPES

Similarly to funeral parlours, administrators are typically not member-governed, but operate for profit. For this analysis an administrator is defined as a company or person that administers a portfolio of policyholders, but is not a registered insurer and, therefore, needs to obtain underwriting from an insurer. This means that the administrator will manage all the administrative aspects (e.g. payment collection and claims) but will not carry or manage the underlying risk of the policies.

In some cases, this service is provided on behalf of an insurer. The insurer has control over the client base and the administrator simply deals with the operational issues. An example of this is “The Best Funeral Society” administrator, owned and used by Hollard to administer their funeral parlour groups. However, it is often the case that the administrator has control over the client base and can obtain underwriting from one or more insurers. Pahkama Administrators provide their services to Safrican on such a basis. The insurer has no contact with the client and the client sees the administrator as the provider of the product. They are, therefore, different to brokers in that they own the client base (e.g. an administrator can move its book between insurers with the client’s consent), they have a larger role in the administration of the premiums and claims of a policy, and they can charge additional fees for these administrative services (i.e. their income is not restricted to commission). In an attempt to retain control over the client base, Safrican insists that monitoring groups consisting of policyholders be set up. These groups communicate directly with the insurer and inform them of what is happening at policyholder level.

Types	Categories	Regulatory risk character
Self-insured	<i>Fully self-insured</i> : such administrators may have been intermediaries for an insurer, but decided to (illegally) manage their own book without underwriting from an insurer. This is quite rare as it is riskier than partially self-insuring.	Substantial insurance risk as risk management and reserving is at the discretion of the administrator and not compliant with regulation. Unmonitored nature of this component of the industry also creates risk of fraud.
	<i>Partly self-insured</i> : this administrator will have a relationship with one or more insurers through which it obtains underwriting, but it will not underwrite all the policies on its book, and will carry some on a cash flow basis.	Substantial insurance risk for those policies not underwritten by formal insurer. This is difficult to control without full and enforceable disclosure between administrator and insurer or administrator and regulator as it is easy to hide behind the insured component. Using multiple insurers for underwriting makes it difficult for the regulator or insurer to ensure that all risks are covered. Introduction of FAIS and changes to PPR will reduce this risk.
Underwritten	<i>Member-owned</i> : occurs where a member group negotiates an insurance contract with an insurer, but establishes its own administrator to manage the collection of premiums and claims processes in order to reduce costs to members.	Insurance risk is dealt with through underwriting agreement. Some insurance risk remains where the book is moved between insurers, but member governance should reduce this and ensure that it is to the benefit of the member and not only the administrator. Introduction of FAIS and changes to PPR will also reduce this risk. Member ownership controls for excessive profit taking and ensures appropriate product design.
	<i>Independent</i> : the administrator is not owned by an insurer or member group and can provide its services to several member groups and insurers. These administrators sometimes self-insure part of their book.	Insurance risk is dealt with through an underwriting agreement. Some insurance risk where moving between insurers or where full information on the book is not disclosed to the insurer. Introduction of FAIS and changes to PPR will reduce this risk.
	<i>Insurer-owned</i> : insurers make use of an administrator to reduce delivery costs. In this case the administrator is owned by the insurer and acts as a 'tied' administrator (i.e. do not provide services to other insurers).	Insurance risk dealt with through underwriting agreement. Tied nature should ensure appropriate disclosure of information to insurer.

Table 5: Types of administrators and their risk character

Source: Genesis Analytics

Lesaka Administrators is an interesting case, with the clients being both 'owned' by the administrator (i.e. not under the control of the insurer) and owners of the administrator. They are owned by a number of unions, the members of which form the client base of the administrator. It is, therefore, similar to a bargaining group through which the union members can negotiate underwriting with insurers and provide their own administration to reduce costs. This setup has ensured that the efficiencies gained through the administrator have been applied to the benefit of the client, and has resulted in premiums to members that are a fraction of those available in the open market. It does, of course, also benefit from the compulsory nature of the schemes provided through the unions, which have contributed to lower premiums. Lesaka does not see itself as an intermediary but rather as a product provider, as it designs its own products and then finds an underwriter who is willing to underwrite them. They are currently investigating the possibility of becoming a fully-licensed insurance company.

Unlike brokers, the administrator can also set the price of a product (a broker can only negotiate commission with the insurer). Administrators are, furthermore, known for their advanced and efficient administrative systems, that allow them to

provide their services to a large number of clients at low cost. In this analysis administrators are, therefore, considered to be both intermediaries and product providers, as they often structure and price a product for which underwriting is then obtained from an insurer.

Clients. At policyholder level, the members of administrator schemes may cover the full spectrum of clients (as they can intermediate on all levels). Due to administrator integration with formal insurer operations (and illegal self-insurance) it is not possible to accurately define their membership profile. In most cases, however, the services of an administrator are used for lower-income policyholders, due to the small premiums and the requirement for a low-cost administration system. Administrators manage a variety of insurance schemes, which may include the following member/policyholder groups: funeral parlours, burial societies, employer groups, other formal insurance groups or other affinity groups (covering both voluntary and compulsory groups).

5.3.

MANAGEMENT AND GOVERNANCE

Administrators operate in a variety of business forms, including one man operations, closed corporations and publicly limited companies. In many cases, the services provided are of a 'back-office' nature, and are sold to the client through another intermediary, such as burial societies, affinity groups and employer schemes. Consequently, administrators typically do not have a visible 'shop' presence and do not use their brand to sell products.

As with funeral parlours, the primary relationship is between the client and the administrator (and not the insurer). Where the administrator is not owned by the insurer they therefore often have control over the client base, and can select the underwriting insurer.⁴⁰ This relationship may be one where the administrator develops and structures products, for which it obtains underwriting, or one where the administrator merely on-sells and administers the products developed by an insurer. In both cases this relationship means that often the only client information provided to the insurer is the name and ID number of the person who is underwritten. The administrator does not provide further information to the insurer for fear that clients will be poached. As a result, the administrator retains control of the book, which can thus be moved to a different insurer.

Unlike other intermediaries such as brokers, who are limited in the fees and commission they may charge, administrators determine the final price of the product through the charges added to the risk premium without communicating this to the insurer. As a result, the insurer often has no control over the final premium. In this way, the relationship between the administrator and insurer is similar to a re-insurance relationship, where the insurer charges a risk premium for the risk insured. The major difference is that the administrator is not allowed to keep any risk on its book and effectively has to re-insure all risk (although this is not always the case). There may be room to develop this 're-insurance' relationship as part of

⁴⁰ An interesting case was discovered where the administrator was owned by the group it served. In a sense, this could be termed a captive administrator.

a new licensing regime, which will allow the use of this flexible model while ensuring proper risk management and control.

Contributions and benefits. Administrators have developed low cost business models and systems through which they can cost-effectively set up and manage group schemes, both voluntary and compulsory.

Although the product survey in this analysis did not explicitly cover administrator schemes, the information collected from industry discussions suggests that premiums on administrator schemes will be similar to or lower than comparable formal insurance group schemes. The accusation of 'excessive' profit taking, therefore, seems to be defined relative to the cost base and risk premium rather than in absolute price terms.⁴¹ In special cases where an administrator has access to a captive market (i.e. compulsory group schemes), they have often been able to offer products at remarkable value, which would otherwise not have been provided.

The benefits offered by administrators are similar to those offered by formal insurers, as they mostly on-sell insurance products. However, in many cases the closer relationship between the administrator and client base has allowed it to tailor the product to better suit the needs of a particular client group.

5.4.

MARKET FAILURES AND ABUSES

The lack of disclosure on charges and underwriting, together with the inability of insurers to communicate directly with policyholders, presents problems in terms of FAIS, which holds insurers responsible for the disclosure of charges and other information to policyholders. Administrators are not incentivised to facilitate disclosure as it will reveal their margins.⁴² It must, however, be noted that high administration charges are not necessarily problematic, as the need for cash collections often makes it quite costly to serve this market.

Due to the lack of communication between insurers and policyholders, and the limited information provided by administrators, insurers have very little control over administrators. If any pressure is placed on the administrator in terms of charges or disclosure, the administrator can move the book to a different underwriter (this is particularly easy if they do not comply with legislation requiring the consent of each policyholder, or where the policyholder is given incorrect information to convince them to consent with the move).

Like funeral parlours, administrators are also in a position to split the book: keeping the healthy part to underwrite themselves and passing the riskier section on to the insurer. With the limited information currently disclosed to the insurer and the fact

⁴¹ As an example, an insurer may be concerned about the fact that an administrator charges R80 per month for a policy for which it pays only R10 in risk premium to the insurer. In this case, the R80 may seem excessive, but it must be noted that the cost of administering such policies are high (e.g. collecting cash, etc.) and, if the insurer had to offer it themselves, they would not be able to charge much less than the R80 due to their own internal costs and overheads.

⁴² Even where these margins may be justified due to the cost of managing the policies, this may not be acceptable to the client.

that administrators may obtain underwriting from more than one insurer, it is very difficult to monitor or control for this.

HIV/AIDS. In terms of administrators' exposure to HIV/AIDS risk, indications are that this is managed through waiting periods, managing targeted groups or improving the risk of the pool through compulsory schemes. There is some concern over the flow of information to the insurer who underwrites the risk (which may result in the build-up of liability), but this liability is limited through the short policy period. The management of this risk, therefore, boils down to a pricing issue, and the difficulty of maintaining an affordable and sustainable product.

5.5. INDUSTRY ASSOCIATIONS

The only known association of administrators is the Group Administrators Forum (GAF) with about 15 members. GAF aims to be a self-regulating body. However, it is not clear what level of unity has been achieved by the association and it has yet to prove itself as being representative of the administrators. Questions have been raised about the reputability of GAF members, which has resulted in some administrators not wanting to associate with the group in the fear of being tainted by its reputation.

6. FORMAL INSURERS

6.1. PURPOSE AND ROLE

Formal insurers⁴³ are primarily in the business of providing financial services.⁴⁴ The focus of the report is funeral insurance products, which may combine insurance and/or savings components. As with the other providers, this section will focus on providing a framework for identifying regulatory and market issues⁴⁵.

The focus groups revealed that the perception is that insurers, generally, take too long to pay out and that thus they should be used to provide a type of post-funeral cash benefit to settle outstanding debts. This lump-sum payment would go directly to beneficiaries to help them cope with what may be a difficult financial period. A benefit of having a policy with a formal insurer is that the cash benefit is assured as long as the papers are all in order. This is not always the case with other providers.

A large proportion of current African burial society members have never had a policy with a formal institution. This confirms the notion that burial societies are often the first means of providing for funeral insurance and also the first port of access to such services. Table 6 shows that only 17% of African members of burial societies *currently* have a funeral policy. This seems to contradict the focus group finding that most respondents used more than one provider of cover. The FinScope survey, however, did not ask respondents about funeral parlour policies, which may explain the discrepancy.

Directly or indirectly through a burial society. The burial society is, therefore, often the first provider accessed when someone is planning ahead for death. This is probably due to the cultural familiarity of African society with burial societies. Burial societies may, however, approach a funeral parlour or formal insurer to provide benefits to their members. In this instance the burial society can be described as a client to the funeral parlours and formal insurers.

	Member of a burial society	
	Africans	Other races
Never had a funeral policy with a big institution	78%	33%
Currently have a funeral policy with a big institution	17%	62%

Table 6. Burial society membership and possession of a funeral policy: overlap⁴⁶

Source: FinScope 2003

⁴³ For this analysis, formal insurers are defined as companies that are formally registered as insurers and, therefore, actively regulated by the FSB.

⁴⁴ The exceptions may be insurers such as AVBOB or Rentmeester who also own their own funeral parlours. For these companies it seems that the primary services offered are funeral services and, similar to the discussion under funeral parlours, the insurance component is used to secure a market for these services.

⁴⁵ See the Insurance Scoping Study (Genesis, 2004) prepared for the FinMark Trust for a more detailed discussion of cost structures, products design and pricing in the formal long-term insurance sector (and assistance business market).

⁴⁶ The FinScope questionnaire also gave respondents the options of "used to have" and "don't know" when asked whether they had a funeral policy with a big institution. As so few respondents (in some cases less than 5 people) indicated either of these as their response they are not worth representing.

Assistance business can be written under either a life or an assistance licence⁴⁷ and, in terms of statutory returns, assistance policies can be reported to the regulator under either of these categories. As at 30 June 2003, there were 42 insurers registered with assistance licences, of which 6 were not registered for any other policy category and 36 were registered under both life and assistance business categories. Only 27 insurers reported writing business under the assistance business category (although this is misleading as insurers such as African Life and Sanlam report assistance business under the life category). Therefore the figures reported in the FSB Annual Report may not reflect the market size or position of companies in the assistance business market.

6.2.

DESCRIPTION AND TYPES

In this analysis, formal insurers operating in the assistance business market will be categorised using a combination of three characteristics:

- *Insurance licences*: assistance business only or life and assistance business. Some short-term insurers also provide add-on products that closely resemble assistance policies. These will be dealt with as a separate category.
- *Group structure*: the insurer may be tied to a bank, retailer or funeral parlour. This will impact on their market strategy and on the distribution channels used.
- *Product focus*: the group may have funeral business/insurance as their core focus, or provide funeral insurance as an add-on to other products or services.

Using these criteria, it is possible to define a number of categories of formal insurers (set out in Table 7). These are not mutually exclusive categories but illustrate categories of insurers with shared market and regulatory characteristics. In some cases, a single insurer may fall under more than one of these categories (e.g. those selling directly to the public as well as through funeral parlours).

⁴⁷ Until the passing of the Insurance Amendment Act (2003) it was also possible to write assistance business under a short-term insurance licence. This Act prohibits the use of terms such as funeral, burial or derivatives thereof in short-term policies. Although it is clear that the intention of the regulator is to prohibit the writing of assistance business under a short-term licence, the amendment only addresses the naming or description of policies and not the actual provision of the policy under a short-term licence. See section 9.4 for further details.

Type	Description	Regulatory risk character
Assistance license only: insurance only	These insurers are licensed for assistance business only, and are restricted to selling products with benefits of less than R10 000. This is often circumvented by offering the same client two (or possibly more) policies. Commissions are not capped. These companies only write funeral insurance business, which may be of voluntary or compulsory group nature and use a wide range of distribution models. Two of these (Constantia Life and KGA) were administrators before registering for an assistance business licence. They make extensive use of church groups, funeral parlours, burial societies and brokerages for distribution, and their business is dominated by voluntary groups. Constantia also underwrites funeral insurance, sold as part of credit agreements through the furniture retailer Ellerines (and is partly owned by the Ellerines Group).	<p>The insurance risk is covered by regulation.</p> <p><i>Inappropriate products:</i> Short policy periods may not be appropriate for funeral insurance products (policies are structured as a renewable policy with a short term in order to get around the controls of the Long-term Insurance Act). Prices are often only guaranteed for one month. Products do not deal with long period of illness before death (policy lapses irrespective of the term of membership).</p> <p><i>Reputation risk:</i> These insurers are quite small and do not use their brand to sell their products. The reputation risk due to inappropriate market behaviour is, therefore, less of a disciplining factor.</p> <p><i>Bundled products:</i> Where funeral insurance is packaged with other financial products like credit agreements on retail sales, clients are forced to take funeral insurance as part of the insurance package, which will expire at the end of repayment (24 months for retail credit). There are concerns over the level of disclosure to clients and whether their rights are made clear to them (e.g. that they do not have to take the product offered by the retailer's insurer).</p> <p><i>Disclosure and control over intermediaries:</i> Where these insurers use intermediaries such as funeral parlours or administrators, they do not always have contact with the insured party or, in extreme cases, even a list of the people insured. This means that they have no control over the client book and cannot ensure the implementation of disclosure as required under FAIS.</p>
Assistance license only or multiple licence: tied to funeral services group	These insurers may be licensed for assistance business only (e.g. Grobelaars, Goodall and Bourne and Goodall and Company), or for other insurance categories as well (e.g. AVBOB, HTG and Rentmeester), but have funeral insurance as their core focus, are tied to funeral parlour operations and sell their policies through their parlours. Funeral insurance is used to capture clients for the funeral parlour business and to fund purchases of their funeral parlour services. Where the insurer is also registered for life business, this is used to offer funeral benefits that exceed R10 000 as well as general life insurance products.	<p>The insurance risk is covered by regulation.</p> <p><i>Inappropriate products:</i> As discussed above</p> <p><i>Reputation risk:</i> These insurers rely very strongly on their brands and reputational risk is a strong disciplining factor in ensuring appropriate behaviour. As funeral services are the core of the business, the insurance component is managed to support the funeral services component.</p> <p><i>Funeral parlour linkages:</i> May be structured to prevent/discourage clients from exercising their right to a monetary benefit. This raises general concerns over the disclosure of options to clients and the advice provided.</p>
Multiple licence, independent insurers with funeral as core	This group includes independent insurers (e.g. African Life and Safrican) that are not tied to specific funeral parlours or other financial service operations. Their core focus is funeral insurance, and they write both voluntary and compulsory group business. Their focus is, however, on compulsory business. They also make use of administrators or other distribution mechanisms such as the Post Office to reduce the cost of distribution and extend their services beyond the banked population.	<p>The insurance risk is covered by regulation.</p> <p><i>Inappropriate products:</i> As discussed above.</p> <p><i>Reputation risk:</i> As these insurers have funeral insurance as their focus and have a recognisable brand on which they rely to sell their products, they tend to be more innovative with their products and more sensitive to the reputation risk of inappropriate behaviour.</p> <p><i>Disclosure and control over intermediaries:</i> As discussed above</p>
Multiple licence insurers: tied to other product or financial services groups	This group consists of insurers that are registered for life and assistance business categories and form part of banking groups (e.g. Charter) or retail furniture groups (e.g. Relyant). The focus in the large group is on other financial services, particularly credit. Insurance is used to secure the risk of credit extended, and funeral insurance is provided as an add-on to this. Cover expires when the product has been repaid. Insurance is also used by retailers to get around the restrictions of the Usury Act, which limits the interest that may be charged. In the case of bank-tied insurers, they have access to a substantial database of bank clients as well as their financial details, which allows for the targeted selling of insurance products.	<p>The insurance risk is covered by regulation.</p> <p><i>Inappropriate products:</i> As discussed above</p> <p><i>Reputation risk:</i> The insurance brand is not used to sell the product. In fact, the product is not really sold, but simply attached to another product (see bundled products discussion above). Reputational risk is questionable as a disciplining factor, and the insurance component is mostly used to circumvent the Usury Act.</p> <p><i>Bundled products:</i> As discussed above</p>

Type	Description	Regulatory risk character
		<i>Disclosure and control over intermediaries:</i> As discussed above
Multiple licence: direct marketing	A small number of formal insurers (e.g. Clientele and Hollard) follow a direct marketing model ⁴⁸ using, for example, telephone-based sales or network marketing. The purpose behind such a business model is to maintain full control of their client base and not pass any control over to an intermediary. This is a fairly new market phenomenon and their market share is still quite small but showing substantial growth.	<p><i>Inappropriate products:</i> As discussed above</p> <p><i>Reputation risk:</i> These insurers rely very strongly on their brands to establish the trust that cannot be established with personal interaction of a sales person. Reputational risk is a strong disciplining factor in ensuring appropriate behaviour. As funeral insurance is at the core of their business, they tend to be more innovative with their products and more sensitive to the reputation risk of inappropriate behaviour.</p> <p><i>Advice:</i> Some concerns have been raised that the 'tick-of-the-box' nature of direct sales allows the avoidance of disclosure and consumer protection regulation imposed by FAIS.</p>
Multiple licence: large insurers offering wide range of financial products	These insurers (e.g., Momentum, Sanlam and Old Mutual) are licensed for assistance, life and other policy categories and offer a wide range of insurance and investment products. This allows them to structure products with higher benefits than the assistance business would allow, while still utilising the higher commission rates allowed under the assistance business licence. Funeral insurance is often provided as an add-on to other financial products (e.g. employee pension schemes). It is only a small component of their book in terms of value but more substantial in terms of numbers of policies. These insurers employ a wide range of distribution methods, but traditionally have a strong reliance on brokers or agents. Partly for this reason, they traditionally focus on higher-income clients and have only recently moved their focus to include lower-income clients and the funeral insurance market.	<p>The insurance risk is covered by regulation.</p> <p><i>Inappropriate products:</i> As discussed</p> <p><i>Reputation risk:</i> These insurers rely strongly on their brand to sell a variety of insurance and financial products. Reputational risk is a strong disciplining factor in ensuring appropriate behaviour.</p> <p><i>Disclosure and control over intermediaries:</i> As discussed above</p>
Short-term license only	A number of short-term insurers (e.g. Mutual & Federal and SANTAM) provide add-on products to their core short-term insurance policies, which closely resemble assistance business policies. As the Insurance Amendment Act (2003) prohibits the use of the term funeral, burial or derivatives thereof in the description and marketing of these products, the products go under different names such as 'bereavement benefits' or 'death benefit plans'. It seems that the Amendment Act was intended to prohibit the writing of assistance business under a short-term license, but that legal loopholes are allowing the writing of such business packaged under a different name.	<p><i>Insurance risk:</i> There is some debate on whether the insurance risk of death benefits is sufficiently dealt with under the short-term license. Those who contend that it is not suggest that the low reserving requirements are not sufficient to cover the risks involved. At the same time, however, the same players apply very similar approaches to their own managing and pricing of risk under their long term insurance licences.</p> <p><i>Reputation risk:</i> These insurers rely strongly on their brand to sell a variety of insurance and financial products. Reputational risk is a strong disciplining factor in ensuring appropriate behaviour.</p> <p><i>Bundled products:</i> As discussed above</p> <p><i>Disclosure and control over intermediaries:</i> As discussed above</p>

Table 7: Types of insurers and their risk character

Source: Genesis Analytics

⁴⁸ This may be the distribution model for all of their business (i.e. Clientele Life) or only a portion (i.e. Hollard)

Clients. Very little information exists on the client base of the various insurers and the insurers themselves mostly do not have a clear idea of the demographics of their client base. Even where insurers do capture information, this is only done on the sale of a product and, in a lifetime product such as funeral insurance, the information quickly becomes outdated. Traditionally, formal insurers are considered to serve only the higher LSM categories. Assistance business has been noted as the exception as it was assumed to be mostly used by lower-income households. Figure 5, however, shows a somewhat different picture.

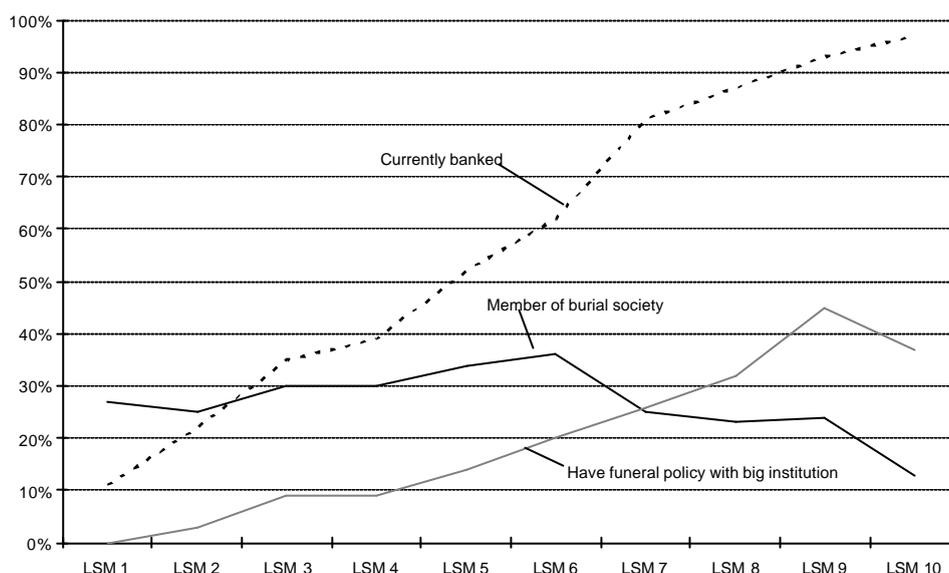


Figure 5. Formal funeral policy ownership across LSM categories (proportion of LSM category)

Source: FinScope 2003

FinScope results show that contrary to expectation, funeral insurance usage is substantially skewed towards higher income clients. Figure 5 illustrates this in terms of the proportion of each LSM category that uses funeral insurance. When considering only those with funeral insurance policies, half of funeral insurance policyholders fall within LSMs 7-10. However, two substantial flaws in the data have to be noted:

- Firstly, as with all surveys, FinScope results are based on clients' awareness of the policies they own. Where funeral insurance products are sold as add-ons to other financial products, this may not necessarily be the case.
- Secondly, the formulation of the question excludes funeral policies sold through funeral parlours and other smaller intermediaries.⁴⁹ The absence of funeral parlour-intermediated funeral policies in the data may result in a substantial underestimation of penetration levels in lower LSMs. The research done during this analysis found that funeral parlours (and some administrators) mostly provide products to lower-income households.

⁴⁹ Respondents were asked whether they have a funeral policy with a "big institution".

The FinScope results have been contested by the industry, and research on the insurers' databases, commissioned by the FinMark Trust, is currently underway to verify the FinScope figures. Early indications are that, given the restrictions in market coverage noted above, the funeral insurance results are realistic. Evidence arising from FinMark research (Eighty20, 2004) on the penetration of long-term insurance products across LSM categories has found that even those insurers that have considered themselves to be targeting the lower-income market, have overestimated their penetration into the lower LSM levels. For most insurers, very little demographic information has been captured on their client base, or has been captured in a manner that does not allow for detailed analysis. Furthermore, company and database structures do not facilitate the analysis of multiple product ownership (and certainly not across companies), which makes it difficult to control for double counting.

6.3. MANAGEMENT AND GOVERNANCE

Management and governance of formal insurers is to a large extent governed by their institutional form and the concomitant governance and reporting requirements.⁵⁰ The governance and management requirements imposed by the Companies Act are designed to ensure the protection of the shareholder and the financial integrity of the institution, and do not explicitly consider the direct interests of the client. In addition, governance and management is also directed by the requirements under the Long-term Insurance Act. Once again, this focuses on prudential and stability issues rather than on the direct interest of the client (e.g. product structure).

Contributions and benefits. In this analysis a brief survey was done of the products provided by a number of formal insurers, both directly and intermediated through funeral parlours. In general it was found that:

- The basic product structure and benefits offered by insurers were comparable in covering the main member, spouse and children, with the option of adding parents and extended family at additional cost.
- All policies had waiting periods, which varied from 3 months to 12 months for the core family, and up to 2 years for extended family.
- In terms of innovation, a few insurers had added special features such as the option to make the policy paid up after a certain period,⁵¹ an option of a premium waiver, the option of a savings plan attached to the funeral policy or an additional post-funeral benefit to paid out to the family of the deceased some time after the funeral. In most cases, however, the policies offered did not have a build-up value, did not include premium waiver options and would only pay out the standard death benefit.

⁵⁰ The Long-term Insurance Act requires insurers to be registered as publicly limited companies and they will, therefore, be governed by the Company's Act.

⁵¹ This option would attract an additional charge. After the policy has been paid up, the benefit values will remain static and not increase with inflation.

- Benefit values varied between R1 000 to R20 000 per life covered. In a few cases benefits of up to R200 000 were offered, but these were sold under life licences (and not assistance business), and would generally contain a funeral component, which would be paid out sooner than the overall benefit and would be comparable to the benefit values mentioned above. The benefits allocated to children, parents and extended family would vary between R1 000 and R20 000, but on entry level packages would tend not to exceed R10 000.

The benefits of policies sold through funeral parlours are often specified as services (e.g., removal, storage and preparation of body) and funeral items (e.g. casket, flowers, etc.), to which a nominal value is attached. In such cases, the Long-term Insurance Act requires that the policyholder should also be given the option of a monetary benefit. Where the insurer does not have direct contact with the client, the benefit will mostly be claimed through and paid out to the funeral parlour. The parlour, in turn would provide the funeral service to the policyholder.

6.4.

MARKET FAILURES AND ABUSES

Policy or premium guarantee period: under the Long-term Insurance Act, an insurer is not allowed to cancel a policy⁵² - this may only be done by the insured party. The insurer may therefore be tied into the policy for a substantial period. In the assistance business market, insurers get around this by offering policies with a short-term period. In some cases, this may be as short as a month, but usually it is twelve months. To exit from a policy, the insurer does not have to cancel the policy, but simply does not 'renew' the policy for the next contract period. This also allows the insurer to increase the premium on each policy 'renewal'. It has to be questioned whether such behaviour is in the best interest of the policyholder and meets the reasonable expectations of policyholders.

Paid-up value: most assistance business products do not have a paid-up or investment value.⁵³ As a result, policies are payable for life and the full benefit is forfeited on lapsing. Thus, if a policyholder has an extended period of illness before death (as may be the case with HIV/AIDS), where they are unable to work or pay premiums, the policy will lapse exactly as cover is required. This does not seem appropriate.

However, insisting on paid-up values on all policies may not be appropriate as it will increase the cost of providing insurance. The recommendation here is, therefore, not to regulate this, but that other ways should be investigated through which the clear product failure can be corrected. It may be appropriate to considerate this as part of appropriate product design in the Financial Sector Charter CAT standards, for example. Such pressure may stimulate innovative ideas to correct the problem,

⁵² See discussion in Section 9.

⁵³ Although, there are a limited number of examples, amongst formal insurers, of products offering a paid-up benefit. One of these is AVBOB, who offers clients a paid-up benefit if they are unable to continue paying the premiums. The paid-up value is based on the period over which the premiums have been paid and is calculated on a sliding scale. Included in this product is the option of a savings component. AVBOB also offers different terms, where an individual can choose, for example, to pay premiums for ten years, after which he/she is covered for life. Paid-up in this case means the value of the benefits remain the same.

such as simpler paid-up value models (such as an agreement to return some premiums on lapsing after a certain period of membership, which is already offered on some products) or a secondary market for insurance policies.⁵⁴

Bundled products: in retail (and to some extent bank-tied) distribution, funeral insurance is sold as an add-on to other products, which raises concerns over the miss-selling of funeral cover. In retail distribution, for example, credit-life insurance may provide relevant risk mitigation on the credit product, and it is questionable whether it is appropriate to bundle funeral insurance into the package (particularly when the consumer does not have the option of refusing the funeral cover, or where the funeral cover automatically falls away once the debt has been settled. Assuming that the consumer needed funeral cover in the first place, this need will surely continue beyond the repayment of the debt). Selling insurance to credit clients is often seen as a way of circumventing the usury limits, as no limits are placed on the value of insurance that may be included. The needs analysis component of FAIS should ideally have dealt with this, but given that this may be considered as 'tick-of-the-box' selling without advice, insurers may be able to use this as a loophole to sell funeral cover without the appropriate advice.

Linkages with funeral parlours: although, technically, cash benefits are offered, certain insurers structure their agreements to force customers who have taken out insurance policies to use the services of their parlour. This is done by either offering discounts to insurance clients on the service offered by their parlour, or by only paying cash into the estate of the deceased instead of to the beneficiaries. Getting money out of the estate takes longer and will not be available in time to be used for the funeral. As a result, the family will usually accept the services of the parlour instead of allowing the money to be paid into the estate. These parlours generally serve higher-income markets, but now also aggressively pursue the lower-income market.

HIV/AIDS: the exposure of formal insurers to HIV/AIDS risk is hedged or managed through reserving requirements, actuarial management, exclusions and waiting periods. A major concern, however, are the inappropriate terms of funeral insurance products, considering the impact of HIV/AIDS on the affected life (as discussed under the issues of paid-up values above).

6.5.

INDUSTRY ASSOCIATIONS

The Life Offices Association (LOA) is a voluntary industry association representing the formal insurers. Its purpose is to facilitate interaction amongst members and offer joint representation to industry players. Brokers are represented by the South African Financial Services Intermediaries Association (SAFSIA), the Independent Brokers Council (IBC) and the Black Brokers Forum (BBF), which are voluntary industry bodies representing members.

⁵⁴ Under such a market, a third party may offer to continue paying the premiums for the remainder of the individual's life or until recovery in return for a share of the pay-out. This is, of course, highly problematic in a life insurance market where the third parties would profit from the earlier death of the covered life and would need to be carefully structured. The benefit values under assistance business may also be too low to facilitate such a market.

7. PRODUCT COMPARISONS AND LINKS

Table 8 provides a brief comparison⁵⁵ of the voluntary⁵⁶ insurance products offered by funeral parlours and formal insurers, and the risk mitigation offered by stand-alone⁵⁷ burial societies. Administrators have not been explicitly included, but the products they provide⁵⁸ when intermediating for, or underwritten by, a formal insurer, will generally fall somewhere between funeral parlours and formal insurers. Insurance products that are tied to other financial products (i.e. credit life) have different characteristics to those shown in Table 8 as discussed in Section 6.

	Burial societies	Funeral parlours	Formal insurers
Joining fee	R100 to R1 500	R50 to R200	None
Waiting period	3 months	6 months up to 2 years for conditions such as HIV/AIDS	3 to 6 months
Premium range	R50 to R200	R30 to R350. Varies according to number of lives covered and benefits stipulated	R50 to R150. Varies according to age of member and number of lives covered
Policy period/ period of premium guarantee	1 month to 12 months ⁵⁹	1 month	1 to 12 months
Grace period	3 months (fine for missing a payment)	3 months	3 months
Premium collection	Cash	Cash and debit order	Debit order (cash only through an intermediary or administrator)
Basic cover⁶⁰	Core and extended family ⁶¹ , plus a defined number of dependents (four to six)	Core family	Core and extended family
Benefit value per insured life	R1 000 to R5 000 (plus emotional and physical support)	Generally lower than R10 000 in value. ⁶² Where underwritten, this sometimes extends higher	Varies between R5 000 to R20 000 ⁶³

Table 8: Comparison of voluntary insurance products across provider categories

Source: Genesis Analytics

⁵⁵ Based on the focus group discussions and a survey of about 14 formal insurers and 40 funeral parlours where they were asked about their **basic product** for an individual policyholder. Basic product refers to cover for the core family (see footnote 61).

⁵⁶ The comparison is between voluntary products as those are comparable to the products offered through funeral parlours and burial societies, which are both voluntary in nature.

⁵⁷ Not linked to any of the other insurance providers.

⁵⁸ Not much is known about products that are self-insured by administrators.

⁵⁹ Burial societies generally require the consent of a quorum of members to adjust the premium. For smaller societies, this could be done at a monthly meeting. For larger societies, and particularly where it has broken up into units of smaller societies, this would mostly be done at an annual general meeting.

⁶⁰ Included in the premium range indicated in Table 8. Additional lives can be covered at a cost - over and above the premium range indicated for each provider in Table 8.

⁶¹ Core family is defined as the spouse and children. Extended family includes parents and in-laws.

⁶² This is difficult to evaluate as the nominal value placed on funeral packages often does not reflect the 'cash' value of the package.

⁶³ Insurers can offer higher value policies through a life licence or the use of multiple policies under an assistance business licence. The product survey conducted as part of this study, however, showed that basic policies are mostly in the order of R10 000.

The important points to note from Table 8 are as follows:

- Accidental death is generally covered immediately by *funeral parlours* and *formal insurers*, whereas *burial societies* insist that the joining fee be paid and the waiting period completed before cover is provided.
- *Funeral parlours* view the joining fee as part of the commission on the policy.
- The waiting period is longer at *funeral parlours* than at *burial societies* and *formal insurers*, and is extended up to two years for death from HIV/AIDS. It is doubtful whether this can be enforced as HIV/AIDS is often not recorded as the cause of death and it will be damaging to the reputation of the parlour if they are seen to renege on their policies.
- The cash benefit paid by the *burial society* is typically substantially less than the benefits offered by the other two types of providers. However, this excludes the value of emotional and physical support, which is hard to quantify. In addition, all causes of death are covered by *burial societies* with no questions asked, whereas both *funeral parlours* and *formal insurers* exclude (or at least make it difficult to claim on) certain deaths (i.e. HIV/AIDS, suicide, cancer etc.).
- In general, benefits are not automatically linked to inflation for burial societies, funeral parlours or formal insurers. However, *burial societies* can adjust benefits through membership decisions, and will do so where circumstances change. Most *funeral parlours* specify the benefit in terms of actual funeral services (i.e. type of coffin, number of chairs etc.), therefore the risk of inflation is for the funeral parlour and not the policyholder.⁶⁴ Some *formal insurers* give the option of benefits increasing, but this is linked to a corresponding premium increase.
- In some cases the cash benefit paid by *formal insurers*, both directly to the client or through a *funeral parlour*, extends beyond R10 000. In this case the additional benefit above R10 000 is written under their life licence, or by simply issuing two policies. All providers pay lower benefits for children or dependents than for the main member or spouse.

The market has seen the launch of some innovative products over the last few years including: i) additional life insurance add-ons, which offer a larger delayed payout some time after the funeral, ii) post-funeral income replacement benefits, that pay an amount each month to the beneficiaries or a lump-sum, usually a year later, and iii) a contribution skip benefit, which is a form of premium waiver.

In order to assess the value to policyholders across different categories of insurers and funeral parlours, a smaller sample of insurers and parlours were asked to provide a quote for funeral cover on a standardised family profile with comparable benefits.⁶⁵ Although the sample is small and was not chosen to be statistically representative of the industry, it does provide interesting views on premiums and

⁶⁴ In coping with the risk of inflation, some funeral parlours may adjust the quality of the service.

⁶⁵ The details of the quotes and basis for calculation are shown in Appendix D.

value per rand spent, for individually sold voluntary insurance products at the main categories of insurers as well as some funeral parlours. The sample shown in Table 9 includes quotes received directly from the insurer (through a broker or agent), from funeral parlours distributing formal insurance products (i.e. the parlours are only intermediaries), as well as two parlours suspected of illegally self-insuring.⁶⁶ The results are shown in Table 9:

Insurer or underwritten funeral parlour	Total premium/month	Total nominal cover	Cover/premium ⁶⁷
Formal insurer E: Smaller insurer, not bank-tied, funeral insurance focus	R 840	R 93 700	R 111.5
Formal insurer G: Large insurer, multiple product lines	R 665	R 85 000	R 127.9
Formal insurer B: Own funeral parlour, funeral insurance focus	R 592	R 84 000	R 141.9
Formal insurer C: Bank-tied, multiple products	R 547	R 79 000	R 144.5
Formal insurer F: Direct sales	R 615	R 96 000	R 156.1
Funeral parlour B: Johannesburg (Wynberg) single branch	R 445	R 78 500	R 176.4
Formal insurer A: Bank-tied, multiple products	R 446	R 85 000	R 190.6
Funeral parlour E: Potentially self-insured: Johannesburg township	R 160	R 39 000	R 243.8
Formal insurer D: Smaller insurer, Not bank-tied, multiple products	R 260	R 85 000	R 327.6
Funeral parlour C: Johannesburg: Three metropolitan branches	R 225	R 82 000	R 364.4
Funeral parlour D: Potentially self-insured: Polekwane	R 265	R 100 500	R 379.2
Funeral parlour A: Johannesburg, Township single branch	R 210	R 85 500	R 407.1

Table 9: Funeral insurance premiums charged for a standardised family portfolio⁶⁸ (formal voluntary schemes)

Source: Genesis research

Substantial variation was found in the value to the customer, measured as the cover per rand spent. Surprisingly, the policies sold through funeral parlours (underwritten and potentially self-insured), offered the highest cover per premium ratio. This applied to both underwritten and potentially self-insured parlours.

Amongst the policies not sold through funeral parlours, cover per premium was substantially lower, with one exception (insurer D). This contradicts the view that funeral parlours tend to add substantial charges to the distribution of policies at the cost of the client. However, it must be noted that this calculation is in terms of the policy value and not in terms of the actual service provided. Although a nominal value may be attached to the service, this is not necessarily the actual value.

7.1.

RELATIONSHIPS AMONGST PROVIDERS OF INSURANCE

One of the most complex challenges in understanding this market is to unpack the relationships amongst providers of assistance business. Such relationships stem from the fact that insurance is provided and intermediated through a hierarchy of

⁶⁶ Parlours were generally reluctant to provide details of the underwriter in fear of the potential client going directly to the insurer. In the case of the two parlours shown as potentially self-insured, they refused to provide details of underwriting but the discussion suggested that they were not underwritten.

⁶⁷ This is a simple calculation dividing the total nominal cover provided by the total premium charged and provides an indication of the value per rand spent.

⁶⁸ Refer to Appendix D.

institutions, and can be in the form of both explicit contracts and tacit agreements. Figure 6 provides an overview of the potential relationships.

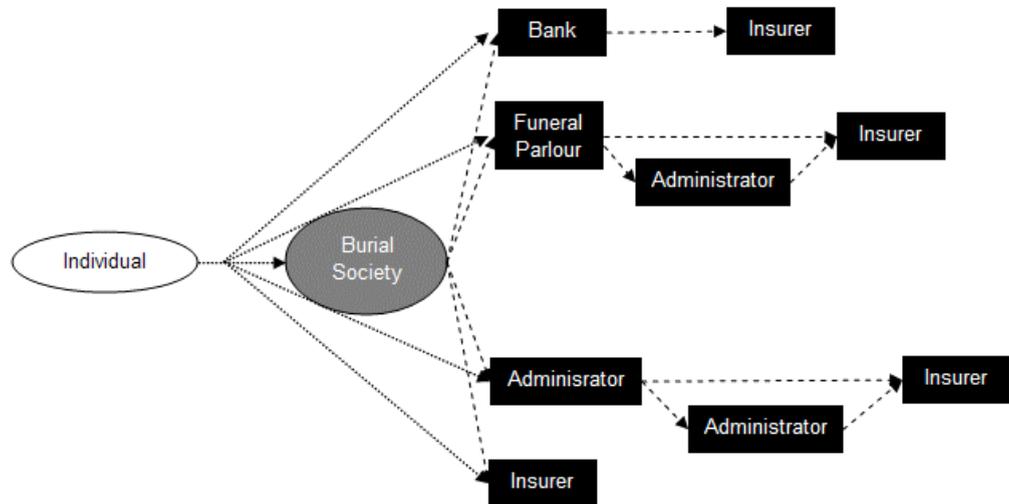


Figure 6. Overview of the relationships amongst providers of funeral cover⁶⁹

Source: Genesis Analytics

The discussion commences with the assumption that individual policyholders are the ultimate consumers of financial products, and that their relationship to the primary provider is visible to them. From this basis, backward linkages will be discussed to the point of termination. It is important to note that the dashed lines in Figure 6 indicate potential relationships and not all relationships end with the formal insurer (e.g. illegal self-insurance by some funeral parlours).

7.1.1.1.

INDIVIDUAL LINKAGES

The ultimate consumer in this market is the individual in need of financial services to pay for funeral expenses. In the rural focus groups, burial societies were found to be the predominant way that African people provide for death, and they typically did not have policies with funeral parlours or formal insurers. In the urban areas, although the burial society was still the first stop, most respondents seemed to also hold a product from either a funeral parlour and/or formal insurer.

As shown in Figure 6, a client (either individual or burial society) can access a formal insurer through a bank, a funeral parlour or an administrator. In addition to these, there are a number of other intermediaries through which the individual can access the formal insurer:

- *Agents*: salaried staff of the insurer selling only the product of that insurer.
- *Brokers*: brokers sell the products of a number of different insurers, and are given a predetermined commission rate by the insurer. They generally do not

⁶⁹ In Figure 6, the role of the administrator has been depicted as an intermediary. However, as discussed, in a number of instances the client sees the administrator as the product provider (insurer), especially where administrators design their own product/s and get an insurer to underwrite the product/s.

manage or maintain records for the insurer and do not set the price. The contractual relationship is between the client and the insurer. The broker, therefore, does not own the client.

- *Employers*: a large and lucrative component of the funeral insurance market is based on compulsory group schemes sold through employer groups. Access to the payroll presents the insurer with an easy mechanism to deduct premium payments, and the compulsory nature ensures a more balanced risk pool.
- *Post Office*: products are sold over post office counters.
- *Affinity groups*: products are sold through affinity groups such as consumer or sport clubs.
- *Retailers*: insurance products can be sold as add-ons to credit agreements. This category of intermediary is somewhat different, as funeral insurance is only a component of a larger insurance package and the client is often forced to take the funeral insurance product with the larger insurance package.

7.1.2.

BURIAL SOCIETY LINKAGES

Due to the close relationship between members and burial societies, they essentially play the role of a client (or client bargaining group) rather than intermediary in their interaction with other providers.

Links with banks: 80% of African burial societies surveyed in FinScope 2003 indicated that they have a bank account.⁷⁰ Bank accounts are used to store the society's savings, and the bank is chosen by a collective vote amongst the members. When there is a surplus in the account, this can then be moved to an investment account.⁷¹

Links with funeral parlours: in many cases, burial societies have a link with a funeral parlour. Usually this link is beneficial to both the burial society, as it creates a preferred-buyer status for burial society members, and for the funeral parlour, as it ensures a constant stream of business. The link generally takes one or a combination of three forms:

- *Preferred provider*: the burial society has a verbal or written contract with the funeral parlour, stating that society members will only use the services of that particular parlour, or at least that the parlour is their preferred provider. In return, the parlour provides a discount to society members.
- *The burial society pre-pays for a number of funerals*:⁷² typically, a part of the monthly premium paid to the burial society is 'banked' with the funeral parlour, as described in Box 3 and section 4.2. In order to manage the risk of theft or fraud by the parlour, the maximum number of fully paid funerals is typically limited to two or three. In this situation, the burial society retains the full mortality risk of its member pool. The benefit for the society of banking with the

⁷⁰ This includes individual or group accounts.

⁷¹ Some societies use the surplus to provide loans to members, go on holiday or hold an end of year party. Providing loans is a way of the society both supporting the members and trying to increase the return on its savings.

⁷² This is typical of rural burial societies.

funeral parlour is that the relationship with the parlour is strengthened, which typically secures a discount for members, and may result in the parlour providing funerals on credit in times when the society does not have sufficient money. This more than offsets any loss from not earning interest on the money saved with the parlour.

- *The burial society insures members with the funeral parlour:* a standard package would usually be negotiated between the society and the parlour to include a set premium for each member, a set number of lives covered and a set funeral service. The burial society would be responsible for collecting the premiums at its monthly meetings, and paying this over to the parlour. The parlour would keep a list of the lives covered. Discussions with burial society members revealed that pre-paying with funeral parlours works very well. No problems have been experienced in trying to withdraw funds from a funeral parlour to be used at another parlour, as the burial society retains full control over the funds. However, the funeral parlour may or may not be underwritten. In the latter case the funeral parlour will carry the insurance risk.

Links with formal insurers. Finally, the burial society may decide to insure its members with a formal insurer. The burial society may go through an administrator or one of the intermediaries mentioned in section 7.1.1. In this case the burial society may act as a bargaining group in negotiating products with the insurer. The decision on which insurer to use will be made by the members.

7.1.3.

FUNERAL PARLOUR LINKAGES

It is often difficult to distinguish from survey data whether the product offered by a funeral parlour is:

- illegally self-insured (either fully or partly).
- a product developed by the parlour, with the risk pool being underwritten by a formal insurer.
- a formal insurer's product distributed through the parlour.

In all cases, the funeral parlour may interact with burial societies, as discussed above. However, in the second and third case the funeral parlour will also interact with administrators and formal insurers, as shown in Figure 6.

Links with formal insurers: underwritten. In general, most independent funeral parlours (i.e. not tied to any single insurer) sell what is perceived to be their own product. They do not normally indicate whether they are underwritten, and if they are, are usually loath to say who the underwriter is in fear of being cut out as intermediary. In some cases, they may be operating through an administrator who they see as the underwriter.

Links with formal insurers: intermediary. Funeral parlours that act as intermediaries and sell the products of formal insurers are generally parlours that are owned or controlled by the formal insurer (such as AVBOB, HTG and Rentmeester). As has

been discussed, the insurance side of the business is often used to capture a market for parlour services. A number of independent funeral parlours also on-sell products of formal insurers.

In both cases (that is, selling underwritten products or products of a formal insurer), there is little control from the insurer. The funeral parlour is free to set their own mark-up and, as a result, the final price paid by the client. In addition, the funeral parlour is responsible for collecting premiums and settling claims. The funeral parlour will often settle the claim (i.e. conduct the funeral) out of its own funds, in order to not delay the funeral, and claim later from the insurer. The insurer will then pay the amount directly into the funeral parlour's account and the parlour will usually ensure that the nominal value of the funeral provided is about the same as the value of the benefit, leaving no additional cash for the dependents or family.

Links with administrators. The funeral parlour may deal with the insurer directly or through an administrator. In the latter case, the administrator will manage, on behalf of the formal insurer, the group of parlours selling the product.

The soft middle: From the above discussion of linkages, it is clear that funeral parlours and administrators play an important role in the provision of funeral insurance. These institutions intermediate between insurers and clients and could collectively be described as the 'soft middle' of the market. It is deemed to be 'soft' as neither insurers nor the regulator have effective control over the conduct and operation of this section of the market. In addition, the clients have limited power to affect the relationship. A large component of the funeral parlour market is unregistered (from both a health and insurance perspective) and, in many cases, provides insurance schemes that are not regulated or underwritten by regulated insurers. Similarly, intermediation by administrators has not been effectively monitored or controlled by either regulators or insurers, with both parties considering it to be the responsibility of the other.

Due to the presence of this soft middle, it is very difficult for regulation implemented at insurer level to affect intermediation to clients and it is, therefore, difficult to ensure consumer protection and appropriate market behaviour. This opens up opportunities for abuse.

8. ECONOMIC RATIONALE FOR REGULATION

At its most basic level, the goal of industry regulation is to improve economic welfare. This is necessary because real-world markets are imperfect, and are characterised by market distortions, risks and externalities. The cost of these imperfections is carried by market participants, reducing their welfare and the welfare of the overall market. It is worthwhile re-visiting some of the assumptions underlying the theory of perfect markets, as this illustrates the ways in which markets can fail and thus provides the rationale for regulatory intervention:

- *Full information:* in perfect markets it is assumed that all buyers and sellers have full information on prices and quantities offered in the market. The problem of asymmetric information (see discussion below) therefore does not exist. With full information, there is little prudential risk as the markets have all the necessary information to react to risks in a timely manner and risks cannot be concealed. Full information also means that clients know what the equilibrium price in the market is, and will not pay more than that for the product or service.
- *Homogenous products:* product homogeneity ensures that prices across goods are comparable and that goods are fully substitutable, which ensures that providers compete on price.
- *Large number of buyers and sellers of the service or product:* this ensures that no single buyer or seller has the power to determine prices, and that market risk is low, as the collapse of a single player will be hedged by the large number remaining.
- *No entry barriers: no cost to entry into or exit from the market:* the absence of barriers to entry ensures that any change in the profitability of a market will result in providers entering or exiting the market. This ensures that resource allocation across the economy is optimised. However, the theory assumes that goods are purchased and paid for on a once-off basis, which is quite different to the contractual nature of insurance products, for which premiums are paid over a long period of time. Applying the original theory to such products would require that there should also be no cost for the consumer to enter or exit an insurance contract.
- *Markets are in equilibrium:* the net result of the above assumptions is that markets are always in equilibrium. In other words, supply equals demand at the equilibrium price, which ensures maximum economic welfare for providers and consumers, as well as optimal resource allocation.

Under ideal circumstances (i.e. perfect markets), regulation would therefore not be necessary, as markets essentially regulate themselves. Market forces ensure that resources are allocated efficiently, that the quality of goods and services is optimal, and that consumers are protected. Perfect markets, however, do not exist in reality,

and in most cases, markets are substantially flawed. Most market failures are due to imperfect information on products and providers, which means that:

- A large number of consumers can be misled simultaneously as to the risk they face, by the inappropriate behaviour of individual firms. This increases the risk of systemic crisis and instability (prudential risk) with potentially large and devastating effects on the general market and economy.
- Consumers are unable to assess the true value and quality of the product purchased (even if consumers are assumed to be fully rational).
- Providers are able to set prices above equilibrium and also apply price differentiation amongst different market segments.

In these circumstances, regulation is used to correct for market failures and ensure consumer protection. Regulation can address information asymmetries through:

Regulating entry into and operation in the market (asymmetric information on the provider): if entry is regulated, consumers do not need to do detailed and costly assessments of each insurer to ensure that their operations are legitimate. Regulation usually requires that providers of goods and services report financial and other relevant information to the regulator on a periodic basis to allow for on-going assessment. This usually implies a substantial compliance cost for these companies. To compensate for this cost, entry into the market is licensed (and thereby limited to licensed operators), which allows the licensed operators to recover the cost of regulation (as there is not full competition) and get preferential access to the market.

Intermediary, conduct and disclosure regulation (asymmetric information on the product or service): this refers to regulations that specifically focus on regulating interaction with clients, to ensure appropriate quality of products and services, as well as advice relating to these.

Stability/prudential regulation: this area of regulation focuses on the business risk taken by specific companies and provides guidelines and regulations on what is acceptable behaviour by a company. The rationale behind this is that a failure of a specific company will result in a loss to its clients as well as its shareholders and other associated companies. Companies are never completely isolated and failure of one company may result in a run on the sector or similar companies. In highly integrated and sensitive sectors such as banking or insurance, such failures and their second order effects have led to collapse of financially sound institutions on numerous occasions. In the insurance sector, such regulation may take the form of investment rules, financial disclosure and auditing regulation, company structure regulation to ensure corporate governance, regulation determining the nature and extent of interaction between companies in the sector (in order to ensure that risks are not hidden in company structures), and capital requirements to serve as a buffer in case of cash flow problems.

But at what cost? Regulation is never cost neutral and someone will have to carry the cost of compliance. In addition, regulation may also have indirect and unintended impacts on the market and may in itself result in market failures and sub-optimal outcomes (adapted from Alfon & Andrews, 1999: 15).

- *Direct costs of the regulator:* designing, monitoring and enforcing regulations requires resources.
- *Compliance costs:* the value of the additional resources (including cost of time spent) that would be used by firms and/or individuals to comply with regulation is known as the compliance cost.
- *Quantity of products and services sold:* as regulation can increase or decrease the cost of bringing a product to market, it can also increase or decrease retail prices. This will then impact on the volume of sales. If regulation impacts differently on different products or providers, it will also affect relative prices and may, therefore, lead to market distortions.
- *Quality of products and services offered:* typically, a large component of financial regulation aims to improve and monitor the quality of products supplied, by, for example, mandating minimum disclosure standards or product features. However, the FSB explicitly does not regulate product features. Instead, by regulating only the intermediation process, it tries to allow market dynamics to regulate quality. This analysis will illustrate that there are several instances of inappropriate product features in the funeral insurance market. In the absence of regulation of product features, the Financial Sector Charter may present an opportunity to affect product design.
- *Variety of products and services offered:* by influencing the cost of specific products within a general class, regulation plays a role in determining the variety of products available in that class. Regulation may also indirectly affect this, by imposing different regulatory costs on different types of intermediaries and institutions and, in so doing, biasing for or against the products normally sold by the respective institutions.
- *Efficiency of competition:* regulation plays an important role in determining how firms compete (for example, by affecting the level of entry barriers), and so influences whether competition creates value or wastes resources. In the South African system, this is achieved through a separate set of legislation and regulatory agencies focusing on competition.

The recommendations on interventions discussed in section 12 will be based on the framework set out above.

8.1. MARKET FAILURE AND NEED FOR REGULATION IN THE ASSISTANCE BUSINESS MARKET

From the market analysis it is evident that several forms of market failure may provide motivation for more regulation of the sector.

- *Extreme asymmetry of information with regards to the product:* the client typically has very little information about the quality of the product being offered, the nature of the organisation offering it and, where relevant, the intermediary advising the client to buy. This lack of knowledge makes it difficult for clients to distinguish between good and bad products. Insurance products are considered to be *credence goods*, which are defined as goods whose quality is unknown even after the purchase has been completed. The purchaser therefore has to rely on the reputation of the company selling the product to assess quality. In the case of funeral insurance, the consumer will only be able to assess the quality of the product purchased when a claim is made, at which time it is too late to affect the process. It is therefore a very different process to purchasing a good such as a television, where the asset is immediately transferred to the buyer, who can evaluate the product immediately and return it to the store if not satisfied.
- *Absence of clear market prices:* the information asymmetry in the insurance market is exacerbated by the absence of clear, comparable market prices. *Firstly*, most consumers will not be able to assess whether or not the actuarial calculations underlying a specific policy have resulted in a fair price. *Secondly*, due to the complexity of the products and large variance in product features, consumers are generally not able to compare products. This is compounded in the funeral services market where, in many cases, consumers are not given a choice between a monetary/cash benefit and the funeral service, or receive a substantially reduced pay-out if a monetary benefit is chosen. *Thirdly*, on the death of a family member, the family is usually emotionally vulnerable, and not in a condition to negotiate on price.

The net result is that the policyholder can't easily compare prices across competitors (even if they are in a state of mind to do so). Furthermore, where consumers do not have the option of a monetary benefit, they can't exercise their right to choose a different service provider at the time of pay-out. Competition in the market is therefore severely restricted and, essentially, consumers are forced to make the choice of funeral provider 20 to 30 years in advance, a period over which none of the providers can guarantee that they will provide a service of the same or comparable quality.

- *Policy and premium guarantee period:* funeral insurance is sold on a short-term basis (sometimes as short as one month), with no guarantees on pricing beyond that period. The insurer can therefore increase prices after every contract period. As re-pricing can be done on short notice, insurers may not apply effort to establish the appropriate premium, and may instead establish prices on a 'cash-flow' basis (i.e. premiums are simply adjusted based on the previous year's claims). This means customers do not have any certainty about the value of products, as value can quickly be undermined by price increases. Insurer can also use low (or even loss-making) prices to enter a market, and then increase prices to a profitable level. Although this can be seen as a competitive entry strategy in the market, such competition may be destructive to the longer term market function.

- *An incentive to ‘promise and obfuscate’*: aggressive sales and marketing techniques can create the impression of quality for inferior products. Most consumers are not in a position to evaluate a company’s financials in order to confirm the image projected. Unscrupulous providers and intermediaries have an incentive to hide as much information as possible (e.g. on risk and other implicit costs of the product) while promising high returns.
- *Cost of switching*: where consumers do become aware of a better product offering, or realise that they have bought an inappropriate product, it is difficult to switch without losing money already invested in a specific product or incurring explicit or implicit transaction costs. Most funeral insurance products are pure risk products with no build-up of value so there is no explicit value lost when switching away from such a product. However, switching will mean starting from scratch with the new service provider where a waiting period may apply and premiums will be re-rated. This is particularly problematic if the consumer is of an advanced age, when entry into a new scheme becomes costly⁷³ if possible at all. Even where there is an endowment component (which is rarely the case for funeral insurance), substantial transaction costs are incurred by moving to a different service provider. As a result, competition to sell funeral insurance is much fiercer than competition on service.
- *Low sunk costs of market entry*: the business of providing both financial products and intermediary and advisory services can be entered at fairly low cost (particularly where it is done on an unregistered basis). In industries where the sunk, irrecoverable costs of entry are high, such as auto manufacturing, the costs of reputational damage are likewise high. The insurance industry is, consequently, more hospitable to ‘fly-by-nights’.

The assistance business market is therefore prone to several market failures, creating a need for regulatory intervention. To be effective and sustainable, intervention should, however, not be targeted at symptoms but at underlying causes. The specific need for regulation and other intervention will vary across the different segments of the assistance business market and is driven by the characteristics of the players and consumers involved. These characteristics (discussed in more detail in section 2) are set out in Table 10 below:

⁷³ Being a member of a scheme from an earlier age allows the insurer to subsidise the increased risk at old age with premiums gathered over the life of the policyholder. It is, therefore, expected that someone entering a scheme at a higher age will pay higher premiums than someone of the same age who have entered a scheme at an earlier stage and remained a member.

Need for intervention	Burial Societies	Funeral Parlours	Administrators	Formal Insurers
Governance (size, profit nature, control mechanisms, etc.	<p>(Governance imposed by regulation: only when insurance provided; Enforcement: Low; Effective governance: High)</p> <p>Burial societies' member-governed and not for profit nature have resulted in the development of natural control mechanisms in this market, which are generally adhered to and quite effective in ensuring governance.</p> <p>However, the informal nature of these governance structures has some drawbacks. When societies grow beyond certain limits, the efficacy of the member-governance system is undermined and a separation is introduced between management and ownership. At such a point, the burial society has also accumulated substantial assets, which increases the risk of fraud or theft to a degree that informal/member governance will not be able to control. It is at this point where some formalisation is required and where regulation needs to be imposed.</p>	<p>(Governance imposed by regulation: Low, but improving through FAIS; Enforcement: Low; Effective governance: Low)</p> <p>No specific legal persona is enforced on funeral parlours, resulting in them assuming the most lenient of persona. These are mostly not publicly listed companies, which means that they are not subject to public scrutiny, and that clients can't access their financial information. Until the introduction of FAIS, no insurance regulation was applied to funeral parlours (other than that which was indirectly applied through the regulation of insurers, and the prohibition on unregistered insurance businesses). This implied that no protection was afforded to clients on insurance offered by or through funeral parlours. Regulation controlling unregistered insurance businesses was not effectively applied, which resulted in the development of a substantial unregistered insurance market. Health regulation applicable to funeral parlours should have imposed some form of governance on these institutions, but weak enforcement of regulations has undermined this and has contributed to a culture of non-compliance in the sector.</p> <p>Reputation is the only incentive for funeral parlours to act in the interest of clients.</p>	<p>(Governance imposed by regulation: Low, but improving through FAIS; Enforcement: Low; Effective governance: Low)</p> <p>No specific legal persona is enforced on administrators, resulting in them assuming the most lenient and convenient of persona, which generally do not require substantial disclosure and financial reporting. These are mostly not publicly listed companies, which means that they are not subject to public scrutiny, and that clients can't access their financial information.</p> <p>Unlike insurers and funeral parlours, reputation is not an effective market substitute for regulation as the administrator is often not in a position of final responsibility towards the client (or can defer such responsibility to the funeral parlour or insurer involved). The absence (or non-enforcement) of appropriate institutional regulation as well as insurance specific regulation means that very little protection or recourse is afforded to clients of such institutions.</p>	<p>(Governance imposed by regulation: High; Enforcement: High; Effective governance: High)</p> <p>Insurance regulation requires insurers to be public companies under the Companies Act, which imposes a variety of regulations relating to the governance of the organisation (auditing, activities and powers of the board, disclosure to shareholders, etc.). Furthermore, several insurers are publicly listed, with the concomitant additional disclosure requirements and subjection to public evaluation and scrutiny. Insurance regulation requires additional reporting to the regulator and communication with clients, who are generally not shareholders in the company and, therefore, are not protected by the basic company regulations. Insurance regulation also imposes specific risk management requirements on insurers to ensure the management of client-specific as well as prudential risk. These governance requirements ensure that governance remains intact even if a very large client base is served. The combination of the two sets of regulation (insurance and institutional) ensures that the insurer, while pursuing its for-profit nature, acts in the best interest of shareholders and clients.</p>
Fiduciary risk	<p>(Regulatory control and definition of fiduciary duties: none; Enforcement: not applicable; Effective control over fiduciary duties: High)</p> <p>With most burial societies, their co-operative, member-governed nature ensures that there is no separation between ownership and management. The fiduciary duty of the society is, therefore, limited as they simply manage their own funds. However, there is a point in terms of size beyond which the informal governance system will not ensure effective control over fiduciary duties. It is at this point where some formalisation is required and where regulation needs to be imposed.</p>	<p>(Regulatory control and definition of fiduciary duties: none, may change through FAIS; Enforcement: not applicable; Effective control over fiduciary duties: Low)</p> <p>Where funeral parlours administer funds on behalf of individuals, burial societies or other groups (e.g. through pre-paid funerals), they assume fiduciary duties in terms of the management of client funds. However, these duties and responsibilities are not currently defined in legislation applicable to funeral parlours (as opposed to lawyers, for example), except where the funeral parlour plays an intermediary role between client and insurer. In the latter case, FAIS requirements will impose certain regulations on the management of client funds (e.g. keeping client funds separate from operational</p>	<p>(Regulatory control and definition of fiduciary duties: none, may change through FAIS; Enforcement: not applicable; Effective control over fiduciary duties: Low)</p> <p>Where administrators manage funds on behalf of individuals, burial societies or other groups, they assume fiduciary duties in terms of the management of client funds. Before the introduction of FAIS, these duties and responsibilities were not defined in legislation applicable to administrators (as opposed to lawyers, for example). In the absence of such regulation, there was little control over the duties of administrators with regards to client funds. Following the introduction of FAIS between client and insurer, certain regulations are now imposed on the management of clients' funds (e.g. keeping client funds</p>	<p>(Regulatory control and definition of fiduciary duties: High; Enforcement: High; Effective control over fiduciary duties: High)</p> <p>The Long-term Act requires insurers to maintain a financially sound condition at all times. Their assets and liabilities must comply with statutory requirements.</p>

Need for intervention	Burial Societies	Funeral Parlours	Administrators	Formal Insurers
		<p>accounts). Where the client simply pre-pays for funerals without any intermediation to an insurer, these regulations do not apply. In the absence of such regulation, funeral parlours manage these funds as part of their operations, and do not keep separate accounts for each client group.</p> <p>The study uncovered evidence of at least one funeral parlour that went under, causing a number of clients to lose their savings for prepaid funerals as well as insurance premiums paid. Their risk is increased by the tendency not to separate the funeral services component of the business from the financial services component of the business. There is thus a need for prudential oversight.</p>	<p>separate from operational accounts) where the administrator plays an intermediary role between insurer and client. This still, however, does not regulate the management of clients outside of the intermediary role.</p>	
Externalities	<p>From our review no negative externalities were identified, which will require regulatory intervention.</p>	<p>The need for regulation may arise from negative externalities created by a specific component of the market. In the case of funeral parlours, potential negative externalities such as disease risk provide the rationale for regulating health activities. From our review no negative externalities were identified on the financial side of the funeral parlour business, which would require regulatory intervention.</p>	<p>From our review no negative externalities were identified, which will require regulatory intervention.</p>	<p>From our review no negative externalities were identified, which will require regulatory intervention.</p>
Prudential risk ⁷⁴	<p>(Management of prudential risk imposed by regulation: High, not allowed to write insurance business except under Long-term Insurance Act or Friendly Societies Act; Enforcement: Weak; Effective exposure: low)</p> <p>Prudential risk stems from the links between financial institutions. If the performance of formal insurers was linked to that of burial societies and they were thus exposed to the risks assumed by these societies, this would constitute a prudential risk to the system. In such an environment, events leading to the collapse of the burial society system would result in problems for the insurers to which they were linked.</p> <p>However, this does not seem to be the case.</p>	<p>(Management of prudential risk imposed by regulation: High, not allowed to write insurance business except under Long-term Insurance Act or Friendly Societies Act; Enforcement: Weak; Effective exposure: Medium).</p> <p>Due to the low value of individual benefits and the short-term nature of the liability created through insurance contracts between client, funeral parlour and insurers, the prudential risk is quite low.</p>	<p>(Management of prudential risk imposed by regulation: High, not allowed to write insurance business except under Long-term Insurance Act or Friendly Societies Act; Enforcement: Weak; Effective exposure: low)</p> <p>Due to the low value of benefits and the short-term nature of the contracts between client, administrator and insurers, the prudential risk is quite low.</p>	<p>(Management of prudential risk imposed by regulation: High, not allowed to write insurance business except under Long-term Insurance Act or Friendly Societies Act; Enforcement: high; Effective exposure: high).</p> <p>Due to the size of formal insurers, the failure of any one institution could hold substantial systemic risk for the formal industry, potentially causing widespread losses to clients and other companies.</p>

⁷⁴ We focus here on the risk stemming from the insurance operations. It may be necessary to review of the risk stemming from the providing of savings and credit products by these players as well, but this falls beyond the scope of the current study.

Need for intervention	Burial Societies	Funeral Parlours	Administrators	Formal Insurers
	<p>Firstly, burial societies do not guarantee benefits contractually and, accordingly, there is no build-up of liability that could cause the collapse of the system. Secondly, the risk of the formal insurers in their relationships with burial societies is limited and similar in nature to the risk they have towards individual clients.</p> <p>Links with illegal funeral parlour or administrator insurance schemes may present prudential risk. This risk is however limited to the clients involved. Due to the similar risk hedging between funeral parlour/administrator and insurer, the risk of affecting the insurance market seems to be limited. The risk is, therefore, that imprudent management of risk by administrators/funeral parlours may result in the collapse of a number of burial societies simultaneously. Even this risk is limited by the fact that burial societies often maintain a separate fund even when 'insuring' with other entities. In addition, even in the case of a complete collapse of a burial society fund, some adjustment would be possible (e.g. convert to collections for some time to rebuild funds) and the society is likely to continue operations.</p>			
Risk of abuse (criminal)	(Management of risk of criminal abuse imposed by regulation: High, through normal criminal justice system; Enforcement: low, low priority crimes; Effective exposure: low)	(Management of risk of criminal abuse imposed by regulation: High, through normal criminal justice system; Enforcement: low, low priority crimes and technical nature of offences; Effective exposure: high, because of general unregulated nature and information asymmetries)	(Management of risk of criminal abuse imposed by regulation: High, through normal criminal justice system; Enforcement: low, low priority crimes and technical nature of offences; Effective exposure: high, because of general unregulated nature and information asymmetries)	(Management of risk of criminal abuse imposed by regulation: High, through normal criminal justice system; Enforcement: low, low priority crimes and technical nature of offences; Effective exposure: low, because of regulated nature of industry)
Risk of abuse (non criminal)	(Management of risk of abuse imposed by regulation: None specific to burial societies; Enforcement: Not applicable; Effective exposure: low)	(Management of risk of abuse imposed by regulation: Some control provided through FAIS; Enforcement: Yet to be implemented; Effective exposure: high)	(Management of risk of abuse imposed by regulation: Some control provided through FAIS; Enforcement: Yet to be implemented; Effective exposure: high)	(Management of risk of abuse imposed by regulation: Some control provided through FAIS and insurance ombudsman; Enforcement: FAIS yet to be implemented and ombudsman mandate restricted; Effective exposure: fair)
Risk of market failure	Member control mechanisms are sufficient to manage market behaviour, except where management and ownership are separated. This mechanism also ensures appropriate pricing.	Nature of product (a complicated credence good), asymmetries of information and non-enforcement of existing regulations result in market failure, which includes excessive profit taking. FAIS will improve this, but will not be sufficient.	Control mechanisms are sufficient to manage market behaviour, except where management and ownership are separated. This mechanism also ensures appropriate pricing.	Nature of the product (a complicated credence good) and asymmetries of information increase the risk of market failure. Current regulation reduces risk and FAIS will improve this further.

Inappropriate products	<p>(Appropriate product design imposed by regulation: none; Enforcement: Not applicable; Effective exposure: low)</p> <p>As products are designed and managed by members and can be adjusted as needs change, the risk of inappropriate products is low.</p>	<p>(Appropriate product design imposed by regulation: Limited control through FAIS; Enforcement: Yet to be implemented; Effective exposure: high).</p> <p>The absence of member governance, the for-profit nature of the business as well as the general absence of regulatory enforcement results in a fair risk of inappropriate products. This is seen in the widespread non-compliance with insurance legislation in terms of providing an option of a monetary benefit, as well as in the bundled nature of products (which reduces consumer choice).</p>	<p>(Appropriate product design imposed by regulation: Limited control through FAIS; Enforcement: Yet to be implemented; Effective exposure: low).</p> <p>As with funeral parlours, the absence of member governance, the for-profit nature of the business as well as the general absence of regulatory enforcement results in some risk of inappropriate products. In most cases, however, administrators exist because they have managed to structure products that are more suitable for consumers than standard insurance products, or because they use distribution and payment collection methods that are cost effective and suit the client. Both of these contribute to appropriate product design.</p>	<p>(Appropriate product design imposed by regulation: Limited control through FAIS; Enforcement: Yet to be implemented; Effective exposure: high).</p> <p>Lack of competition on product features results in a product-driven approach rather than one focused on clients' needs. Burdensome insurance regulation limits entry into this market by institutions that may be closer to clients in this regard. The result is products that generally do not provide benefits in the time required, do not have a value build-up and contracts that allow for short-term pricing strategies, which is only in the interests of the insurer.</p>
Capacity to comply	Low	Fair	High	High

Table 10: Overview of regulatory need and current framework

Source: Genesis Analytics

9. THE CURRENT REGULATORY ENVIRONMENT FOR ASSISTANCE BUSINESS

In the context of the legal framework set out in Figure 7, this section provides an overview of the regulatory framework that currently applies to the assistance business market, as well as common law rules applicable to burial societies, and the draft Co-operatives Bill.

9.1. THE GENERAL LEGAL FRAMEWORK FOR ASSISTANCE BUSINESS

The general legal framework, within which we have to evaluate the regulation of the assistance business market, is depicted in Figure 7. At the broadest level our legal system can be divided into the common law, and legislated or statutory law.

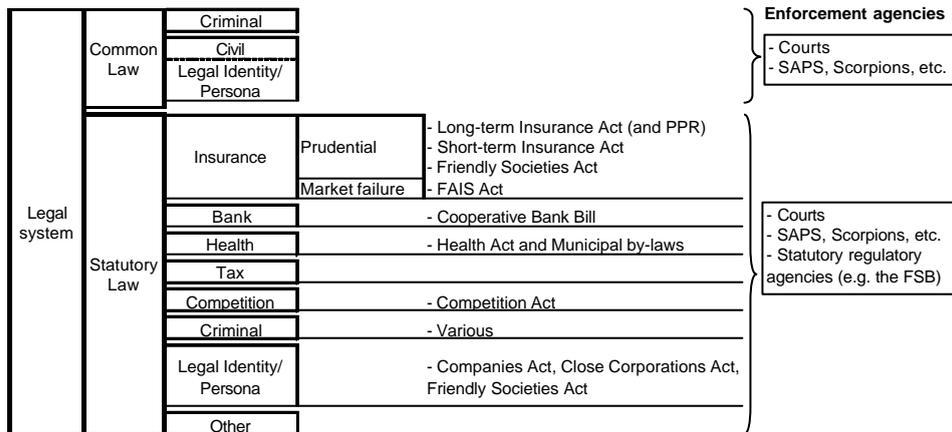


Figure 7: South African legal system

Source: Genesis Analytics

The *common law*, in turn, can be divided into two branches: criminal law and civil law. It is common civil law that confers legal personality, with varying rights, to individuals and also to voluntary associations like burial societies. The enforcement of the common law takes place through claims in the civil courts while criminal behaviour is disciplined by the state through the criminal courts.

Statutory law includes several bodies of law which impact on the assistance business market. These include the field of insurance law, which defines the regulatory environment in which the insurance market operates and has two focus

areas relating to prudential risk⁷⁵ and market failure.⁷⁶ Other fields of law with relevance to the assistance business sector include health law, banking law, tax law, competition law, and legislated criminal law. The specific statutes directly relevant to assistance business are listed in Figure 7. Statutes also confer sophisticated legal personality on commercial bodies like companies, close corporations, trusts and co-operatives. As with common law, enforcement of statutory law takes place through the courts. However, in addition, there also exists an enforcement arm in the form of statutory agencies like registrars, regulators, ombudsmen and state agencies.

It is interesting to note that the above-mentioned structure results in a natural although not always clear cut differentiation between institutional and functional regulation. The laws conferring statutory legal identity generally fall under the jurisdiction of the Department of Trade and Industry (DTI), which regulates the *institutional* nature and governance of those bodies (e.g. registration under the Company's Act). The *functional* nature of the organisation, or in other words the business they conduct, is regulated under different statutes. These statutes are generally the domain of a statutory regulatory agency, which, in the case of insurance regulation, is the Financial Services Board (FSB). There is, therefore, a split between the institutional nature of insurers as public companies, which is regulated by the DTI, and their functional nature, which is regulated by the FSB.

9.2.

THE CURRENT REGULATORY REGIME

Assistance business forms part of the law of insurance. The concept of insurance is not defined in the statutory body of law and must take its common law meaning. In **common law**, before a valid contract of insurance can exist, the parties must reach consensus on the *essentialia*, that is, the essential terms of the contract in the absence of which an insurance contract does not exist. The *essentialia* for a contract of insurance are⁷⁷:

- the payment of a premium;
- in return for a provision of an agreed benefit;
- on the occurrence of a certain event;
- in which the insured has some insurable interest.

In terms of **statutory law**, both the conduct of assistance business as well as the distribution of assistance business products are regulated. Organisations who wish to conduct assistance business must do so in terms of either the *Long Term Insurance Act (Act 52 of 1998)* (the Long-term Act) or the *Friendly Societies Act (Act 25 of 1956)* (the Friendly Societies Act).

⁷⁵ Prudential risk refers to the risk that behaviour by individual players may result in the introduction of systemic risk to the market, which may lead to its collapse.

⁷⁶ In perfect market conditions, the market mechanism provides the discipline to players to act appropriately and the protection to consumers. There are several reasons, however, why insurance markets are not perfect and in such cases, regulation plays a role to correct and control for market failures in order to allow the market to fulfil its role.

⁷⁷ Reinecke, M. et al (2002) at par 100

Intermediaries who provide advice or intermediary services on behalf of a registered insurer are regulated by the *Financial Advisory and Intermediary Services Act (Act 37 of 2002)* (FAIS) which seeks to ensure professional conduct from such intermediaries.

9.3. THE LONG-TERM INSURANCE ACT

9.3.1. DESCRIPTION

The Long-term Act provides for the registration and control of long-term insurers dealing in long-term insurance policies. In terms of the Act, no person may carry on any long-term insurance business unless that person is registered as a long-term insurer.⁷⁸ Long-term insurance business means the business of undertaking to provide policy benefits under long-term policies.⁷⁹ Several categories of long-term policies are defined in the Act, including life and assistance policies⁸⁰ (assistance policies is the regulatory term for funeral insurance).⁸¹ The Act requires insurers to register for and report on each category of insurance they provide.

Funeral insurance can be written under either the life or assistance business policy categories. An assistance policy is defined as “a life policy in respect of which the aggregate value of the policy benefits, other than an annuity, to be provided....does not exceed R10 000 or another maximum amount prescribed by the Minister.”⁸² To the best of our knowledge no such amount has been prescribed. A life policy means “a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits upon, and exclusively as a result of, a life event.”⁸³ A policy benefit means “one or more sums of money, services or other benefits, including an annuity”.⁸⁴ Consequently, any person who enters into a contract to pay an agreed sum of money or to provide a service (i.e. a funeral) on a life event (i.e. the death of the insured) is selling an assistance policy and is, therefore, conducting long-term insurance business, and, subject to the exceptions set out below, must be registered as a long-term insurer. Legally, in terms of the definition of the contract of insurance, the value of the funeral benefit provided must be set out in the contract, in other words the value of the benefit must be contractually *guaranteed*.

There are three main differences between assistance policies and other long-term policy categories:

- The benefits payable under an assistance policy on any one life are limited to a maximum of **R10 000**. No such cap applies to the life category. However, in reviewing the legislation no sections could be found explicitly preventing a

⁷⁸ Section 7 (1)

⁷⁹ Section 1 (xx)

⁸⁰ Other categories are disability policies, fund policies, health policies and sinking fund policies

⁸¹ Section 1 (xxiii)

⁸² Section 1 (ii)

⁸³ Section 1(xix)

⁸⁴ Section 1 (xxv)

person from taking out more than one assistance policy either with the same insurer, or more than one insurer.

- Unlike other long-term policies, there is **no limitation on the commission** that may be paid to an intermediary in respect of an assistance policy.⁸⁵ Although the FSB has in the past threatened to apply commission capping, it was recently publicly announced that it will no longer be seeking to cap assistance business commissions.⁸⁶
- The Act specifically requires that insurers give assistance policyholders the option of a **monetary benefit**, even in cases where the terms of the policy contract specifies that payment will be in kind (i.e. the provision of a funeral).⁸⁷

9.3.2.

REGISTRATION AND PRUDENTIAL REQUIREMENTS

A person wishing to carry on long-term business (including assistance business) must register as a long-term insurer⁸⁸ with the Registrar of Long-term Insurance, who is the executive officer of the FSB. The registrar shall not grant an application unless:

- The applicant is a **public company** which has the carrying on of long-term insurance as its main business, or is incorporated without a share capital under a law providing specifically for the constitution of a person to carry on long-term insurance business as its main object⁸⁹; and
- the applicant can show that it has the “financial **resources** organisation and management” to carry on the insurance business concerned.⁹⁰ The exact level of financial resources, though not defined in the Act, is currently set at the discretion of the FSB as minimum capital at registration of R10 million, irrespective of what business the insurer will be writing (including assistance business).⁹¹

The registrar has the discretion to grant the application subject to the conditions contemplated in Section 10.⁹² These may include authorising the insurer to enter into only certain long-term policies, limiting the terms and conditions of any policy, limiting the value of policy benefits, limiting the premiums that the insurer may receive on the policy, and requiring the long-term insurer to enter into reinsurance policies.⁹³

⁸⁵ Section 49 and Part 3 of the regulations to Long-term Act

⁸⁶ Deon van Staden of the FSB, at the meeting of the Assistance Business Standing Committee on 30 June 2004 in Pretoria

⁸⁷ Section 53

⁸⁸ Section 7. A person who *appears* to be carrying on long-term insurance business will be *deemed* to be – and the onus falls on the insurer to show that it is not.

⁸⁹ Section 9 (3) (a)

⁹⁰ Section 9 (3) (b)

⁹¹ Telephone interview with Johan Heyneke of the FSB on 26 July 2004

⁹² Section 9 (2)

⁹³ Section 10

Other requirements are that the applicant must have a head office in South Africa⁹⁴ and must also at all times have an **auditor** and an **actuary**.⁹⁵ The actuary must ensure that any long-term policy is “actuarially sound”.⁹⁶ This term is not defined in the Act but the Actuarial Association of South African Practice Guidance Note 106 (ASSA, 2004), sets out best practice for statutory actuaries with regards to long-term insurance business. Amongst other things, actuaries are obliged to ensure that policies meet the reasonable expectations of policyholders, and that the premiums being charged are sufficient to enable the insurer to meet its emerging commitments under the policies, having regard to factors like the terms of the business, the assets of the insurer, likely future expenses and current and likely future levels of mortality and morbidity.⁹⁷ The requirement for actuarial valuation is specific to long-term business – short-term insurance does not require the application of actuarial processes.⁹⁸

Once registered, a long-term insurer is under the prudential obligation to maintain its business in a “financially sound condition” by holding appropriate assets, providing for its liabilities, and generally being in a position to meet its liabilities at all times,⁹⁹ i.e. it is obliged to hold **reserves** (also known as the Capital Adequacy Requirement (CAR)) to support its long-term liabilities and potential claims. The appropriate level of CAR is determined by the actuary, though minimum levels have been set by the FSB as the higher of R10 million or the equivalent of 13 weeks’ operating expenses. The registrar does, however, have the discretion to relax the CAR requirements for a specific insurer.¹⁰⁰ For example, when the Act came into force in 1999, existing insurers with reserves of less than R10 million were given five years to reach the requisite CAR level. In practice the FSB currently insists that new applicants satisfy the R10 million requirement.¹⁰¹

Despite the fact that the risk under assistance business is limited due to the reduced nature of the policies (only up to R10 000 cover), the above CAR requirements currently apply equally to long-term insurers writing only assistance business. According to the FSB, before the introduction of the Long-term Act, an insurer writing assistance business was required to hold CAR of only R5 million (provided the value of benefits on any one assistance policy did not exceed R5 000). However, with the introduction of the Long-term Act in 1999, the CAR was raised to R10 million and the value of benefits to R10 000. No historical motivation for this increase in CAR for assistance business was forthcoming during the study.

⁹⁴ Section 16

⁹⁵ Sections 19 and 20 respectively

⁹⁶ Section 46(a)

⁹⁷ Section 3.2 and 4.1 of ASSA Practice Guidance Note 106.

⁹⁸ There is a review process under way to consider whether this should also be a requirement for short-term insurance.

⁹⁹ Section 29

¹⁰⁰ FSB Guidelines for Registration, 15 January 2004, Section 6.2, pg. 16

¹⁰¹ Telephone interview with Johan Heyneke of the FSB on 26 July 2004, and Phillip Langenhoven of the FSB on 19 October 2004.

In addition, in the case of long-term insurers at least 90% of profits arising from profit-sharing policies must be allocated towards increasing the benefits payable under such policies.¹⁰²

Certain exemptions may be provided from registration as a long-term insurer: amongst others, friendly societies registered under the Friendly Societies Act are excluded in so far as they enter into long-term policies in respect of which the value of the benefits to be provided do not exceed R5 000 per member.¹⁰³ In other words, if a friendly society, which may in certain cases include burial societies or funeral parlours, distributes benefits of more than R5 000 per member, that society is obliged to register as a long-term insurer.

9.3.3.

CONSUMER PROTECTION

The Long-term Act imposes on long-term insurers and intermediaries a list of requirements designed to protect consumers. These are found in the Act itself and also in the Policyholder Protection Rules issued under the Act.

Under the Long-term Act

Provisions focussing on consumer protection include, amongst others:

- When a premium is paid in cash, the recipient (whether the insurer or its intermediary) is obliged to give a written **receipt**.¹⁰⁴
- Payment of a premium made to a person on behalf of the long-term insurer (i.e. to an intermediary) is **deemed to be a payment** to the long-term insurer.¹⁰⁵ The Act does not require the payment to actually *reach* the insurer. The implication of this is that any misappropriation of premiums by an intermediary is the concern of the insurer, not the policyholder.
- The insurer is obliged, within 60 days of transacting, to provide to the policyholder a **summary** of the policy, including information on agreed premiums and benefits, the events in respect of which benefits are to be provided, together with any exclusions.¹⁰⁶
- If the policyholder fails to pay the premium, the insurer is obliged to notify the policyholder of **non-payment**.¹⁰⁷
- The registrar has the power to declare any particular **business practice to be undesirable** and to suspend such practice.¹⁰⁸

¹⁰² FSB Guidelines for Registration, 15 January 2004, Section 3, pg. 11

¹⁰³ Section 7 (2)

¹⁰⁴ Section 47 (1) and (2)

¹⁰⁵ Section 47 (3)

¹⁰⁶ Section 48

¹⁰⁷ Section 52

¹⁰⁸ Section 50

Under the Policyholder Protection Rules

Policyholder Protection Rules (PPR) were first issued in terms of the Act in February 2001.¹⁰⁹ These dealt with *inter alia* the obligatory disclosures to be made to a client and other duties of insurers and intermediaries. The Financial Advisory and Intermediaries Act (FAIS) (see section 9.6), which came into effect on 30 September 2004, and which comprehensively deals with the role of intermediaries, effectively made redundant the PPR requirements regarding intermediaries. A PPR replacement was promulgated to come into law simultaneously with the arrival of FAIS on 30 September 2004.¹¹⁰ The new PPR also adds new terms with regard to assistance policy group business, which are of particular interest to this study. The new PPR provide, amongst others, for matters relating to:

- *The use of intermediaries:* where an intermediary is used, the insurer must furnish the intermediary with a **written mandate** and the intermediary must be registered under **FAIS** as a financial service provider or representative¹¹¹ (see section 9.6 for more on FAIS).
- *Rules relating to assistance business group schemes and administrators:* an administrator of an assistance business group scheme is obliged i) to have a **written mandate** from an insurer and ii) to be licensed as a financial services provider or representative in terms of **FAIS**.¹¹² An insurer will only be allowed to conduct business with an assistance business group scheme or an administrator if the insurer has entered into a **written agreement** with such a scheme or its administrator, which sets out the premium, the period within which premiums will be paid over to the insurer, *and the names of all policyholders and beneficiaries, and identity numbers of all policyholders*.¹¹³ Moreover, where an assistance group scheme is transferred between insurers, cancellation is void unless the new insurer issues a **written confirmation** to the previous insurer that it will take over the underwriting of the scheme. The terms of the policy (apart from premiums) may only be changed with the **consent** of each individual policyholder.¹¹⁴ For its part, the previous insurer will be obliged to provide information to the new insurer relating to the policyholders, the premiums and claims history.¹¹⁵

9.4.

THE SHORT-TERM INSURANCE ACT

Although technically assistance business may no longer be written under short-term insurance, we include a description of the Short-term Act as a useful comparison with the long-term requirements. This is useful when considering the risk nature of assistance business and the appropriate regulatory controls required.

¹⁰⁹ See GN No. R 165 in Government Gazette No. 22085 of 23 February 2001

¹¹⁰ Government Gazette No: 26854, 30 September 2004

¹¹¹ Rule 5 of the PPR

¹¹² Rule 8 of the PPR

¹¹³ Rules 9 and 10 of the PPR

¹¹⁴ Rule 11 of the PPR

¹¹⁵ Rule 13 of the PPR

A clear distinction is drawn under the Long-and Short-term Acts between long-term and short-term insurers. A long-term insurer cannot also be a short-term insurer¹¹⁶ and a short-term insurer cannot also be a long-term insurer.¹¹⁷ In other words, no person may carry out both long-term and short-term insurance business without establishing separate long-term and short-term insurance companies.

Until recently, it was possible to write funeral insurance under the Short-term Act, and there is still *no outright prohibition* in the Act preventing a short-term insurer from providing a funeral benefit to a policyholder. However, there is a prohibition on short-term insurers using the term “burial” or “funeral” in any policy or advertisement,¹¹⁸ and technically, as assistance business is not listed as short-term business (and is listed as long-term business¹¹⁹), the converse implication is that assistance business should not be written under a short-term licence. It seems the regulator has indeed taken the view that it is inappropriate to write funeral insurance under the short-term licence.

The requirements to register and act as a short-term insurer are less onerous than for a long-term insurer. An application to write short-term business will not be granted unless the applicant has “the financial resources, organisation and management that is necessary and adequate for the carrying on of the business concerned.”¹²⁰ The FSB has taken the view that capital of R5 million is the appropriate for registration as a short-term insurer (as opposed to R10 million for a long-term insurer). Once registered, the short-term insurer is obliged to hold a minimum CAR of R5 million (as opposed to the greater of R10 million or 13 weeks’ operating expenses for long-term insurers).

Short-term insurance companies are also obliged to maintain their business in a financially sound condition by holding assets and providing for liabilities. Assets should be worth at least R3 million or 15% of net premium income in the previous financial year, whichever is higher.¹²¹ In addition, the short-term insurer must maintain reserves: 7% of the net premium for the twelve months preceding as provision for claims incurred but not yet reported; and an additional contingency reserve of 10% of the net premium for the 12 months preceding. There are no actuarial requirements for short-term business. However a review is under way as to whether actuarial requirements should be imposed on all policies under short-term insurance following the September 11th shock to global short-term insurance.

¹¹⁶ Section 15 (4) of the Long-term Act. (Other than a person carrying on reinsurance business only).

¹¹⁷ Section 15 (5) of the Short-term Act. (Other than a person carrying on reinsurance business only).

¹¹⁸ Section 27 of the Insurance Amendment Act, Act 17 of 2003. However, at least one insurer offers a form of funeral insurance on short-term basis under the name of “bereavement policy”, as an add-on to other short-term insurance products.

¹¹⁹ Short term policy is defined as an engineering policy, guarantee policy, liability policy, miscellaneous policy, motor policy, accident and health policy, property policy or transportation policy (Section 1 of Short-term Insurance Act).

¹²⁰ Section 9 (3)

¹²¹ FSB Guidelines for Registration, 15 January 2004, Section 5, pg. 15

9.5. THE FRIENDLY SOCIETIES ACT

Friendly societies are essentially mutual assistance organisations of a private kind where the members share a common bond, and where the members are the owners of the society. The essence of the institution is mutuality of interest between members. Societies operate on principles analogous to those of insurance.

The Friendly Societies Act of 1956 was designed to provide a regulatory framework to incorporate and provide protection from maladministration to the members of these mutual organisations. Traditionally, these groups have included death, sickness and disability, and funeral groups.

A friendly society is defined in the Friendly Society Act as “any association of persons established for any of the objects specified in section two, or any business carried on under a scheme or arrangement instituted for any of those objects”.¹²² These objects are broad and include providing relief during minority, old age, widowhood and sickness; payments on the birth of a child or death of a family member; insurance of implements used in a member's trade; financial assistance on resignation or dismissal; unemployment relief; the provision of sums of money for the advancement of the education of members or of their children, and “the *insurance* of a sum of money to be paid or other benefit to be provided towards the expenses *in connection with the death or funeral* of any member.”¹²³ Friendly societies as defined must apply to the Registrar of Friendly Societies (the executive officer of the FSB) for registration.¹²⁴ However, the Act exempts friendly societies from compliance with the Act where the aggregate value of income of the society is below R100 000 per annum.¹²⁵ The Registrar of Friendly Societies can also exempt a friendly society which “operates exclusively by means of policies of insurance issued by a person lawfully carrying on insurance business within the meaning of the Insurance Act.”¹²⁶ In other words, all friendly societies must register unless i) their aggregate annual income is less than R100 000 or, ii) the registrar is satisfied that their risks are underwritten by a registered long-term insurer.

In addition, friendly societies which pay insurance benefits to members of more than R5 000 per member are obliged to register as long-term insurers in terms of the Long-term Act.¹²⁷ However, friendly societies that do not offer insurance to their members, that is, who do not contractually *guarantee benefits*, are not conducting insurance and are therefore required to comply with neither the terms of the Friendly Societies Act nor the Long-term Act. They are effectively unregulated.

Upon registration under the Friendly Societies Act, the friendly society becomes a body corporate, capable of suing and being sued in its name and of doing all things

¹²² Section 1

¹²³ Section 2 (d) (iii)

¹²⁴ Section 5(1)

¹²⁵ Section 3(2) (a)

¹²⁶ Section 3 (2) (b)

¹²⁷ Section 7 (2) of the Long-term Act

necessary for the performance of its functions in terms of its rules.¹²⁸ That is to say, the Act confers on the society that chooses or is obliged to register as a friendly society a new and particular legal personality.

Registering as a friendly society is not a simple task. An applicant must:

- *Have and submit a set of rules* containing *inter alia* the name and objects of the society, the manner in which funds are to be raised and the purpose for which they are to be applied, the nature and extent of benefits, fines for non-payment, how officers are to be appointed and removed, how accounts are to be kept, how contracts are to be entered into, arranging for the appointment of an auditor and a method of deciding disputes.¹²⁹
- *Submit a certificate by a valuator* (defined as an actuary or other person of sufficient actuarial knowledge¹³⁰) as to the soundness of such rules from a financial point of view or other information as to their financial soundness, or if there is no valuator available, such information regarding financial soundness as the applicant may possess.¹³¹
- *Satisfy the registrar* that the society is *financially sound*.¹³²

In addition, membership of the society must not be open to the public and should be confined to a specific group or employer. The persons responsible for the administration of the society must have the ability (experience and education) to manage such an organisation, and the society must have a board of management of at least four members, at least half of whom must be elected by the members.

Once registered, the burial society must have a registered office,¹³³ a principal executive officer,¹³⁴ a registered auditor (if such an auditor is not readily available the registrar may approve the appointment of a person nominated by the society, or any other person he considers suitable),¹³⁵ and within six months of the expiration of its financial year must submit to the registrar detailed financial statements.¹³⁶

Finally, a friendly society which wishes to apply to the Registrar of Long-term Insurance to carry on a particular class of insurance may apply to the Registrar of Friendly Societies for approval of its conversion to a company, so as to be able to make such application.¹³⁷ The society must submit with the application a proposed memorandum and articles of association for the public company to be established by the conversion.¹³⁸ As soon as the Registrar of Friendly Societies has granted approval for the conversion, the society may apply to be incorporated as a

¹²⁸ Section 7

¹²⁹ Section 13

¹³⁰ Section 1

¹³¹ Section 5 (2)

¹³² Section 5 (4)

¹³³ Section 9

¹³⁴ Section 10

¹³⁵ Section 11

¹³⁶ See sections 22, 25 and 24.

¹³⁷ Section 38A (1)

¹³⁸ Section 38A (2)

company under the Companies Act (Act 61 of 1973) and the society is by such registration by the Registrar of Companies converted into a company,¹³⁹ at which point all assets, liabilities, rights and obligations of the society vest in the new company and the Friendly Societies Act ceases to apply.¹⁴⁰

9.6. THE FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT

As its name suggests, the Financial Advisory and Intermediary Service Act (FAIS), was introduced to regulate market conduct in relation to certain advisory and intermediary services. In essence, it seeks to ensure that every person authorised to render financial services to a client is fully qualified to discharge this responsibility, so as to improve the flow and quality of information in the market and to ensure consumers enjoy full disclosure and professional conduct. Most of the provisions of the FAIS Act came into operation on 15 November 2002; those relating to licensing of *financial services providers* (FSPs) came into operation on 30 September 2004.

Where advice or intermediary services in respect of any financial product (including an assistance policy) are provided through a broker, agent, funeral parlour, administrator or other class of intermediary, that provider is obliged to first obtain a licence to act as an FSP.¹⁴¹ This includes any transaction where money is received from a policyholder or client on behalf of a financial institution, even where that money is merely held or passed on to the institution.

In addition, an employee or contractually bound agent of an FSP who renders a financial service to a client for or on behalf of an FSP must be registered as a *representative* of the FSP, unless that person renders only clerical, administrative, or other service in a subordinate capacity, which service does not require judgement and does not lead a client to any specific transaction.¹⁴²

9.6.1. REGISTRATION OF FSPS AND REPRESENTATIVES

An application for a licence to act as a **FSP** must be made to the registrar, who is the executive officer of the FSB.¹⁴³ The application procedure is onerous and considerable information must be supplied to show that the applicant complies with certain “fit and proper” requirements. This includes information about the honesty

¹³⁹ Section 38B

¹⁴⁰ Section 38C

¹⁴¹ Section 1. A financial services provider is any person (natural or juristic) who as a regular feature of its business furnishes advice, renders an intermediary service, or does both.

¹⁴² Section 1. “Advice” in this context means any recommendation or guidance in respect of buying a financial product (including an assistance policy). It does not, however, include factual advice given merely in relation to the description of a financial product, or in answer to routine administrative queries, or in the form of objective information about a particular financial product, or by the display or distribution of promotional material. An intermediary service means an act other than advice, performed by a person for and on behalf of any client, with a view to, buying, selling, administering, managing or otherwise dealing in an assistance policy purchased by the client from a product supplier, or collecting or accounting for premiums payable by the client, or receiving, submitting or processing the claims of a client (Section 1).

¹⁴³ Section 7

and integrity, competence, operational ability and financial soundness of the applicant.¹⁴⁴ With respect to those FSPs involved only in assistance business (called “Category A” applicants¹⁴⁵) the applicant:

- must not be an un-rehabilitated insolvent;
- must not within five years of the date of application have been found guilty of acting fraudulently or dishonestly¹⁴⁶;
- must have a fixed business address and bank account, and at least a cell phone and typing facilities;
- must have a minimum of six months experience in the assistance business or must have completed a relevant SETA learnership; and
- must have a minimum Standard 8 education or a certain number of credits in an INSETA-approved skills programme¹⁴⁷.

The FSB has granted an exemption to Category A applicants who apply prior to 31 December 2004, such that they will be exempted for three years (until 30 September 2007) from compliance with the minimum academic qualification requirements.¹⁴⁸

FSPs must also name and appoint a key individual within the organisation as compliance officer,¹⁴⁹ must maintain records,¹⁵⁰ and meet certain accounting and audit requirements.

By contrast, **representatives** do not hold a licence in their own right – they are registered under the licence of an FSP (and can act for more than one FSP). The procedure to register a representative requires only the provision by the FSP of the representative’s name, business address, whether the representative acts as an employee or as a contractually bound agent, and the categories in which he or she is competent to render financial services. The onus falls on the FSP to ensure representatives are competent to act and the FSP is obliged to maintain a register of all its representatives for inspection purposes.¹⁵¹ There is no closing date for registration as a representative.

¹⁴⁴ Section 8 (1)

¹⁴⁵ There are three broad categories of FSP: Category 1 is a full FSP; Category 2 is a discretionary FSP (that is, an investment manager or person who manages client funds); and Category 3 is an administrative FSP (that is, an investment manager whose business consists of implementing or capturing instructions given by a client in respect of the management of investments. Within Category 1, those insurers dealing in assistance business are sub-defined as Category A applicants (Board Notice 91 of 2003, Determination of Fit and Proper Requirements for Financial Service Providers, 2003).

¹⁴⁶ Part II of FSB Board Notice 91 of 2003

¹⁴⁷ Table A, FSB Board Notice 91 of 2003. INSETA is the Insurance SETA.

¹⁴⁸ Board Notice 104 of 2004, Government Gazette 26844, 29 September 2004

¹⁴⁹ Section 17 (A sole proprietor of is exempt from this requirement (FSB Board Notice 99 of 2004)).

¹⁵⁰ Section 18

¹⁵¹ Section 13 (1)

9.6.2. THE CODE(S) OF CONDUCT

Under FAIS, a number of codes of conduct for each financial sector are planned. No assistance business-specific code has yet been issued, but a General Code was issued on 8 August 2003 which applies to all FSPs. The following are pertinent provisions:

- *General duties:* information supplied by an FSP must be factually correct, confirmed in writing upon request and provided timeously. The FSP must disclose to the client, amongst other things, the existence of any personal interest or conflict of interest in the service being rendered.¹⁵²
- *Record keeping:* an FSP must have procedures and systems in place to record all verbal and written communications relating to a financial service rendered to a client.¹⁵³
- *Information on product suppliers:* an FSP must supply the client with full information about the product supplier and the FSPs' relationship with the product supplier.¹⁵⁴
- *Information on financial services:* an FSP must supply information to the client about the product or service concerned. This must include, amongst others, the name and type of the product, the monetary obligations assumed by the client and the nature and extent of any commission payable to the FSP.¹⁵⁵
- *Analysis of client's financial needs:* when an FSP provides advice to a client, it must, prior to providing the advice, obtain information about the client's financial situation in order to identify the products that will be appropriate to the client's risk profile and needs, and must also take reasonable steps to ensure that the client understands the advice given.¹⁵⁶
- *Custody of the product and funds:* an FSP which receives or holds financial products or funds on behalf of a client must provide the client with a receipt. The FSP must operate a separate banking account designated for client funds only, and must within one business day deposit such funds into the account.¹⁵⁷

The terms of FAIS, as far as the clients of FSPs are concerned, are to be enforced primarily by the Ombud for Financial Services Providers who will consider complaints and has wide-reaching powers of enforcement, including the power to make a monetary award for any damage that a client may suffer.¹⁵⁸ Contraventions of the FAIS Act can attract fines of up to R1 million or imprisonment for a period not exceeding ten years.¹⁵⁹

¹⁵² Part II, Section 3 (1) of the General Code

¹⁵³ Part II, Section 3 (2) of the General Code

¹⁵⁴ Part II, Section 4 (1) of the General Code

¹⁵⁵ Part VI, Section 7 (1) of the General Code

¹⁵⁶ Part VII, Section 8 (1) of the General Code

¹⁵⁷ Part VII of the General Code

¹⁵⁸ Section 28

¹⁵⁹ Section 36

9.7. THE REGULATOR

The Financial Services Board (FSB) was created in terms of the Financial Services Board Act (Act 97 of 1990). It is an autonomous, statutory, public body regulating and supervising the business of non-banking financial services. The Executive Officer of the FSB is ex officio the Registrar of Long-term Insurance in terms of the Long-term Act, the Registrar of Short-term Insurance in terms of the Short-term Act, the Registrar of Friendly Societies in terms of the Friendly Societies Act, and the registrar of FSB under FAIS.

Until recently the FSB insurance department was split along long- and short-term lines. However, following a merger, the split is now made on the grounds of prudential matters and policy matters.¹⁶⁰ Previously, the Long-term Insurance Act, which dealt primarily with prudential regulation, was the only tool the FSB had to regulate the assistance business industry. The promulgation of FAIS, which deals with market conduct regulation, especially regarding intermediaries, has left the FSB better placed to deal with regulation of the industry.

The staff of the FSB numbers 237. The Inspectorate Unit is responsible for carrying out inspections to ensure the laws falling under the remit of the FSB are applied, and to assist the prosecuting authorities to institute prosecutions where necessary. There are 14 inspectors in the Unit, three of whom are dedicated to enforcement of the insurance and friendly societies' legislation (in collaboration with the police)¹⁶¹. From 1 April 2003 to 31 March 2004 the Inspectorate finalised 53 inspections, 32 of which were finalised for the Insurance Department (including 27 burial schemes in Limpopo Province)¹⁶².

9.8. THE LEGAL PERSONALITY OF BURIAL SOCIETIES

Burial societies which are exempt from statutory regulation or which are not formally registered nonetheless have certain characteristics conferred by the common law. To date, these have not been well ascertained in legal texts or judicial precedent and there is some debate regarding the exact legal personality of burial societies. It has been submitted they amount to a form of partnership¹⁶³ (Schulze, 1997). However, a partnership is a legal relationship between persons who carry on business "with the object of making a *profit*" (Hutchison et al, 1991: 609). As the object of burial societies is arguably not to make a profit in any ordinary sense of the word, it is submitted that burial societies more likely fall under the **law of voluntary association** which deals with non-profit associations.

A voluntary association is a legal relationship which arises from an agreement among three or more persons to achieve a common objective, primarily other than the making or division of profits (Bamford, 1982: 117). In common law, there are two types of voluntary association: an *universitas* and an unincorporated

¹⁶⁰ Interview with Deon van Staden, Head Registration and Policy, Insurance, FSB on 27 July 2004.

¹⁶¹ Telephone interview with Martin Dzviti, Head of Inspectorate, FSB on 15 December 2004.

¹⁶² FSB, Annual report 2004, p.13.

¹⁶³ See Schulze (1997)

association¹⁶⁴. An *universitas* has a stronger personality in law than an unincorporated association: it exists as an entity independent from its individual members with a separate legal personality, whereas an unincorporated association does not.

To be recognised as an *universitas*, a voluntary association must:

- Enjoy perpetual succession;
- not have as its object the acquisition of profit for itself or its members; and
- be founded on the basis of mutual agreement, that is, the individuals making up the association must have the serious intention to associate and must be in agreement on the essential characteristics of the association.

Otherwise, whether or not an association possesses the required characteristics of an *universitas* is a factual question which depends in each case on the nature of the association, its objects, activities and rules (Bamford; 1982: 128). It does not necessarily need a written constitution, but it is improbable that an association with no constitution at all will be an *universitas*.¹⁶⁵

A strong case can be made that a burial society which satisfies all three of the above characteristics and in which the objectives, activities and rules are well recognised and constituted by the members (if not in writing, then at least expressly) will in legal character be an *universitas*. This view has yet to be tested judicially. However, its implication is that a burial society does not need the sanction of the state, nor does it have to undergo formal registration to benefit from certain common law-conferred qualities.

Thus a burial society that meets the characteristic of an *universitas*, has legal personality separate from that of its members, and acquires rights and duties as an entity separate from the rights and duties of its individual members. In practice, this means that a burial society can open bank accounts, purchase property, enter into contracts, incur debts, and be held accountable for various delicts, *all in its own name*, as opposed to the names of its members. (As a non-corporeal entity it will, like any other juristic person, need to act through a human representative, who should be duly authorised). It can also sue and be sued in its own name¹⁶⁶, but there is no presumption that an association is an *universitas* and any alleged *locus standi* must be properly pleaded (Bamford, 1982: 208).

The important point is that burial societies, even those that are not constituted as friendly societies by statute or formally registered, have legal personality in law, one that is distinct from its members.

¹⁶⁴ See Law of South Africa, Vol 1, pp 462 - 498

¹⁶⁵ Ex parte Doornfontein, Judiths Paarl Ratepayers Association 1947 (1) SA 476 (T) at 477.

¹⁶⁶ Even if a burial society is characterised as an unincorporated association rather than an *universitas* it has the right to sue and be sued in its own name: rule 14 (2) of the Uniform Rules of Court states that an association, which is defined in the rules as any unincorporated body of persons not being a partnership, may sue or be sued in its own name (see LAWSA, Vol1, at para 616).

9.9. DRAFT LEGISLATION: A NEW CO-OPERATIVE FRAMEWORK

The government has strongly endorsed the development of co-operatives as part of its strategies for job creation in the South African economy. In 1999 President Thabo Mbeki said:

“The government will place more emphasis on the development of the co-operative movement to combine the financial, labour and other resources among the masses of people, rebuild our communities, and engage in sustainable economic growth.”¹⁶⁷

On the back of this endorsement, the Department of Trade and Industry (dti) has recently developed a co-operative support strategy outlining a number of measures to assist in the promotion and development of co-operatives.¹⁶⁸ This strategy was the result of a long consultative process which was initiated in 1997 with the establishment of the Co-operative Policy Task Team.

Co-operatives are distinguished from other types of enterprise in that:

- They are associations of people who agree to be the owners, the makers of democratic decisions, and the users of their joint enterprise (i.e. they are member-owned);
- Their main purpose as an economic unit is to promote their own members by rendering services, rather than to maximise profits.

Current legalisation governing co-operatives can be found in the **Co-operatives Act, Act 91 of 1981**. According to this Act all co-operatives must be registered with the Registrar of Co-operatives. However, only three types of co-operatives are recognised by the Act, namely agricultural co-operatives, special farmers' co-operatives and trading co-operatives. All of these operate in the agricultural sector and have tended historically to be “white” co-operatives. After 1994 most of these converted to private companies.

Non-agricultural co-operatives have not had suitable legislation under which to form and operate, and have had to register under other legislation, including the Companies Act or Close Corporation Act, or in the case of the small credit or savings co-operative movement, under the Mutual Banks Act. The existing Act is not well designed for co-operative-like structures where financial services are the main activity (for example, burial societies).

Government has recognised that the existing Act is insufficient for the needs of co-operatives. As a sign of its growing interest in the co-operative as a vehicle of enterprise, responsibility for co-operatives will be transferred from the Department of Agriculture to the dti, and a co-operative development unit has been established

¹⁶⁷ Speech, Opening of Parliament, 25 June 1999, Cape Town

¹⁶⁸ See October L, and Maluleke, N. (2004) *A Co-operative Development Policy for South Africa*, June 2004

in the dti. The new Co-operatives Bill, 2004 is expected to be passed into law in early 2005.¹⁶⁹

The **Co-operatives Bill, 2004** provides for co-operatives to be legal entities with limited liability, and provides for their formal registration and administration. It seeks to promote a more diverse variety of co-operatives than the current Co-operatives Act, including agricultural co-operatives, housing co-operatives, transport co-operatives, medical co-operatives, worker co-operatives and financial service co-operatives. Provision has been made in the bill for the inclusion of **burial societies** as co-operatives.¹⁷⁰ The bill also makes it clear that “a financial services co-operative providing funeral benefits to its members is not required to register in terms of the Friendly Societies Act”.¹⁷¹ From this it seems clear that it is dti’s intention to pull burial societies under the co-operatives framework, and that a burial society which chooses to register as a co-operative will not need to register as a friendly society.

The focus of the Bill is on emerging co-operatives, mainly owned by African entrepreneurs. Registration is voluntary, although only registered co-operatives will be able to take advantage of the government support programme. The details of this programme are still to be finalised, but may include assistance with starting capital (of up to R200 000), and training and education from government-sponsored service providers in basic business and financial skills, business planning, marketing, as well as co-operative-specific training.¹⁷²

According to the dti, the institutional regulation function presently carried out by the Registrar of Co-operatives in the Department of Agriculture will in due course move to the dti’s Company and Intellectual Property Registration Office (CIPRO) (i.e. co-operatives will be registered by the dti). In certain cases, it is foreseen that *functional* regulation may remain with the department most appropriate to the nature of the co-operative. For example, banking co-operatives may be functionally regulated by the National Treasury. It has not yet been decided how burial societies (should they fall under the co-operative framework) will be regulated, although it is possible they will fall under the control of the dti.¹⁷³ This will not be ideal for a financial services-based co-operative.

A description of the principal terms of the Co-operative’s Bill is included in Appendix E.

9.10.

THE FINANCIAL SECTOR CHARTER AND CAT STANDARDS

The Financial Sector Charter has added a new dimension to the regulation of the financial sector in South Africa. The Charter itself will be given regulatory status by

¹⁶⁹ This section refers to a version of the bill dated 14 June 2004. The dti hopes to finalise the Act by March 2005.

¹⁷⁰ See clauses 1 and 4 (2) (e)

¹⁷¹ Section 6, of Part 3 to Schedule 1

¹⁷² Telephone interview with Patience Mbewana, dti, on 19 October 2004

¹⁷³ Telephone interview with Ursula Titus, Deputy Director, Co-operatives Development Unit, dti, on 2 November 2004.

being published as a Transformation Charter in terms of the Broad-based Black Economic Empowerment legislation.¹⁷⁴

The Charter contains specific targets for the promotion of access to financial services. In relation to funeral insurance the parties to the Charter, which includes formal insurers, have committed themselves, by 2008, to make available “appropriate products ... affordably priced and through appropriate and accessible physical and electronic infrastructure such that a percentage (to be settled with the life assurance industry) of LSM 1-5 households have effective access to funeral insurance products”.¹⁷⁵ The LOA has formed an Access Committee to formulate proposals for the implementation of this undertaking. Although their proposals have not yet been finalised, indications are that they may adopt a UK CAT standards approach, agreeing on appropriate product characteristics for low income clients. Individual insurers will then be given a period to develop products that comply with these standards.

9.11. APPLICATION OF THE CURRENT REGULATORY REGIME TO THE MARKET ANALYSIS

When we apply the currently regulatory regime as set out above to the market analysis of the various components of the assistance business market as set out in the earlier sections of this report, it yields some interesting results. Although our primary focus is the regulation of the financial services involved, we also consider the applicable institutional forms or legal personalities, as these determine the corporate governance rules of the institutions concerned and thus have a direct impact on the control of potential abuse.

9.11.1. BURIAL SOCIETIES

The traditional view is that burial societies should be treated as friendly societies under the Friendly Societies Act. This would seem not to be the case.

Institutional form: under the South African common law of voluntary associations, a burial society, operating as a non-profit body with perpetual succession in terms of an express or implied constitution, is classified as an *universitas*. As such it acquires a legal personality separate from its members. It has this legal personality by operation of the common law. However, if the burial society has a profit motive the situation changes. If it has fewer than 20 members, it is considered to be a partnership. If it has more than 20 members, it has to register under the Companies Act to acquire corporate legal personality.¹⁷⁶ A burial society does not qualify as a co-operative under the current Co-operatives Act.

Financial services: The core finding of this study is that vast majority of truly community-based burial societies, with very few exceptions, do not guarantee benefits to their members and take no third party profits from risk management.

¹⁷⁴ Clause 14.4 of the Charter.

¹⁷⁵ Clause 8.3.1 of the Financial Sector Charter.

¹⁷⁶ See Genesis (2003), p.60.

They therefore do not offer insurance in the legal sense of the word, but rather a form of cash flow management or **risk pooling**. Since the Friendly Societies Act applies only to societies offering formal insurance, burial societies, irrespective of their size and turnover, therefore cannot be characterised as friendly societies and do not have to register under the Friendly Societies Act. Should their benefits exceed R5000, they do not, for the same reason, have to register under the Long-term Insurance Act. Those burial societies that changed the nature of their benefits into guaranteed benefits do provide **insurance** in the legal sense of the word. If their benefits are below R5 000, but their turnover above R100 000, they need to register under the Friendly Societies Act and are subject to its provisions. If their benefits exceed R5 000, they must register as long-term insurers.

Intermediary services: burial societies do not provide intermediary services, but rather act on behalf of their members. They therefore do not fall under FAIS.

9.11.2.

FUNERAL PARLOURS

The business model of funeral parlours in South Africa has much in common with the business models of furniture and other retailers focussed on the low income market. Whereas their primary business involves the selling of a tangible product or service, much of their profit derives from the financial services sold with the product or primary service.

Institutional form: Funeral parlours adopt a range of legal personalities. Most of the funeral parlours are one person businesses and the legal personality of the owner is that of his or her business. We also found companies – public and private – and closed corporations. This begs the question whether a funeral parlour can be a friendly society. It certainly is not an “association of persons”¹⁷⁷. Can it be described as a “business carried on under a scheme or arrangement”, which is the other option in the Act? A detailed legal analysis of this question is beyond the scope of this study. We would however suggest that the entire scheme of the Act militates against an institution whose primary object is the provision of funeral services, rather than funeral insurance, being classified as a friendly society.

Financial services: Funeral parlours provide three types of financial services: insurance, savings (pre-paid funerals) and credit. The savings and credit components are not specifically regulated in this market and general consumer protection legislation apply. As far as insurance is concerned – both products that are partly or fully underwritten by a formal insurer, but “owned” by the funeral parlour, or products that are not underwritten – the funeral parlour must be registered under the Long-term Insurance Act, unless its benefits do not exceed R5 000 and it is registered under the Friendly Societies Act. As indicated earlier, we have some reservations whether funeral parlours do indeed qualify to be registered as friendly societies, in which case they must all register under the Long-term Act if they offer insurance.

¹⁷⁷ See the definition of “friendly society” in section 1 of the Act.

Intermediary services: Where funeral parlours sell the products of an administrator or formal insurer, they act as financial intermediaries and must comply with FAIS. When they sell their own products, they usually render advisory services and must similarly register as financial services providers under FAIS.

9.11.3. ADMINISTRATORS

Our study found that in the assistance business market, administrators often assume the role of product providers, which takes them beyond the realm of intermediary services.

Institutional form: Like funeral parlours, administrators can adopt a number of institutional forms, and are sometimes linked to parent organisations, for example trade unions. A variety of regulatory frameworks therefore apply.

Financial services: Administrators who provide insurance products in their own name, managing all the interactions with their clients without, in the case of partial or complete underwriting, disclosing the nature and identity of the underwriting, are deemed to be carrying on long-term insurance business and therefore subject to the Long-term Act.

Intermediary services: Administrators provide both advisory and intermediary services and are subject to FAIS.

9.11.4. FORMAL INSURERS

Formal insurers comprise the fully regulated component of the market.

Institutional form: Formal long-term insurers must be public companies.

Financial services: They conduct long-term insurance business and must comply with the Long-term Act.

Advisory and intermediary services: Formal insurers normally provide advisory services and therefore fall under FAIS.

10. INTERNATIONAL MICRO-INSURANCE: CONTEXT AND REGULATION

The phenomenon of second and third tier insurers in the provision of funeral insurance in this document is not unique to South Africa, and finds resonance in the international debate on the development and regulation of micro-insurance. *Second and third tier insurers* (as opposed to first tier) usually have lower cost structures and simpler institutional design, which allows them to serve lower-income markets where premiums are substantially lower than in the formal market. This is associated with less regulation, simpler products and/or innovative collection and distribution systems. The differentiation between second and third tier is usually based on formality, where the third tier is informal and the second tier may be semi-formalised.

Micro-insurance, in turn, is the latest area of the microfinance family to receive attention from the donor and research community. The micro-insurance concept describes the provision of insurance to lower-income households and often goes hand in hand with the provision of micro-lending. The international micro-insurance drive is aimed at bringing appropriate insurance products to the poor, which is achieved in various ways, including experimenting with new types of institutions and/or risk sharing mechanisms, or through innovative intermediation structures for formal insurance products.

Although no literature focused specifically on funeral insurance could be found, one desk study provided some general background to the regulation of micro-insurance and confirmed that a few other studies exist on this issue (Wiedmaier-Pfister, 2004), while another document provided an overview of micro-insurance as applied to health insurance (Dror & Preker, 2002). Several regulators are also currently individually engaging with this issue in their own jurisdictions. Two examples of such jurisdictions relevant to South Africa are discussed in Box 4 and Box 5 below.

Through a confluence of events and circumstance, micro-insurance has not developed as a separately defined concept in South Africa. The goal of extending access to financial services (including funeral insurance) to lower-income households has, however, been adopted as an explicit objective of the formal financial industry, as manifested in the Financial Sector Charter. Pressure is therefore being placed on mainstream formal insurers to find ways of extending their services to lower-income markets. In addition, there is substantial interest in burial societies' provision of insurance-type services to lower-income households. The provision of micro-insurance is, however, still restricted to funeral insurance with little success with other products. However, the distribution channels developed for funeral insurance may eventually serve as channels for the distribution of a wider variety of micro-insurance products, with some formal insurers currently experimenting with distributing short-term insurance through

burial societies. It is also possible that burial societies may eventually be able to expand their product range to include other insurance products.

Box 4. Self-help groups as intermediaries in India¹⁷⁸

Since opening up of the Indian insurance market to private companies in 2000, regulators have changed their view on the development of the market from an institutional approach (i.e. forcing formal insurers to expand access through quotas) to a focus on the intermediation of micro-insurance products (which comprises new products to be developed by the formal insurers and will cover both life and general insurance) through formal and informal intermediaries.

The Indian insurance markets have been dominated by government monopolies since a monopoly was granted to the Life Insurance Corporation of India in 1956 (the Life Insurance Corporation Act, 1956) and the nationalisation of short-term insurers in 1972 (through the General Insurance Business (Nationalisation) Act, 1972) and was only opened to private providers in 2000 with the first entries at the end of 2000. Government has tried to facilitate the extension of access to insurance products through regulation passed on 14 July 2000, which stipulated that 15% of policies be sold to the “rural social sector”. This has, generally, not been effective as a method of extending access to lower-income households and the focus of the regulator has, subsequently, changed to the intermediation of micro-insurance products through various types of intermediaries (IRDA, 2004) including informal self-help groups (SHGs) and NGOs. Regulation is, therefore, focused on developing these institutions as intermediaries rather than creating a second tier of providers to serve lower-income households.

The insurance industry in India currently comprises of a range of short-term and long-term insurers (both private and state-owned), a number of co-operative insurers as well as NGOs and self-help groups acting as intermediaries to the formal insurers. The industry is governed primarily by the Insurance Act, 1938 (as amended) and the Insurance Regulatory and Development Authority (IRDA) Act, 1999 and is regulated by the IRDA. There are insurance ombudsmen in 12 cities that deal with complaints relating to insurance policies with an insured value of less than Rs. 20 lakhs (R270,000).

The Insurance (Amendment) Act, 2002, allows co-operative societies, registered under the Co-operatives Society’s Act, 1912 or Multi-State co-operatives societies Act, 1984 or “any other state law relating to co-operative societies” to conduct any form of insurance business. However, there is no exemption from the capital adequacy requirements for co-operatives. The minimum capital requirement is Rs. 100 crores (R135m). The federal government may exempt a co-operative society from the provisions of the Insurance Act. The IRDA regulates co-operative insurers. Co-operative insurers in India are generally large, formally registered insurance companies and very different to burial societies in South African (which are closer in nature to the Indian self-help groups).

Insurance agents and direct insurance brokers are regulated in terms of regulations issued by the IRDA in accordance with the Insurance Act, 1938. These regulations generally encourage NGOs, SHGs and co-operatives to become *tied-agents* of insurance companies. However, any person representing an NGO or SHG at a point of sale (as an *agent*) has to, at a minimum, be in possession of a matriculation and should complete all formalities normally applicable to an individual agent. *Agents* are also bound to a code of conduct.

NGOs and SHGs may also act as *brokers*. As a *broker* the NGO or SHG has to fulfil capital requirements of Rs. 50 lakhs (R675,000) in order to place insurance business with any insurance company. However, any person representing an NGO or SHG at a point of sale (as a *broker*) has to, at a minimum, be in possession of a graduate degree and should complete all

¹⁷⁸ Law Commission of India; Wiedmaier-Pfister, 2004.

formalities normally applicable to brokers. *Brokers* enjoy higher scales of remuneration than *agents*.

In an attempt to expand access to insurance, the Indian regulator is in the process of establishing a different set of regulations for intermediaries of "micro-insurance" products and policymakers are contemplating relaxing the requirements for these intermediaries. The new regulations seek to establish links between formal and informal insurers. New products from formal insurers are envisaged and it is intended that SHGs and NGOs will distribute these products. At this stage it seems that "micro-insurance" will be defined according to a relevant policy "ticket size" (value of benefit) and agents selling these products will have to comply with the code of conduct developed for traditional agents but the educational requirements will be waived. This is intended to reduce mis-selling without limiting entry into this market through overly burdensome regulation. Other interesting ideas proposed in the concept note (IRDA, 2004) are:

- Life companies and non-life companies will both be allowed to offer both life and non-life "micro-insurance" products, provided that a life-company ties up with a non-life company to offer the non-life component of its business, and vice versa;
- Minimum and maximum terms of cover for both life and non-life business will be set;
- There is provision for NGOs and SHGs to distribute these products as agents;
- Commissions will be capped;
- Agents will be subject to the same code of conduct and other disclosure and advertisement norms - insurance companies are to ensure that this is abided by; and
- All "micro-insurance" products will count towards the social and rural provision obligations of insurers established in the Insurance Act, 1938.

There are number of parallels with and lessons for the South African market:

- Both India and South Africa have adopted explicit goals of extending access to insurance services to lower-income households. India first tried this through explicit quotas, which did not succeed and, subsequently, moved to a facilitative approach where it tries to promote the design and intermediation of insurance products for lower-income households. The failure of quotas should serve as warning to South Africa where targets are being negotiated through the Charter process. It is clear that quotas by itself will not facilitate the required expansion in access.
- India is focusing its efforts on the development of intermediaries of micro-insurance products. South Africa is currently focused on the regulation of intermediaries rather than the development and promotion of appropriate intermediaries to serve the lower-income market. This is a focus that may be usefully included in the current regulatory drive.

Box 5. . Co-operatives and small informal insurers in Japan¹⁷⁹

The growth of formal and informal co-operatives in Japan has facilitated broader access to insurance services. The Japanese insurance industry is regulated by the Financial Services Authority (FSA) under the Insurance Business Law and comprises a number of formal insurance companies and co-operative insurers known as *Kyosai*. The minimum initial capital requirement for a formally regulated insurance company is ¥1bn (approximately R55m). There are two forms of *Kyosai*:

- The first is generally larger, and is regulated under various pieces of co-operative legislation and by various ministries, but is exempted from Insurance Business Law. Regulated *Kyosai* generally provide welfare benefits to employees of individual companies or to civil servants in local governments. They exist for the benefit of members and are generally operated as co-operatives (i.e. not for profit).
- The second form is smaller and completely unregulated (both from the insurance and co-operative perspective). Unregulated *Kyosai* are often run for profit as enterprises owned by individuals,¹⁸⁰ but can also be run entirely as co-operatives for the benefit of their members. Both forms of ownership are considered legal. Interestingly, unregulated *Kyosai* are often reinsured, though access to reinsurance may become less available in future due to problems discussed below. Unregulated *Kyosai* currently have a substantial market share in the Japanese insurance industry due (at least in part) to the fact that their premiums are generally lower than those of formal insurance companies.

Both forms of *Kyosai* offer a wide variety of short-term and long-term products (including life insurance, annuities, fire insurance, personal accident insurance, auto insurance and medical insurance) that compete directly with those of regulated insurance companies. Both *regulated* and *unregulated Kyosai* are not deemed to conduct insurance business (and are therefore exempt from insurance regulation). This exemption is based on the requirements that membership must be voluntary, payments to members must be “negligible” and the *Kyosai* must target a “specific group of people”¹⁸¹ or people in a specific region. Where regulated, *Kyosai* fall under various laws applicable to co-operatives, including:

- The Agricultural Co-operative Society Law
- The Consumers’ Livelihood Co-operative Societies Law
- Law on Co-operatives of Small and Medium Enterprises

Different ministries in the Japanese government are responsible for the regulation of each insurance co-operative falling under each of these pieces of legislation. The Ministry of Agriculture, Forestry and Fisheries supervises insurers under the first piece of legislation, the Ministry of Health, Labour and Welfare administers the second law and the Ministry of Economy, Trade and Industry administers the third.

An interesting development in this market has been the agreements that have been struck between *Kyosai* and formal reinsurers. This greatly enhanced the risk profile of this sector, but was based on the tenuous legality of *Kyosai*.

All the factors described above have resulted in strong growth in the *Kyosai* market, where *Kyosai* have been able to undercut the rates of formal insurance providers. *Unregulated Kyosai* have also become a problem, due to both their growth in size and product innovations. For instance, one *Kyosai* offers products to “anyone with the spirit of loving animals”, another to anyone owning pets. The products of these groups are often marketed publicly, in contravention of the requirement to be marketed to specific groups. Additionally, many of these

¹⁷⁹ Financial services authority (FSA), Japan, <http://www.fsa.go.jp/refer/ins/kyosai.html>

¹⁸⁰ This form of *kyosai* is no longer co-operative in structure; the term *kyosai*, nevertheless, generally continues to connote the concept of a co-operative.

¹⁸¹ This is derived from the definition of insurance business: Article 2 of the Insurance Business Law reads (emphasis added by Genesis): In this “insurance business” means the business of writing, without reference to any specific groups of persons, insurance mentioned in paragraph 4 or 5 of following Article (Reference: “The Insurance Business Law of Japan”, The Non-Life Insurance Institution of Japan, 2002)

Kyosai make use of network marketing, as each member effectively becomes an agent for the scheme and is paid a commission for each new member they sign up. This has the potential to develop into a pyramid scheme, and therefore poses risks to the consumer (ACCJ, 2004). This growth has resulted in concern from the regulated insurers who, justifiably, feel that they are being undermined as regulated providers of insurance products. In addition, increasing concern about the legality of Kyosai has led to the withdrawal of formal reinsurers¹⁸² from this segment of the market, which increases concerns about the risk carried by the market.

Japan has, consequently, initiated a process to review the regulation of Kyosai. The issue was raised in the Diet in 2003 and the Second Subcommittee of the Financial System Council is currently discussing the issue. Insurance associations have also submitted proposals to the regulator in this regard.

There are several parallels with and lessons for the South African market:

- The absence of a clear definition of the operational nature and legal structure of Kyosai has resulted in it being abused for commercial purposes and to avoid insurance regulation. Allowing this to continue undermines the regulated sector by providing the Kyosai with an unfair cost advantage, which stems from the fact that they are not subject to the same reserving, solvency and other regulatory requirements placed on regulated insurers. They are also paying their agents more commission than would be considered acceptable for a regulated insurer. A major difference between Kyosai and burial societies is, therefore, that the latter is member-governed and not-for-profit by definition. This is an important distinction to clarify and maintain as it prevents the abuse of such institutions for commercial gain.
- Kyosai (including unregulated Kyosai) offer a wide range of short-term and long-term products, which are in direct competition to the formal insurance market and have substantial market share. Exemption from insurance regulation based on the vaguely defined nature and status of Kyosai has led to regulatory arbitrage, which has substantially distorted the market for insurance. This illustrates the potential of such institutions to provide services to lower-income households, but also illustrates the rapid growth of a market where a commercial opportunity is created through a regulatory loophole. Care should be taken in defining any exemptions under insurance legislation to anticipate market developments as a result of such exemptions.
- The lack of definition in the regulation of Kyosai creates uncertainty on the point at which the market becomes regulated. This makes regulation difficult to enforce, and makes it difficult for the formal and informal sectors to interact.
- Spectacular growth suggests demand for services not currently being fulfilled by the commercial sector. It also suggests that the cost of provision through the regulated sector may be high (partly due to regulatory costs).
- Dividing regulation amongst various ministries makes it difficult to apply it coherently and consistently. The ministries involved are, furthermore, not in a position to regulate financial services, which increases the potential for abuse. Care should therefore be taken to ensure consistent regulation of markets and to ensure that the regulator is capable of regulating the markets assigned to it.
- Kyosai have extended their products beyond funeral insurance to also provide medical and other insurance. The burial society model could similarly expand to serve a broader range of needs, and current and future regulation should take this into account.
- Kyosai have forged relationships with reinsurers, which worked well in management of the risk and facilitating the development of these institutions. Regulatory uncertainty with regards to the legality of Kyosai has, however, led to a withdrawal of the reinsurers, who are concerned that their reinsurance agreements may be in contravention of the law. Thus lack of regulation has increased prudential risk to the sector.

¹⁸² The Society of Lloyds (UK) has recently instructed its underwriters and brokers not to accept reinsurance from unregulated Kyosai.

Box 6. The potential of burial societies as micro-insurers

Questions have been raised over the longer term development potential for burial societies in terms of both funeral cover and as broader micro-insurers, and in terms of the potential formalisation of the market.

Development as providers of funeral cover

There are two options to develop the funeral cover provided by burial societies: develop as a standalone entity or as intermediary of a formal insurer.

The nature of burial societies: on the first question, it is necessary to re-iterate the core nature of burial societies. Most burial societies do not contractually guarantee benefits. They are therefore not considered to be insurance schemes (where transfer of risk takes place from the insured to the insurer), but rather risk sharing schemes between members. Risk transfer is only possible to the extent that the funds pool can cover it, and this is known to and managed by the members. The burial society mechanism can also be described as an expenditure-targeted income stabilization scheme, with funeral cost the expenditure being targeted as well as the trigger for benefits to be paid out. The burial society is able to absorb fluctuations in the income of its members as long as those who cannot pay in a specific month are limited in proportion to the total pool of members. Members usually make up lost payments when income becomes available. As a risk mitigation measure, there is usually a limit to the number of payments a member can miss (usually between six and twelve months).

In many cases, the premiums paid over the life of a member may equal or be close to the value of benefits claimed (where the acceptable 'excess' of premiums over benefits may be the value that the individual places on the community and the 'helping hands' aspect of the society). This works as long as the member-governance and community ties are strong enough to ensure that people do not exit once they have made a number of claims. The structure suggests that most burial societies rely on their informal nature and member-governance as a core aspect of risk and fund management.

Formalisation of this through contractual funeral insurance arrangements (both insurance and re-insurance) may, therefore, remove the ability to manage funds and combined financial risk. At the same time, burial societies do show a natural growth path (see Box 0 on the Great North Burial Society), which normally entails the joining of burial societies into a secondary burial society (where risk is pooled for members, who are burial societies) and later also potentially into federations (with secondary burial societies as members and concomitant pooling of risks). This results in a gradual broadening of the risk pool, without undermining the core functioning of the individual burial societies. Interestingly, however, this process sometimes leads to a natural formalisation of contracts with members, at which point the burial society transforms into a pure insurance scheme (as has happened in the case of Great North Burial Society). At such a point of formalisation, it becomes possible for the burial society to interact with the formal system without undermining the society.

Burial societies as intermediaries: alternatively, some burial societies choose to become intermediaries for formal insurers, and simply form a bargaining group of members to interact with the formal sector. This changes the nature of financial management in the society dramatically, as most funds are transferred to the insurer with only a small proportion remaining under the society's management. Although the reduction in risk may be beneficial to the society, the removal of flexibility also potentially undermines the social and adaptive role that the society generally plays.

Beyond funeral insurance

While it is possible that burial societies can extend their cover to include other risks, there are a number of complications in doing so. Two important questions need to be considered:

Why has this not developed as a natural consequence of the needs of the community, as funeral insurance did? Some other applications of the burial society model have evolved, including wedding benefits, but these are very limited, have not been as well-tested as funeral insurance, and present substantial management risks to the society. This may suggest that other mechanisms for dealing with these risks, such as credit, are preferred, or that such risks can't be appropriately dealt with by the burial society model.

Is the nature of the risks compatible with the model of operation? To answer this, it is necessary to compare the operational and risk nature of other insurance categories with that currently offered by burial societies:

- *Simplicity:* the benefits offered by burial societies include cash and "helping hands" (administrative and physical) for a clearly defined single event (the death of the person covered). The most important part of this is often seen as the "helping hands" rather than the cash. This is very different to insurance of, for example, an asset loss. In such cases, the "helping hands" component is not relevant and value will depend solely on the cash benefit offered. Furthermore, in the case of general insurance, multiple claims are possible, which increases the management requirement for such a scheme. Covering general risks may also require the formalisation of guarantees around the benefits at an early stage of the society development.
- *Nature of cover:* death benefits provided by a burial society are intended to supplement the cost of a funeral and rarely cover the full cost where burial societies are not linked to an insurer. The benefit is also not explicitly defined relative to the cost of a funeral but in terms of an amount. Other insurance categories may require full cost cover or variable cover that is specified relative to the loss (similar to general insurance), and will have to be contractually guaranteed.
- *Value of benefit:* the funeral benefit paid by societies is equal for all members. General insurance pay-outs, however, will differ for each member and each claim.
- *Verifying claims:* risk events may be difficult to monitor for other insurance categories. Death is not easy to fake in a community where people know each other but even this occurs if distant relatives are covered. If the cover applies to small losses like items being stolen, this will be very difficult to verify and control.

The combination of the above suggests that care should be taken when interacting with burial societies and particularly in facilitating the extension of cover provided by societies. While it may be possible to achieve, it is not clear whether this is in the long-term interest of the society or within the capabilities of society structures to manage, and it may undermine the core function and existence of these societies.

Re-insurance

Re-insurance is a key issue when considering the development of the provision of funeral cover, as well as extending cover to other insurance categories. In the light of the discussion above, formal re-insurance may require the formalisation of contracts and operation of societies. As illustrated above, this may not necessarily be in the longer term interest of the societies. Where burial societies have naturally grown to this point (as was the case with GNBS), this may, however, be feasible and in the interest of the society to do.

11. SELF REGULATION

This section draws heavily on an excellent review of self-regulatory systems in the context of securities regulation, which was conducted by the International Organization of Securities Commissions (IOSCO), and the principles of which were closely followed in the design of securities regulation in South Africa. This is not intended to provide a detailed review of self-regulation internationally, but rather draws on the research done by IOSCO to highlight the salient features of successful self-regulatory regimes, as well as the underlying factors that drive their success or failure. Although IOSCO focuses on securities regulation, the analysis is relevant to financial markets generally. Furthermore, the self-regulatory model and principles set out by IOSCO have been applied to the regulation of the securities exchange in South Africa, which, like the insurance industry, falls under the jurisdiction of the FSB.

Securities regulation in South Africa. South Africa follows a hybrid self-regulatory model with respect to the regulation of its securities markets. The FSB, which in the person of its executive officer is also the Registrar of Stock Exchanges, regulates the exchanges. The exchanges, in turn, regulate market trading by regulating their members, the brokers, and are therefore known as 'self-regulatory organisations' (SROs). Regulatory coverage is ensured by the Stock Exchanges Control Act, which requires an exchange to play this self-regulatory role as a condition of licensing. Important features of the model as it applies to the Johannesburg Stock Exchange (JSE) are:

- The JSE is both a public company and an industry association owned by its members, the brokers.
- As with insurance intermediaries, brokers provide financial services relating to potentially complex products to the general public, who rely on the broker for advice.
- The JSE self-regulates within the framework set out by the FSB, which oversees the implementation of the model.
- The FSB remains responsible for regulating the industry in final instance.

The model used for securities regulation in South Africa is, as mentioned, based on that developed by IOSCO (see IOSCO, 1998 for further details). IOSCO reviewed the implementation of this model in May 2000 and have identified the following key elements as contributing to its success (IOSCO, 2000). A powerful finding from the review was that the elements identified apply irrespective of distinctions between different financial instruments regulated, market structure, nature of users (wholesale or retail), nature of transactions regulated or even the specific structure of the self-regulatory organisation:

- *Industry specialised knowledge:* in complex markets SROs are in the best position to understand the intricacies of the market and, therefore, provide a valuable source of expertise to the statutory regulator. This is particularly true

for industry association SROs, where the association is staffed by market players and has access to a network of market professionals.

- *Industry motivation*: self-policing systems work because of the business incentive to ensure fair, financially sound and competitive marketplaces. In order to ensure that such incentives are in place, SROs must be designed to prevent specific groups from dominating and abusing the SRO for self interest. In markets consisting of both dominant and very small players this can be achieved by, for example, allowing more than one SRO in a specific market sector. As a test of this, it is recommended that industry financing should be a major source of an SROs' overall funding.
- *Contractual relationship*: the benefit of a contractual relationship between an SRO and its members (which can extend beyond the statutory requirements), is that it can achieve wider regulatory reach, and allows for flexibility as it is easier to change member contracts than it is to affect statutory regulation.
- *Transparency and accountability*: any regulator (including statutory regulators) is subject to pressure from the industry regulated. Setting out clear rules on transparency and accountability will relieve some of this pressure and ensure the credibility of the SRO. This can be enhanced by, for example, public and private representation on the SRO board, and also provides motivation for on-going oversight by and communication with the statutory regulator.
- *Flexible SRO compliance programs*: this ensures that regulations remain relevant and keep up with market changes. Flexibility must, however, come with clear guidelines, objectives and oversight.
- *Coordination and information sharing*: SROs provide a good platform to bring together government, private sector parties and other interests on regulatory issues. Coordination amongst SROs is also important and can be achieved by developing a common definition of best practice.

IOSCO acknowledges that government oversight is an essential element of self-regulatory systems, in order to ensure all interests are served. Oversight should focus on resolving potential conflicts of interest, spot-checking SRO operation and providing enforcement support. SROs should be licensed by the regulator and the renewal of such license should not be automatic, but should depend on the performance of the SRO.

Other relevant points made by the review include:

- It is important to note that the objectives of self-regulation are similar to that of government regulation. IOSCO defines these as i) preserving market integrity (fair, efficient and transparent markets), ii) preserving financial integrity (reducing systemic risk) and iii) protecting investors (or consumers more broadly in the case of insurance regulation).
- Self-regulation is easier where it is pre-empted by voluntary organisation in the sector. In fact, the review found that in several jurisdictions across the world, effective self regulation existed before statutory regulation. With market

development, market participants recognised that regulation was necessary in order to protect the integrity of the market.

- SROs typically derive their authority from statutory delegation of power to a non-governmental entity.
- The self-regulatory model allows for more than one SRO in a market sector.
- Establishing a self-regulatory system is intended to achieve appropriate regulation rather than more regulation.
- Self-regulation is not a form of deregulation and should not be seen as such.

Should self-regulation be introduced in the assistance business market: We are not convinced that self-regulation is appropriate for the assistance business market in South Africa. Firstly, self-regulation is not the same as the absence of regulation because there is no need to regulate. The current dispensation applicable to most burial societies therefore cannot be described as self-regulation. Secondly, when the above analysis is applied to the sub-sector most in need of regulation, i.e the funeral parlour market, we find that a number of the characteristics for successful self-regulation are absent. Our research has not revealed a strong business incentive to “ensure a fair, financially sound and competitive marketplace”. In fact, many market players deliberately implement business practices, such as not being prepared to make a monetary payment in lieu of actual services, designed to limit competition. Moreover, the level of voluntary membership of industry associations is not sufficient to facilitate self-regulation.

Box 7. Reasons for incorporating self-regulation into statutory regulatory frameworks (adapted from IOSCO, 2000:13)

- The statutory regulator has limited capacity and cannot regulate the multitude of players in the market
- Self-regulation has a long history of working effectively in markets with complex financial products
- SROs possess the flexibility to adapt to regulatory challenges in a rapidly changing business environment
- SRO contractual relationships can reach across international and market boundaries
- Industry input and representation contribute to a strong and effective compliance culture
- Self-regulation generally imposes fewer costs than government regulation
- SROs provide an intimate knowledge of the markets and products

12. PROPOSED REGULATORY FRAMEWORK

The regulatory framework proposed for the assistance business market in this section is based on the market analysis contained earlier in the report, our understanding of the current regulatory environment and enforcement capacity as well as developments elsewhere in the world. Our core motivation is to ensure the sustainable development of arguably the largest, in terms of beneficiaries, financial services market in South Africa that meets one of the most deeply felt needs in our society.

The core pillars of our recommended framework are the following:

- Create a dedicated funeral insurance licence, with lower compliance requirements, that will allow smaller players, such as funeral parlours, to enter the formally regulated market;
- remove burial societies and funeral parlours from the operation of the Friendly Societies Act (to the extent that it does apply to them);
- leave the risk pooling financial service provided by burial societies effectively unregulated;
- clarify the legal personality of burial societies by incorporating them under the new co-operatives legislation; and
- enforce the new regulations governing the provision of advisory and intermediary services to the market players in the assistance business market.

It needs to be pointed out that the changes above, although necessary, will not be sufficient to address the market failures identified if the right to monetary benefits and health regulations applicable to funeral parlours are not sufficiently enforced (see Box 2).

12.1. A DEDICATED FUNERAL INSURANCE LICENCE

In our view the existing registration and reserve requirements imposed by the Long-term Act constitute an overly-prohibitive barrier to entry into the assistance business market. This keeps relatively smaller players, including funeral parlours, administrators and some larger, established burial societies, out of the market. In addition, the institutional requirements imposed on insurers mean that co-operatives, friendly societies, close corporations and private companies cannot become insurers, without first converting into a public company. The requirement to employ a full time actuary, an expensive undertaking, adds height to this barrier.

During our research we encountered a number of larger burial societies and funeral parlours who are eager to write assistance business but who are unable to meet the requirements of the full life licence. They are thus forced to seek underwriting for funeral business from established insurers. It would seem that the FSB may be

nervous about the potential growth of HIV/AIDS risk in this market and prefers to err on the side of being overly-conservative in its licensing requirements. We believe that the facts tell a different story and that there is a strong case for lowering the licence requirements in the assistance business category:

Assistance business written as short term business: with the exception of assistance benefits linked to life policies, our research revealed that throughout the sector – funeral parlours, administrators and formal insurers – assistance policies are written on the same basis as short term insurance. Their risk character is therefore very different from that of life and other long-term policies, meriting a different approach. Assistance business risks can be managed, and are indeed so managed by all the market players, on a short-term basis (i.e. with simply defined reserves based on the previous year's risk experience) and does not require more complex reserves and actuarial evaluation (see Box 8).

Box 8. The nature of risk in the assistance business market

Although funeral insurance is sometimes *sold* on an individual basis (i.e. the individual is not required to be a member of group), most policies are *assessed and underwritten* on a group basis. The implication is that the risk of individual lives is not assessed in underwriting the policy and the premium is based on the risk of a group of lives. Premiums are adjusted based on the actual risk experience of the group, which, in turn, implies that the premium will be adjusted on a periodic basis. This will vary based on the contract but generally ranges from one month to twelve months. These groups can either be voluntary or compulsory and the same principles apply to illegal insurance written by funeral parlours or administrators as well as insurance cover provide by burial societies to members (where benefits are guaranteed).

Risk of being tied to contract: Under the Long-term Insurance Act, a formal insurer cannot cancel the policy (only the policyholder can). The implication is that the insurer is tied to the risk assumed and the price has to take into account the change in risk of the life insured over the period insured. With funeral policies, insurers get around this by writing policies with one month contract periods and which are renewable on a monthly basis. In this way, the insurer can simply refuse to 'renew' the policy at the end of the month, instead of having to cancel it. The implication is that the liability is limited to the period for which the premium was paid and that, similar to short-term insurance, premiums not paid out to claims/expenses less claims incurred but not yet settled, reflect profit for that period.

Illegal funeral parlour and administrator schemes use the same method of short contract periods to hedge their risk. Where institutions are dealing directly with the public (i.e. not through an intermediary which the public may perceive as the product provider), there is a risk that using these hedges may result in a loss of reputation (e.g. if the premiums are increased too often or by too much). Although the immediate financial liability can be limited, the risk of losing market share

remains.

Liability due to build-up of policy value: Most formal assistance business policies do not have any build-up of value, which further reduces the liability to the policyholder. If a policy do have a build-up value, it usually only returns a proportion of the premiums paid and, therefore, does not guarantee a rate of return. No policies under illegal insurance schemes have build-up values.

Risk of systematic changes in the risk pool underwritten: The insurer has to deal with the risk that the risk pool underwritten may be systematically changing. This is particularly true of voluntary group schemes where anti-selection may result in a systematic deterioration of the pool. If this goes unmonitored, the insurer may find a build-up of risk that is not reflected in the premium income. Where it is monitored, the risk is that, a deterioration in the book (for whatever reason), will force premium increases (or reduction in benefits), which may eventually lead to the product pricing itself out of the market. Alternatively, the gradual increases in price may result in clients moving to another insurer before potential previous losses have been recovered. To prevent this, insurers have to carefully manage entry into risk pools to prevent the complete deterioration of the risk pool and must carefully select the risk pool within which to underwrite a specific life. Although formal insurers have strict rules and formulae in this regard, they are generally not in touch with the client base (particularly where dealing through intermediaries like funeral parlours and administrators) and can only monitor the risk through the claims experience. Funeral parlours and administrators are generally more in touch with their client base (and risk trends) and very adept at screening and managing entry into the scheme. However, because of the short-term nature of the liability assumed, the risk assumed by both formal and illegal schemes is limited.

Risk of sudden changes in the risk pool underwritten: The major risk facing assistance business is the risk of a sudden shock to the risk experience of the pool, which was not priced for and results in a large number of claims in a single period (e.g. a natural disaster). Although HIV/AIDS is often placed in this category, this is not strictly correct. Unlike natural disasters, HIV/AIDS does not result in a substantial increase in mortality overnight, but will rather result in a gradual (be it rapid), increase in the mortality experience of the group over time. It is, therefore, simply the acceleration of an existing risk trend (similar – although more dramatic – to the effect of increased crime on short-term insurance). This trend is also predictable. The ASSA model takes HIV/AIDS as well as demographic factors into account and allows insurers to price for their exposure to this risk without having to assess individual lives. In formal insurance, this risk is also managed through re-insurance, which spreads the risk over a wider pool of people than will be affected by such a risk experience shock. This is similar to short-term insurers re-insuring disaster risk. Illegal insurance schemes do not have access to re-insurance under the current legislation and, consequently, this is the major risk faced by such schemes.

Ability to manage risk: This aspect is particularly important in considering the difference in risk between formal and illegal or informal insurance schemes. Some

key differences in their ability to manage risk are noted below:

- Formal schemes are forced to put reserves in place. Illegal schemes mostly do not do this and often re-invest premiums into their business (particularly funeral parlours).
- Informal and illegal schemes are generally substantially smaller than those of formal insurers and their risk diversification in the pool is, consequently, limited. As a result, smaller shocks that formal insurers would be able to absorb if it does not affect a substantial proportion of the pool will be difficult for these schemes to manage.
- Illegal schemes are often more in touch with their market and can screen risk better. They are also generally better at premium collection in the lower-income or cash market, which reduces the risk of lapsing and ensures retention of clients.
- Illegal funeral parlours schemes limit their financial liability to clients by stating the benefits in terms of a service (which includes a substantial profit margin for the parlour) and by refusing to offer clients the option of a monetary benefit. Enforcing the option of a monetary benefit will change the viability of their model dramatically.
- Unlike other insurance schemes, burial societies (particularly the smaller ones) mostly do not contractually guarantee benefits to members. Benefit levels are agreed amongst and managed by members and can, therefore, be adjusted in response to the risk experience of the group.

The implication of the above is that the risk underlying funeral insurance (where there is no policy value build-up) is quite similar to that of short-term policies. It is, however, more restricted in terms of the number of claims expected per policy (one claim per life covered rather than multiple claims as with, e.g., household insurance) and the value of the benefit (limited to R10 000 for funeral insurance). HIV/AIDS will result in a faster deterioration of the insurance pool than and equivalent trend, say the increase in crime, will do for short-term insurance. However, except in cases of severe anti-selection, the risk can be managed through pricing appropriate to the risk group and utilising re-insurance. In addition, although it seems possible for unregulated funeral insurance schemes to manage the day-to-day risk of the pool, they are not geared for dealing with sudden shocks to the risk experience. This could be dealt with through re-insurance if the regulatory system could allow such a relationship.

Formalise the informal sector: the stick approach to the formalisation of an essentially informal financial sector seldom works. It is much better to make formalisation both desirable and achievable.

HIV/AIDS: There is little evidence that players in the informal market, especially larger funeral parlours, are in fact unable to manage the risk of HIV/AIDS. They are able to use very similar methods to those of formal insurers to manage the risk, i.e. short contract periods, waiting periods and differentiated pricing. The risk

management techniques of at least the more established funeral parlours and administrators are therefore of a sufficient standard for a market of this nature.

Market development: The formalisation of especially funeral parlours holds great potential for the development of the financial services market generally. As their risk management and financial management skills grow and they are forced to comply with FSB standards for the rendering of financial advice and intermediary services, they will gradually, as is already the trend, become distributors for other financial services as well. Such culturally friendly and trusted financial services providers are in great need in the low income communities of South Africa. We must add, though, that not all or even most funeral parlours currently offering insurance products illegally will be able to successfully register for the dedicated funeral insurance licence proposed here. Neither is it desirable. Only the larger funeral parlours that are able to implement basic risk management and separate their insurance business from their provision of funeral services will qualify.

The current requirements of the Long-term Act as well as the further requirements of the FSB, compared with the proposed requirements of the dedicated funeral insurance license are reflected in Table 11.

	Licence under Long term Act	FSB policies (per FSB guidelines issued 15 January 2004)	Proposed dedicated license
Application Procedure	Application to FSB (Section 9)	NA	Application to FSB
Registration capital	Requires adequate "financial resources" (Section 9 (3)(b)(i))	R10 million share capital on registration required	Reduced requirement to be established through interaction with potential entrants. This must take into account the size and nature of the institutions.
Capital Adequacy Requirement	Must maintain business in "financially sound" condition (Section 29)	The greater of R10 million or 13 weeks' operating expenses required (in theory, FSB has discretion to relax requirements in specific cases) (Section C (6.2))	CAR based on the registration requirement or 13 weeks' operating expenses should allow for entry and scalability
Institutional requirement	Public company <i>or</i> incorporated without share capital under a law providing specifically for it to carry out long-term business as its main object (Section 9 (3)(a))	Same (Section C (2.1))	Companies, public and private, co-operatives, and close corporations, but see financial reporting requirements below
Public officer	Must appoint a public officer to ensure the insurer complies with the Act (Section 16 (1)(b))	Must appoint a public officer (Section C (5.1))	Must appoint a public officer
Auditor	Must at all times have an auditor (Section 19 (1))	Must at all times have an auditor (Section C (7))	Must at all times have an auditor
Actuary	Must at all times have an statutory actuary (Section 20) and all policies must be "actuarially sound" (Section 46 (a))	Must at all times have a statutory actuary (Section C (8))	Need not have an actuary
Fiduciary requirements	As per sections 30 – 34 of the Long-term Act in terms of prescribed assets and liabilities	At least 90% of distributable profits must be allocated towards increasing benefits payable under the policies (Section C (3)(i))	Appropriate guidelines to be developed
Financial reporting	Returns in the prescribed format to be submitted to FSB (Section 36)	-	Simplified returns to be submitted to FSB, even though certain institutional forms may not require public financial reporting.

	Licence under Long term Act	FSB policies (per FSB guidelines issued 15 January 2004)	Proposed dedicated license
Risk management	Insurer liabilities contingent upon life events occurring during the policy period, which usually exceeds 12 months (Section 1). Premiums, benefits and other values calculated based on probability of life events occurring (Section 46).		Insurer liabilities contingent upon death occurring during contract period that does not exceed 12 months. Premiums, benefits and other values based on the claim history in respective risk pools.
Limits on benefits payable	R10 000 (Section 1 (ii))	-	R10 000 ¹⁸³
Commission capping	Commission to intermediaries capped (Section 49) but not for assistance business (Part 3 of the regulations)	-	Commission not capped
Consumer protection	Various requirements under the Act	Policyholder Protection rules issued under Section 62 of the Act	Option of policy benefits as a sum of money must be provided. Should ensure sufficient disclosure (through FAIS/PPR).

Table 11: Requirements of current assistance business licence compared to requirements of proposed dedicated funeral insurance licence.

As to the implementation of such a dedicated licence, we make the following recommendations:

- The licence must apply to funeral insurance only, and not also to other life business. The risks for other life business are managed on a different basis and require different treatment.
- The intention is not to create a bifurcated market where smaller players have in-built cost advantages due to lower compliance requirements. Large current insurers dealing in assistance business should have access to the dedicated funeral insurance licence as well provided that they conduct this business under a separate business entity susceptible to regulation and supervision. However, as soon as an insurer wishes to offer funeral and life insurance as a combined business, they should comply with the full requirements of the Long-term Act.
- Similarly, the burial societies that have mutated to providers of guaranteed benefits, funeral parlours and administrators should all have access to this licence.
- The licence can be implemented via amendments to the Long-term Act or even in stand alone legislation.
- This dedicated licence should also be subject to the CAT standards being developed as part of the implementation of the Financial Sector Charter.

It must be noted that care should be taken in consideration the risk nature of policies with paid-up values or build-up values as these have a different risk nature to pure risk products and may require actuarial support to ensure that these are sufficiently provided for. Further research is required to establish whether mechanisms exist through which these risks can be managed without continued

¹⁸³ We have not found compelling evidence to suggest that the R10 000 limit is inappropriate. It seems high enough to facilitate the cost of funerals in the market.

actuarial support or whether these products should be dealt with separately under the new licence.

12.2.

AN APPROPRIATE REGULATORY REGIME FOR BURIAL SOCIETIES

Burial societies mitigate one of the most strongly felt risks in South African society. Inappropriate regulation would stifle the activities of these important social and economic bodies.

Do not regulate risk pooling by burial societies: A core finding of this study is that the vast number of burial societies do not provide insurance services to their members as this term is currently defined in our law. Rather, they provide a form of risk pooling without guaranteeing any benefits. To the extent that problems do arise in burial societies, they normally revolve around outright theft of funds, and there is little a regulator can do to control such criminal conduct. Moreover, the reality, considering that there are 80,000 to 100,000 burial societies in existence in South Africa, is that the regulator does not have the capacity or resources to regulate and enforce compliance on all burial societies. Neither is it necessary. As long as the governance of a society remains closely linked to those who receive the benefits and the prudential risk and risk to members remain low, there is little need for regulation and recourse to the criminal courts must suffice.

Corporate governance within burial societies – the new Co-operatives Bill: as burial societies grow, which is not necessarily the case for all, a time comes when there is an effective divorce of ownership and management, when governance is no longer closely linked to those who receive benefits, and when the internal management of the society becomes inscrutable. The inflow and holding of income and assets at this point may also become significant, and mechanisms of member-governance and self-regulation may break down. The opportunities for exploitation and abuse increase significantly. From this threshold, it is appropriate that the corporate governance of societies be more closely regulated to control potential maladministration and abuse. At this point, therefore, the common law institutional form of the voluntary association becomes inappropriate and stifling and a statutory alternative needs to be found.

Unless the burial society actually provides insurance (which is the exception), it does not qualify as a friendly society and the Friendly Societies Act therefore does not provide a solution to the corporate governance problem. We recommend that the appropriate institutional form for such a burial society to adopt is indeed that of the co-operative, because it is a co-operative in its very nature. Burial societies should therefore be included in the new Co-operatives Act, with the following provisos: (1) registration should not be compulsory, only once burial societies reach a certain size commensurate with the point where member governance is replaced by distant management (from a regulatory perspective, it would probably be more practical to find an appropriate proxy for this threshold, such as membership size or turnover); (2) the functional regulation of burial societies that do provide insurance, as opposed to risk pooling, should remain with the financial

regulator; and (3) the specific terms of the draft Co-operatives Bill should be tested against the reality of the burial society phenomenon.

Inclusion of burial societies under the Co-operatives Act will also provide larger, more ambitious societies with a legal form that is robust enough to allow their evolution into more sophisticated financial institutions.

Remove burial societies from the Friendly Societies Act. The implication of the previous recommendation is that the Friendly Societies Act should no longer apply to burial societies that do provide insurance products. The Friendly Societies Act does not provide the development forms of the co-operative model. Moreover, it is better to unify all burial societies under one statute, rather than to discriminate on the basis of who provides insurance and who do not.

The provision of insurance by burial societies: We recommend that burial societies that do provide insurance be required to apply for the dedicated funeral insurance licence recommended in the previous section.

12.3.

REGULATING THE “SOFT MIDDLE”

The market segment occupied by funeral parlours and administrators is characterised earlier in this report as the “soft middle” – where most of the abuse takes place and there is least enforcement of current regulations. It is here where the proposed regulatory regime needs to be most incisive.

New dedicated funeral insurance licence: Our core proposal for dealing with this market is the creation of the new dedicated funeral insurance licence that will reduce the entry requirements into the formal market as well as the compliance burden (see section 12.1 above). This licence will be available to both funeral parlours and administrators. Underlying this proposal is the principle that funeral parlours need to separate their funeral services business from their insurance business. The former is the provision of a service tied in with the sale of various products. It should be regulated by the health authorities. The latter is a financial service and requires regulation for all the reasons enumerated in this report. If funeral parlours are not prepared to register under the reduced requirements, they should ensure that their policies are underwritten by an insurer that is registered or limit themselves to the provision of funeral services only.

Enforcement of the option of a monetary benefit. The enforcement of this provision, which is part of the Long-term Act and also recommended for inclusion in the new dedicated licence, must be a key plank in the strategy to clean up this market. It will increase competition and have a beneficial impact on pricing.

Enforcement of FAIS: We do not recommend any regulation additional to the current provisions of FAIS and the Codes of Conduct issued in terms of the Act. The only possible change could be the promulgation of a code of conduct dedicated to the assistance business market. However, we do recommend the

vigorous enforcement of FAIS. Obviously insurers holding the new dedicated licence (and their intermediaries) will be subject to FAIS.

12.4.

FORMAL INSURERS

Formal insurers are heavily regulated. No additional regulation is recommended, with the following provisos:

- Currently registered formal insurers who are registered to provide assistance business policies only, should be allowed to convert to the new dedicated licence.
- The development of appropriate CAT-type standards under the Financial Sector Charter can contribute greatly to ensure that the products marketed by formal insurers to especially the low income market is suitable for that market.

13. ENFORCEMENT

Many of the problems identified in this report are not so much due to the absence of regulation as to the failure to enforce existing regulation. Consequently, the analysis suggests that a clear enforcement strategy must be implemented for the enforcement of both current and future regulation.

Several regulatory and enforcement agencies can be brought to bear on the assistance business market, each with its own focus and current enforcement initiatives:

- *Insurance (FSB)*: the insurance regime described above is currently focused on formal insurers, intermediaries and unregistered insurance schemes. However, as we have described, the FSB has limited capacity to enforce regulation. As a result they tend to focus more on the most serious contraventions of the legislation in the formal sector of the market which is easier to police. Accordingly, the burial society and funeral parlour components of the market have been effectively left unregulated by the FSB. The introduction of FAIS will introduce a useful weapon into the FSB's armoury but its effectiveness still depends ultimately on how well it is enforced. Clamping down on illegal insurance schemes is quite difficult as they are easy to conceal (for example, an administrator might place part of its book with a formal insurer while keeping the remainder secretly on its own books). This practice would be harder to hide if enforcement was co-ordinated with enforcement of tax regulation (see below).
- *Health (Department of Health as well as provincial and local government health departments)*: health regulation on funeral parlours is currently characterised by weak enforcement. Even basic registration requirements are not adhered to resulting in a substantially unregulated and unknown industry. The national Department of Health is in the process of decentralising powers to municipal level, which may improve regulation where municipalities have the resources to enforce (Box 2 provides an example of a municipality, Mogale, that has taken a stand on health regulation). Enforcing insurance regulation on funeral parlours in the absence of an operative health regulatory framework will be difficult and it will be in the insurance regulator's interest to coordinate with and support initiatives to improve health regulation.
- *Tax (SARS)*: the South African Revenue Service (SARS) has substantial capacity for enforcement and also has a direct financial incentive to enforce tax regulation on funeral parlours and other players in this sector. In the effectively unregulated components of the assistance business market, it is also reasonable to expect that the institutions involved will be prone to tax evasion. SARS have recently been involved in random inspections of funeral parlours for tax compliance. The information gathered by SARS could be cross-referenced with FSB information to identify illegal insurance schemes run by untaxed entities.
- *Fraud and other crimes (SAPS and Scorpions)*: the South African Police Services have limited capacity to deal with complicated fraud and insurance

legislation but, following the public outcry around hygiene issues, have recently moved to enforce health regulation in the funeral parlour market. The Scorpions (under the National Prosecution Authority) are involved in more complicated fraud and insurance cases. Both of these agencies are essential partners to the regulators but in turn require substantial support due to the often technical nature of the crimes. Co-operation would thus be beneficial to both sides.

The effectiveness of these agencies could be greatly enhanced and resources better allocated through effective co-operation. Our submission is that enforcement of these applicable regimes would benefit greatly if the responsible agencies could combine forces and spearhead *joint enforcement operations*. At the most basic level this should entail an information sharing agreement amongst the agencies involved. It might also entail a greater use of the Commercial Court network. In the past prosecution efforts have at times been undermined by a court system that is not well versed in the commercially technical nature of the legislation involved. In 2000 a number of regional commercial courts were established, as part of the existing court infrastructure but with a mandate to deal only with cases of a commercial nature. Commercial courts have to date been established in Pretoria, Johannesburg, Port Elizabeth and Durban.

In conclusion, we suggest a number of components to an immediate enforcement strategy:

- SAPS and Health department should enforce basic health regulation.
- FSB, SARS and Scorpions should co-ordinate a crack-down on more complicated illegal insurance schemes (dealing with fraud, contravention of insurance legislation and tax evasion).
- FSB, SARS and municipal health departments should form a working relationship to share information and co-ordinate interventions.
- All enforcers should capitalise on the current political will generated by the parliamentary committee hearing on “abuse” in the market.
- Using the Commercial Courts if necessary, the FSB should secure a number of high-profile and well publicised convictions in the enforcement of the regulations regarding writing unlicensed business.
- The FSB should enforce FAIS vigorously - it represents a fresh start that allows the regulator to gain control over problematic “middle” parts of the market that have previously been effectively unregulated.
- The FSB should enforce the new PPR rules on assistance business group schemes vigorously. The proposed rules will prevent the arbitrary movement of books from one insurer to another by administrators, and enforcement of the rules will be an essential part of gaining regulatory control over the assistance business market.
- The FSB should focus on educating consumers of their right to a monetary benefit and other key issues relating to insurance like the difference between registered and unregistered insurance, and the consumers’ right to disclosure,

through the initiation of a media campaign. The focus groups conducted as part of this study illustrate the power and effectiveness of media like newspapers and radio in reaching the lower-income client base.

- *Complaints procedures:* Informing consumers of their rights is of little use if they do not have access to a complaints line or institution to report abuses. Although a complaints handling mechanism is in place for the long-term insurance market, it is not currently working effectively: the existing complaints handling system is split between the FSB, focusing mostly on illegal insurance issues, and the Long-term Insurance Ombudsman, focusing on complaints related to contractual issues. Many of the problems described in this document, however, do not fall into either of these categories (e.g. the right to monetary benefits) and, therefore, slip through the cracks. The Ombudsman is a voluntary body and only applies to the members of the LOA whereas the problems described above will definitely extend to all formal insurers (irrespective of LOA membership) as well as funeral parlours, administrators and other intermediaries, which do not fall within the scope of the complaints handling system as it stands. The current complaints mechanism is not marketed widely and most lower-income clients will not be aware these services. The system should be reviewed to determine its efficacy and the best manner to deal with the broader spectrum of complaints related to funeral insurance.

14. CONCLUSION

It is clear that the market for funeral cover is substantial and that it is extensively used by lower-income, and particularly Black, households. The market consists of a large number of providers and intermediaries, many of which are effectively unregulated, which raises concerns over the potential for abuse.

The purpose of this analysis was to provide a systematic review of the funeral cover market providing insight into the market dynamics, the nature and categories of the players involved as well as reviewing the current regulatory regime governing the funeral insurance market. In particular, we were tasked to evaluate the efficiency of the current regulatory regime, provide insight into the current nature and extent of abuse in this market and propose a high level regulatory framework to deal with these issues.

Some of the key findings underlying the current functioning were shown to be:

- There are substantial market failures in the market for funeral services and insurance and these are at the cost of a large number of poor households;
- These failures are to a large extent due to the non-enforcement of existing insurance regulation providing policyholders with the right to a monetary benefit as well as the existence of a “soft-middle” of funeral parlours and administrators that are effectively unregulated;
- Current insurance regulation (in design and application) does not provide adequate protection to lower-income households. At the same time, however, it is overly onerous in its requirements and does not facilitate the sustainable development of the funeral insurance market;
- The efficient regulation of the funeral insurance market is closely related to and dependent on the health regulation of funeral parlours;
- Burial societies fulfil a vital role in supporting grieving families and providing towards the expenses and administration of the funeral. The member-governance structures of these societies are effective in managing their risk in an essentially unregulated environment; and
- Most burial societies do not offer insurance.

The high-level regulatory framework proposed includes the following:

- Create a dedicated funeral insurance licence, with lower compliance requirements, that will allow smaller players, such as funeral parlours, to enter the formally regulated market;
- remove burial societies and funeral parlours from the operation of the Friendly Societies Act (to the extent that it does apply to them);
- leave the risk pooling financial service provided by burial societies effectively unregulated;

- clarify the legal personality of burial societies by incorporating them under the new co-operatives legislation; and
- enforce the new regulations governing the provision of advisory and intermediary services to the market players in the assistance business market.

Due to the complexity of the insurance environment and the risk of creating further distortions through inappropriate regulation, it is recommended that the impact of the proposed changes should be carefully assessed before embarking on a process of legislative changes. At minimum the following three checks are recommended:

- Test the proposed dedicated funeral insurance licence with the regulator for regulatory consistency and actuarial soundness of the principles proposed;
- Interact with key insurance and actuarial experts to operationalize the design of the dedicated licence within the broader insurance regulation framework and test the implications for the existing market and players; and
- Test the attractiveness and implications of the proposed regulatory changes for potential takers of the licence.

If the above checks indicate in favour of the proposed changes, the process of drafting the revised legislation can commence.

We further recommend that the drafters of the Co-operatives Bill consider the findings and recommendations of this report and its implications for the Bill.

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GLOSSARY

ASSA	Actuarial Society of South Africa
DTI	Department of Trade and Industry
FAIS	Financial Advisory and Intermediary Services
FFSA	Funeral Federation of South Africa
FSP	Financial Service Provider
GAF	Group Administrators Forum
GFUA	Gauteng Funeral Undertakers Association
GNBS	Great North Burial Society
IFDA	Independent Funeral Directors Association
ILO	International Labour Organization
IOSCO	International Organization of Securities Commissions
JSE	Johannesburg Stock Exchange
LOA	Life Offices Association
NABSSA	National Association of Burial Societies of South Africa
NCASA	National Co-operatives Association of South Africa
NFDA	National Funeral Directors Association
NGO	Non-Governmental Organisation
PCOF	Parliamentary Committee on Finance
PFDA	Professional Funeral Directors Association
PPR	Policyholder Protection Rules
SAFOBS	South African Federation of Burial Societies
SAFPA	South African Funeral Practitioners Association
SAFSIA	South African Financial Services Intermediaries Association
SHG	Self-help group
SRO	Self-regulatory organisation

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APPENDIX B: FINSCOPE ANALYSIS OF USE OF FORMAL AND BURIAL SOCIETY FUNERAL PROVISION PRODUCTS AND SERVICES

FinScope is the first national survey to probe the issue of burial society membership and contributions, risk perceptions of households, previous ownership of formal financial products and allowing the mapping of cross-ownership of formal and informal funeral cover and other financial products. This has made a substantial contribution to the understanding of the financial needs of and financial product usage by lower-income households. At the same time, however, much has been learnt about the funeral provision market in this study and not all of these aspects were sufficiently covered in the FinScope survey. The most prominent gap is perhaps the provision of funeral cover by funeral parlours. This section will provide an overview of burial society membership and use of formal funeral insurance products using all the available information from the FinScope survey. It will also test some of the findings against the insights gained during the course of this project and stylised facts on the market.

The analysis was placed in an appendix to allow for the full exploration of the findings, which may extend beyond what is directly applicable to the main text of the document.

MEMBERSHIP

This section describes and compares the membership of burial society and formal funeral insurance schemes in terms of population group, LSM category, age group, gender and area of residence will be used to describe membership of a burial society and possession of a funeral policy.

POPULATION GROUP COVERAGE

This aspect provided a particularly interesting view on membership as it suggested substantial informal membership in the White and Coloured communities while the traditional view suggests that burial societies are the domain of African communities. In trying to understand the non-African membership, the reasons for joining and the responses on the operation of the society are explored below. The outcome of this suggests that the question regarding burial societies may have been misinterpreted and the non-African responses may be referring to formal insurance policies. This issue needs to be explored by further research and should be monitored and controlled for in the next FinScope survey.

The FinScope survey of 2003 showed that over 80% of members of burial societies are African. Given the size of the African population relative to the other racial groups (74% according to FinScope 2003), it is not surprising that they are the major members of burial societies. It is interesting to note that they are only slightly over-represented in terms of burial society membership (80% vs. 74%). Questions may, however, be raised about the responses of the non-African population groups

to the question on burial society membership and the potential of misinterpretation of the question by these groups. This is discussed below.

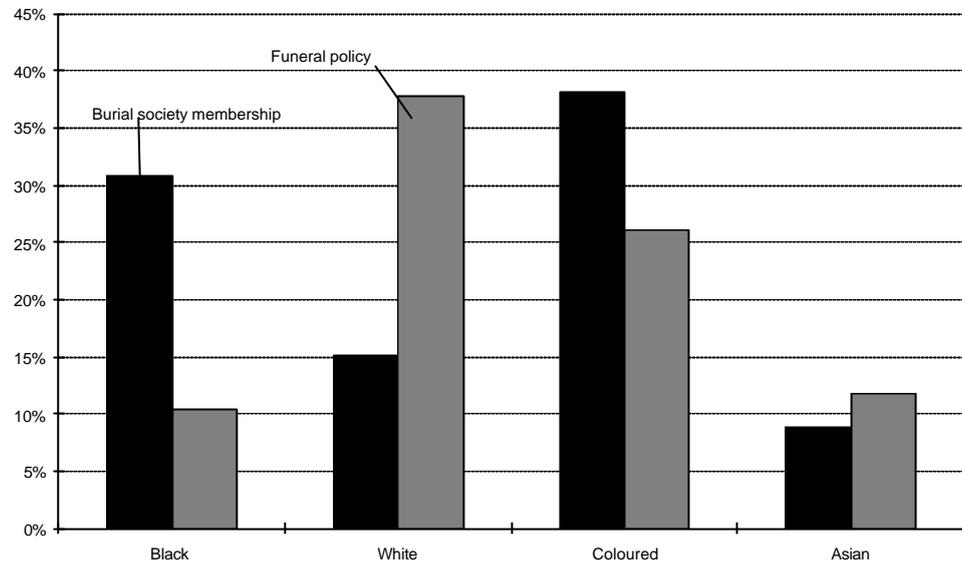


Figure 8 Burial society membership and possession of a funeral policy¹⁸⁴: percentage of race group

Source: *FinScope 2003*

Within the African group, just over 30% are members of a burial society, as shown in Figure 8. This may seem rather small, but, although this figure shows direct membership, it does not measure coverage. From the focus group research conducted for this project it was noted that each society member has about 10 dependents listed under their name. Thus, although 30% of Africans are direct members of a burial society, many more African people will be covered as a result of this membership.

An interesting result, as shown in Figure 8, is the proportion of other race groups who are also members of burial societies. This is especially true for Coloureds where about 38% are members of burial societies. Even more surprising is that about 15% of Whites have indicated that they are members of burial societies. Burial societies have always been thought of as a African phenomenon and, although the results of this question may be showing alternative evidence, it must be queried whether this question has correctly recorded membership of a true burial society¹⁸⁵, as opposed to including people who are members of a funeral parlour or formal institution scheme that may use the word burial society (or something close to this) in its name. With the limited information provided by *FinScope* it is not possible to test this sufficiently. One indirect way to understand the types of societies being referred to by the different respondents is to analyse their responses to the question about how their burial society usually pays for funerals. These results are shown in Figure 9.

¹⁸⁴ In order to count people who currently have a funeral policy with a formal institution, respondents were asked whether they had a "funeral policy with a big institution" (*FinScope*, 2003). This question may, however, have been interpreted to include funeral parlours, administrators and formal insurers.

¹⁸⁵ Not for profit, governed by the members and where a pool of funds is built up over time to provided for death

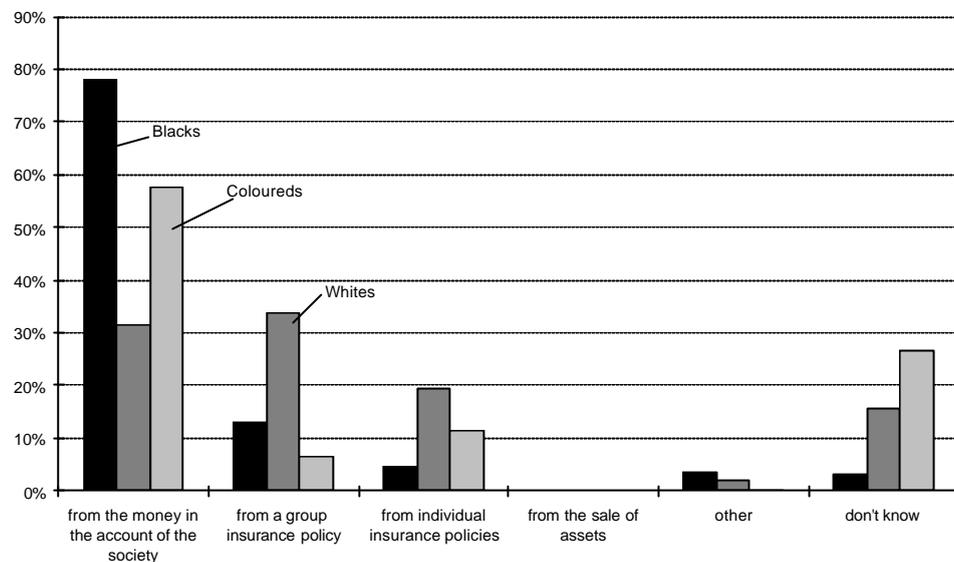


Figure 9 Burial societies: method of payment for funerals¹⁸⁶

Source: FinScope

Contrasting the results for Whites to those of Africans in Figure 9 suggests possible differences in the interpretation of burial society membership. Firstly, almost 80% of Africans indicate that their burial society pays for funerals out of the account of the society, as opposed to 30% of Whites who indicate this method of payment. Secondly, about 55% of Whites indicate either a group or individual insurance policy as the method of payment for funerals, as opposed to less than 18% of Africans indicating this method of payment. This in itself indicates greater formality on the part of White 'burial societies' than for African burial societies. Finally, about 3% of Africans don't know where the funds come from to pay for the funeral, as opposed to 16% of Whites and 27% of Coloureds. This indicates the greater involvement (i.e. member governance) of Africans with their societies than Whites and especially Coloureds and, as a result, the greater detachment between Whites and Coloureds and the societies they profess to be members of. They may, therefore, be members of some sort of funeral parlour or formal insurer 'Burial Society', but they are less likely to be involved with a traditional society (see Footnote 185). What is clear, however, is that a substantial number of White, Coloured and Asian respondents considered themselves to be members of burial societies. Although the discussion above suggests that there may be inaccuracies due to misinterpretation of the question, it also suggests that burial society type structures of providing for funeral expense may not be the sole domain of the African population. Further research will be required to test the use of such informal structures amongst the other population groups.

Throughout the rest of the discussion in this section, the results will be presented for Africans and other race groups as a whole (labelled "other"). This is done on the

¹⁸⁶ Asians have been excluded from this figure as so few (as little as 5) answered these questions

one hand as Africans form the bulk of users of services to provide for funerals and on the other hand because Africans form the majority of poorer people and are expected to be the most vulnerable group to abuse in this market.

LSM COVERAGE

Figure 10 shows how burial society membership and possession of a funeral policy varies across LSM categories. As discussed, this is presented for both Africans and Other (a combination of Whites, Coloureds and Asians). Once again this shows membership and not coverage.

The interesting points to note for Africans are, firstly, the constant level of burial society membership, between 26% and 40%, across LSM categories only falling to about 20% for LSM 10 – the same time at which possession of a funeral policy increases substantially. Secondly, possession of a funeral policy is low and gradually increasing for Africans in LSM 1 to 7 and thereafter increases quite substantially (particularly if the average is take for LSM 8 and 9).

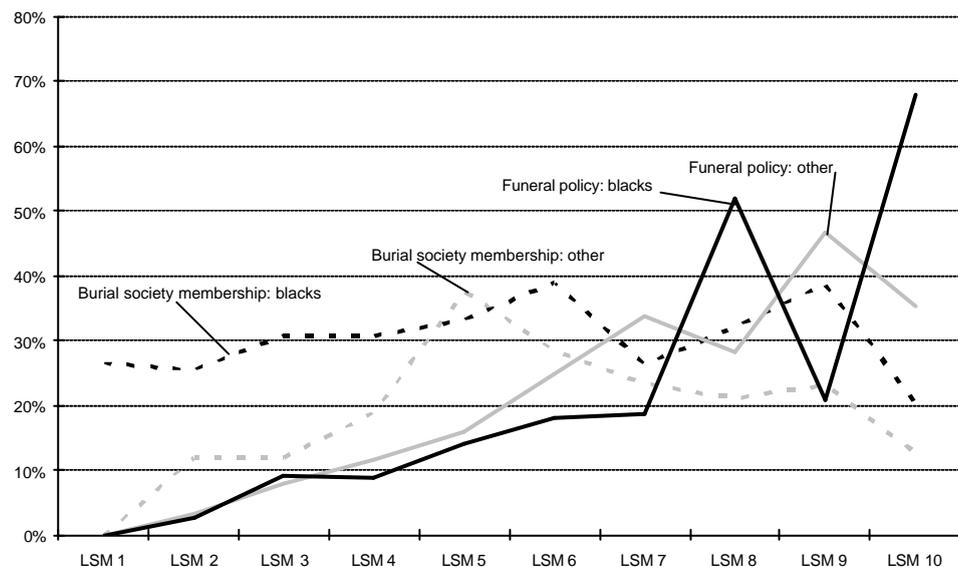


Figure 10 Burial society membership and possession of a funeral policy: percentage of LSM category split by Africans and Other

Source: FinScope 2003

For the Other category, both percentages of LSM with a burial society membership and in possession of a funeral policy gradually increase from LSM 1 to 5. From LSM 6, where the lines cross, the percentage of LSM with burial society membership falls whilst the percentage of LSM with a funeral policy rises. This may suggest that for lower LSMs burial society membership and possession of a funeral policy are complimentary 'products' in providing for death, however, from LSM 6 funeral policies seem to substitute for burial society membership. Once again,

caution must be exercised when reading into the results of the Other category as it is not clear that they refer to burial society membership as defined in this study.

AGE COVERAGE

Figure 11 shows how burial society membership and possession of a funeral policy varies across age groups. As discussed, this is presented for both Africans and Other (a combination of Whites, Coloureds and Asians). Once again this shows membership and not coverage.

For Africans it is interesting to note that at all age groups, burial society membership, as a percentage of age group, is higher than possession of a funeral policy, as a percentage of the age group. This is opposite for Other where, the possession of a funeral policy across all age groups is generally higher than burial society membership.

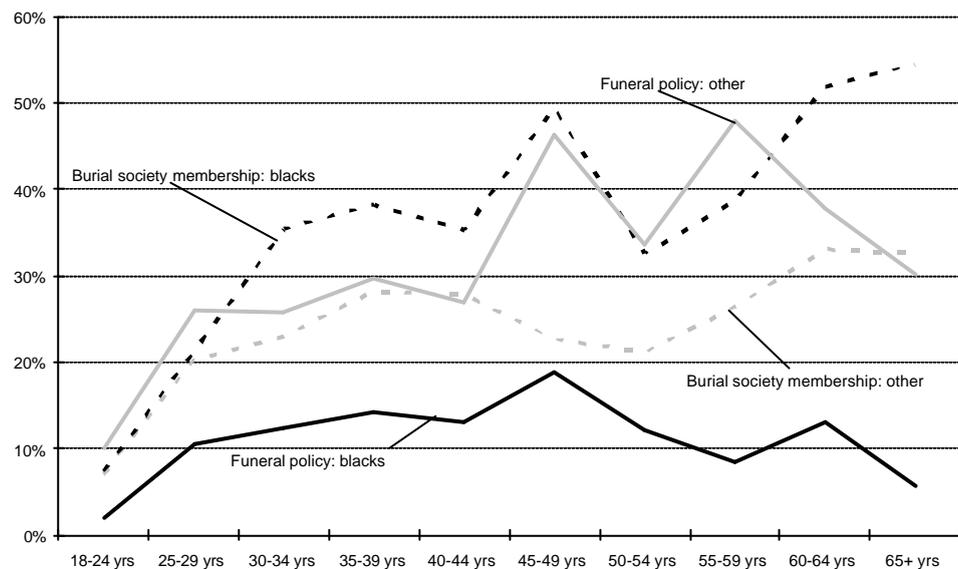


Figure 11 Burial society membership and possession of a funeral policy: percentage of age category split by Africans and Other

Source: FinScope 2003

For Africans, burial society membership, as a percentage of age group, increases as older respondents are measured up to a high of 54% for the 65 years and plus. At the same time possession of a funeral policy, as a percentage of age group, slowly increases up to the 45 to 49 year olds and then slowly tapers away. This tapering away may be explained by the fall in regular income, as one gets closer to retirement age, to support a formal funeral policy. If this is the case, one wonders how many policies are lapsing around middle age with no paid up value or investment value. In addition burial society membership increases substantially through the fifties and into the sixties, possibly indicating the more accommodating nature of the societies to older people without a regular income.

GENDER AND AREA OF RESIDENCE COVERAGE

As a final piece of analysis of burial society membership and possession of a funeral policy, gender and area of residence were brought into the picture. The results are shown in Table 12 and are, once again, split for Africans and Other.

The significant information from Table 12 is that for Africans, a greater proportion of females are members of burial societies than males. This finding was confirmed in the focus group research where females were, in most instances, the main member of the burial society, with the husband and men of the household included as dependents. However, this is not to say that the men are not involved in the society. Quite contrary, as the FinScope results show, about 27% of men are the main member of the society and where they are not, as evidenced in the focus groups, they help out at the time of death, doing such tasks as chopping wood, slaughtering the cow and, where necessary, digging the hole for the coffin. In addition, burial society membership does not vary across area of residence, which proves that burial societies are as much an urban phenomenon as a rural phenomenon.

		Burial society membership ¹⁸⁷	Funeral policy ¹⁸⁸
Africans	male	26.9%	9.2%
	female	34.8%	11.7%
	metro	32.5%	15.7%
	small urban	27.6%	8.2%
	rural	31.4%	7.7%
Other	male	21.9%	31.9%
	female	23.5%	28.6%
	metro	20.8%	31.3%
	small urban	24.3%	30.6%
	rural	36.7%	15.9%

Table 12 Burial society membership and possession of a funeral policy: percentage of gender and area of residence – split by Africans and Other

Source: FinScope 2003

A final point of significance from Table 12 is that, amongst both Africans and Other, a higher percentage of people living in a metro area have a funeral policy than do people living in rural area.

REASONS FOR BELONGING TO A BURIAL SOCIETY

The FinScope questionnaire asked respondents why they belong to a burial society. Respondents were given a list of options to choose from. Figure 12 shows the results of this questionnaire split, once again, for Africans and Other. The most significant reason for belonging to a burial society for both Africans and Other is 'to help me make the funeral arrangements', with more than 80% and 65% of Africans and Other respectively, choosing this option. Other important reasons (indicated by more than 20% of respondents) for belonging to a burial society include 'to provide

¹⁸⁷ Percentage of population segment of population who are members of a burial society.

¹⁸⁸ Percentage of population segment of population who have a formal funeral policy.

for the family', 'to help when there is a death in the family and 'to provide the kind of funerals my family deserves'. This final reason 'to provide the kind of funerals my family deserves' hints at the dignity with which people want to bury loved ones – supporting one of the major findings from the focus group discussions. These responses confirm that the primary reason for burial society membership remains the provision for funeral expenses.

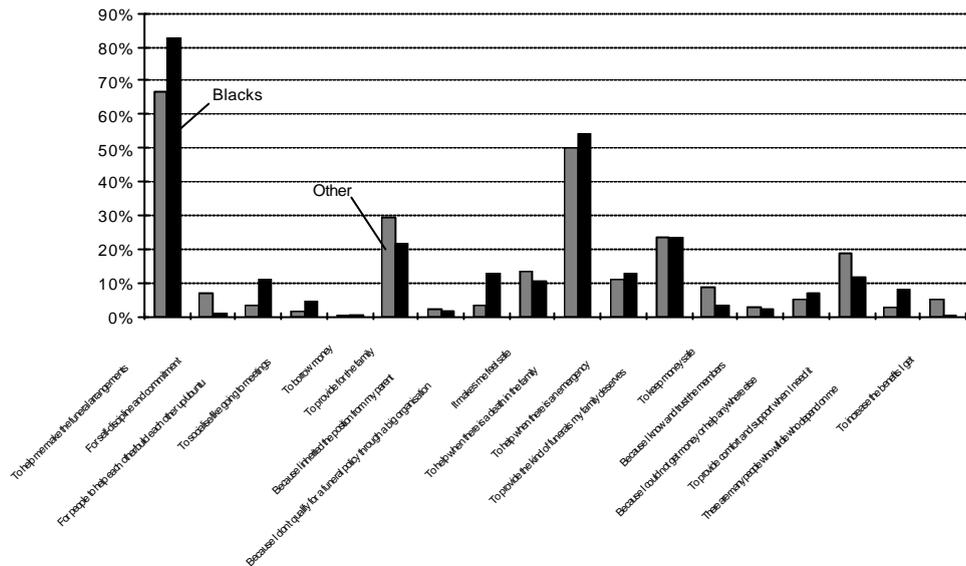


Figure 12 Reasons for belonging to a burial society: split by Africans and Other

Source: FinScope 2003

The significant responses shown in Figure 12 do not shed more light on whether a group of people (Africans vs. Other) are referring to a true burial society or to a 'Burial Society' of a funeral parlour or formal insurer. This is because the reasons mentioned would be those most likely for joining any of the providers.

CONTRIBUTIONS TO BURIAL SOCIETIES

A major finding from the focus group discussions is that urban Africans do not seem to be price sensitive with regards to funeral provision (from a formal insurer or funeral parlour). In order to test this with the FinScope results it would require data on contributions to funeral policies. Unfortunately, only data on contributions to burial societies were collected and it will, therefore, not be possible to assess the price sensitivity for funeral policies. This section will consider the level of price sensitivity towards contributions to burial societies as revealed by the FinScope data.

To find some approximation of price sensitivity, the contributions will be compared between people in LSM 1-6 and those in LSM 7-10, and those who live in metro areas to those who live in rural areas. These results are shown in Figure 13 for African respondents only.

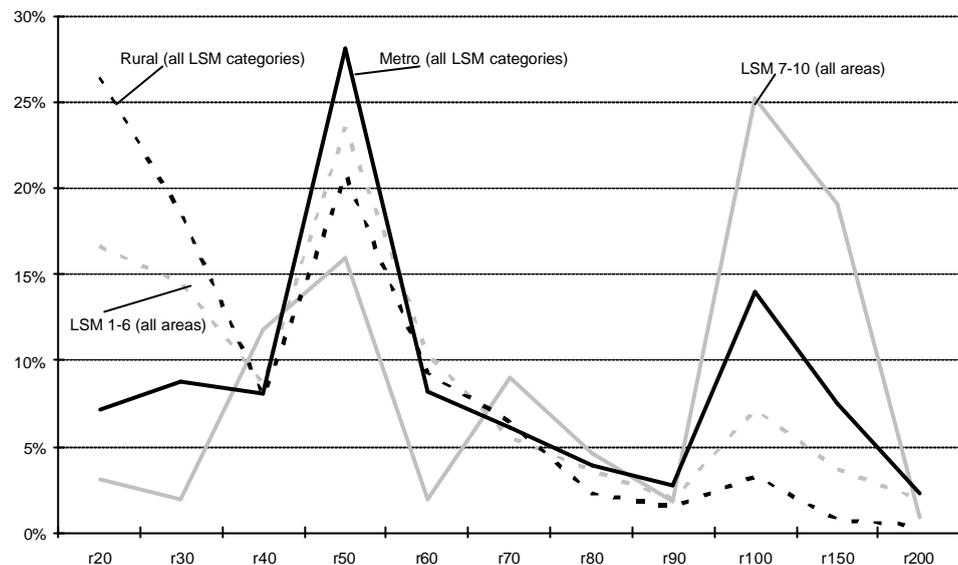


Figure 13 Contributions to burial societies: comparing rural with metro and LSM 1-6 with LSM 7-10

Source: *FinScope 2003*

Before analysing price sensitivity it is interesting to note that contributions to burial societies bulk around the R50 and R100 level. Keeping to these levels may be a way in which contributions and managing contributions are kept simple and easy to manage.

In comparing LSM 1-6 with LSM 7-10 and people who live in rural areas with those in metro areas, it is clear that poorer people in general contribute less per month than wealthier people¹⁸⁹. For example a greater percentage of people in LSM 1-6 contribute R20 (26% vs. 4%) or R50 (24% vs. 16%) per month than people in LSM 7-10 and, a greater percentage of people in LSM 7-10 contribute R100 (25% vs. 6%) per month than people in LSM 1-6.

This suggests that people are price sensitive to what they contribute towards a burial society. This is to be expected as burial societies are formed by people who know each other and live in the same area and who, as a result, will most likely have similar income levels. As a result, through member governance, people will set the contributions according to what they themselves can afford.

The question of price sensitivity should, perhaps, be considered relative to household or personal income rather than in absolute terms. Household income, in turn, may be more appropriate as funeral provision (and particularly burial society membership) seems to be decided within the household framework. Table 13 shows the contribution relative to household and personal income across population groups.

¹⁸⁹ Obviously assuming that those in metro areas are wealthier than those in rural areas

	Average contribution to burial society	
	% of personal income	% of hhold income
African	8.8%	5.0%
White	3.3%	1.0%
Coloured	7.6%	3.6%
Indian	3.2%	1.1%

Table 13. Contribution to burial societies as percentage of household and person income across population groups

Source: FinScope 2004

Interesting to note is that African and Coloured households contribute substantially more to burial societies relative to their household income. This correlates with the importance of these societies found for African households in the focus groups.

Focusing only on the African population, Table 14 and Table 15 shows the difference in contribution between Metro and Rural, and across LSM categories. Interestingly, the variance in contribution relative to household income is very small.

	Average contribution to burial society	
	% of personal income	% of hhold income
Metro	7.7%	4.6%
Rural	9.3%	5.4%

Table 14. Rural/urban differences in contributions to burial society by African households

FinScope 2003

With regards to LSM categories, it is interesting to note that the lower LSMs contribute a substantially higher proportion of their income towards burial societies. This also holds for contributions relative to personal income.

	Average contribution to burial society	
	% of personal income	% of hhold income
LSM 1-6	9.1%	5.2%
LSM 7-10	3.1%	1.5%

Table 15. Contribution to burial societies by African households across LSM categories

Source: FinScope 2003

The above proportions are more significant if it is considered that burial societies are only one of the providers of funeral insurance and that the same households often hold policies with formal insurers and/or funeral parlours. In addition, the implications for the question of affordability may be profound. Given that the above contributions are voluntary and are determined by the members of the societies

themselves, it is significant that such a high percentage of income of lower-income households is contributed to such societies.

USE OF MORE THAN ONE PROVIDER OF FUNERAL INSURANCE

The focus group discussions indicated that burial societies and funeral policies are often seen as complements to each other and are used by people for different purposes (see section 2.5). In order to test this with the FinScope results, Table 16 shows the percentage of those who are members of burial societies and who either currently have, or have never had, a funeral policy with a big institution.

	Member of a burial society	
	Africans	Other races
Never had a funeral policy with a big institution	78%	33%
Currently have a funeral policy with a big institution	17%	62%

Table 16 Burial society membership and possession of a funeral policy: overlap¹⁹⁰

Source: FinScope 2003

The first thing to note is that large proportion of current African burial society members that have never had a policy with a formal institution. This is significant and confirms the notion that burial societies are often the first means of providing for funeral insurance and also the first port of access to such services. The reasons for the low penetration of formal insurance have not been probed in the questionnaire but may be due to issues like cost, features of the products on offer, irregularity of income or distribution and payment collection mechanisms used. It may also be that the needs of these households are sufficiently served by their society.

In addition, Table 16 shows that only 17% of African members of burial societies currently have a funeral policy whereas more than 62% of other races who are members of burial societies have a funeral policy. This may once again be related to the problem of potential misinterpretation of 'burial society membership' by other race groups. For Africans, the proportion of burial society members with a formal policy may also undercount the use of formal products as the burial society itself may be distributing formal products to its members. The questionnaire did not provide sufficient information to analyse this further.

¹⁹⁰ The FinScope questionnaire also gave respondents the options of "used to have" and "don't know" when asked whether they had a funeral policy with a big institution. As so few respondents (in some cases less than 5 people) indicated either of these as their response they are not worth representing.

APPENDIX C: FOCUS GROUP METHODOLOGY

Eight focus groups were conducted during the course of July 2004. Each focus group consisted of seven or eight respondents, selected on the basis that they have experienced death in the household within the past 18 months and made use of one of the categories of providers (burial societies, funeral parlours or formal insurers).

Due to the limited number of focus groups possible in this study, the groups had to be defined very carefully to allow for maximum depth of analysis as well as appropriate coverage. Consequently, respondents were selected from the African population group and from the LSM 4 to 6 income categories (i.e. with household income levels between R500 and R5 000). The African population was chosen as they represent the largest group of consumers of funeral insurance services and also make extensive use of burial societies and funeral parlours for financial provision, something which is less common in the other communities. LSMs 4 to 6 were selected as this category represents the cross-over point in formal financial product usage (where more people start using financial products than those who do not).

Of the eight groups, six were conducted with urban respondents and two were conducted with rural respondents. Of the six urban groups, three consisted of male respondents and three consisted of female respondents, split into three different age categories:

- 25 to 34 years
- 35 to 49 years
- 50+ years

The two rural focus groups were split into male and a female group within the ages of 25 to 49 years.

Overall the groups consisted of a mixture of respondents who were unemployed and employed in a variety of fields. Further demographic information on each respondent is included in Appendix III of the Uthini report on the focus groups (Uthini, 2004). Full details of the focus groups as well as transcripts of the discussions are available in the Uthini Management Report (Uthini, 2004).

APPENDIX D: DETAILS OF FUNERAL INSURANCE QUOTES
FROM SMALL SELECTION OF FORMAL INSURERS AND
FUNERAL PARLOURS

Formal Insurer A: Bank-tied, multiple products		
	Premium/month	Cover
<u>Main member and family</u>		
HH (42)		R 10,000
Spouse (41)	R 47	R 10,000
Child C (17)		R 5,000
Child D (10)		R 2,000
<u>Extended family members</u>		
<65		
Child A (22 - student)	R 25	R 6,000
Child B (20)	R 25	R 6,000
Parent-in-law B (59)	R 25	R 6,000
Extended (sister) (40)	R 25	R 6,000
Extended (cousin) (33)	R 25	R 6,000
Extended (nephew) (17)	R 25	R 6,000
Extended (niece) (8)	R 25	R 6,000
65-80		
Parent A (66)	R 56	R 4,000
Parent B (65)	R 56	R 4,000
Parent-in-law A (72)	R 56	R 4,000
Extended (aunt) (73)	R 56	R 4,000
Total premium and cover	R 446	R 85,000
Total cover/monthly premium	R 190.6	

Formal insurer B: Own funeral parlour, funeral insurance focus		
	Premium/month	Cover
<u>Main member and family</u>		
HH (42)	R 75	R 10,000
Spouse (41)		R 10,000
Child A (22 - student)		R 5,000
Child B (20)	R 10.50	R 5,000
Child C (17)		R 5,000
Child D (10)		R 3,000
<u>Parents</u>		
Parent A (66)	R 64	R 4,000
Parent B (65)	R 51	R 4,000
Parent-in-law A (72)	R 81	R 4,000
Parent-in-law B (59)	R 41	R 4,000
<u>Extended family members</u>		
Extended (sister) (40)	R 47	R 6,000
Extended (cousin) (33)	R 47	R 6,000
Extended (nephew) (17)	R 25	R 6,000
Extended (niece) (8)	R 25	R 6,000
Extended (aunt) (73)	R 128	R 6,000
Total premium and cover	R 592	R 84,000
Total cover/monthly premium	R 141.9	

Formal insurer C: Bank-tied, multiple products		
	Premium/month	Cover
<u>Main member and family</u>		
HH	R 75	R 10,000
Spouse		R 10,000
Child A		R 5,000
Child B	R 10.50	R 5,000
Child C		R 5,000
Child D		R 3,000
<u>Parents</u>		
Parent A	R 64	R 4,000
Parent B	R 51	R 4,000
Parent-in-law A	R 81	R 4,000
Parent-in-law B	R 41	R 4,000
<u>Extended family members</u>		
Extended (sister-40)	R 39	R 5,000
Extended (cousin-33)	R 39	R 5,000
Extended (nephew -17)	R 21	R 5,000
Extended (niece-8)	R 21	R 5,000
Extended (aunt-73)	R 106	R 5,000
Total premium and cover	R 547	R 79,000
Total cover/monthly premium	R 144.5	

Formal insurer D: Smaller insurer, Not bank-tied, multiple products		
	Premium/month	Cover
<u>Main member and family</u>		
HH (42)		R 10,000
Spouse (41)		R 10,000
Child A (22 - student)	R 60.5	R 5,000
Child B (20)		R 5,000
Child C (17)		R 5,000
Child D (10)		R 5,000
<u>Parents</u>		
Parent A (66)	R 30	R 5,000
Parent B (65)	R 30	R 5,000
Parent-in-law A (72)	R 30	R 5,000
Parent-in-law B (59)	R 30	R 5,000
<u>Extended family members</u>		
Extended (sister) (40)		R 5,000
Extended (cousin) (33)	R 39.5	R 5,000
Extended (nephew) (17)		R 5,000
Extended (niece) (8)		R 5,000
Extended (aunt) (73)	R 39.5	R 5,000
Total premium and cover	R 260	R 85,000
cover/monthly premium	R 327.6	

Formal insurer E: Smaller insurer, not bank-tied, funeral insurance focus		
	Premium/month	Cover
<u>Main member and family</u>		
HH (42)	R 66	R 11,700
Spouse (41)	R 66	R 11,700
Child B (20)	R 29	R 8,600
Child C (17)	R 29	R 8,600
Child D (10)	R 29	R 8,600
Child A (22 - student)	R 29	R 8,600
<u>Parents</u>		
Parent A (66)	R 143	R 5,600
Parent B (65)	R 91	R 5,600
Parent-in-law A (72)	R 143	R 5,600
Parent-in-law B (59)	R 91	R 5,600
<u>Extended family members</u>		
Extended (sister) (40)	R 21	R 2,700
Extended (cousin) (33)	R 15	R 2,700
Extended (nephew) (17)	R 10	R 2,700
Extended (niece) (8)	R 10	R 2,700
Extended (aunt) (73)	R 72	R 2,700
Total premium and cover	R 840	R 93,700
Total cover/monthly premium	R 111.5	

Formal Insurer F: Direct sales		
	Premium/month	Cover
<u>Main member and family</u>		
HH (42)		R 10,000
Spouse (41)		R 10,000
Child B (20)	R 77	R 10,000
Child C (17)		R 10,000
Child D (10)		R 4,000
Child A (22 - student)		R 10,000
<u>Parents</u>		
Parent A (66)	R 142	R 5,000
Parent B (65)		R 5,000
Parent-in-law A (72)	R 171	R 5,000
Parent-in-law B (59)		R 5,000
<u>Extended family members</u>		
Extended (sister) (40)		R 5,000
Extended (cousin) (33)	R 54	R 5,000
Extended (nephew) (17)		R 5,000
Extended (niece) (8)		R 2,000
Extended (aunt) (73)	R 171	R 5,000
Total premium and cover	R 615	R 96,000
Total cover/monthly premium	R 156.1	

Formal Insurer G: Large insurer, multiple product lines		
	Premium/month	Cover
<u>Main member and family</u>		
HH (42)	R 50	R 10,000
Spouse (41)	R 50	R 10,000
Child B (20)	R 10	R 5,000
Child C (17)	R 10	R 5,000
Child D (10)	R 10	R 5,000
Child A (22 - student)	R 10	R 5,000
<u>Parents</u>		
Parent A (66)	R 90	R 5,000
Parent B (65)	R 90	R 5,000
Parent-in-law A (72)	R 90	R 5,000
Parent-in-law B (59)	R 90	R 5,000
<u>Extended family members</u>		
Extended (sister) (40)	R 25	R 5,000
Extended (cousin) (33)	R 23	R 5,000
Extended (nephew) (17)	R 10	R 5,000
Extended (niece) (8)	R 10	R 5,000
Extended (aunt) (73)	R 90	R 5,000
Policy fee	R 7	
Total premium and cover	R 665	R 85,000
Total cover/monthly premium	R 127.9	

Funeral Parlour A: Johannesburg, Township single branch		
	Premium/month	Cover
<u>Main member and family</u>		
HH (42)		R 11,250
Spouse (41)		R 11,250
Child B (20)	R 60	R 5,000
Child C (17)		R 5,000
Child D (10)		R 3,000
<u>Parents</u>		
Parent A (66)	R 15	R 5,000
Parent B (65)	R 15	R 5,000
Parent-in-law A (72)	R 15	R 5,000
Parent-in-law B (59)	R 15	R 5,000
<u>Extended family members</u>		
Child A (22 - student)	R 15	R 5,000
Extended (sister) (40)	R 15	R 5,000
Extended (cousin) (33)	R 15	R 5,000
Extended (nephew) (17)	R 15	R 5,000
Extended (niece) (8)	R 15	R 5,000
Extended (aunt) (73)	R 15	R 5,000
Total premium and cover	R 210	R 85,500
Total cover/monthly premium	R 407.1	

Funeral Parlour B: Johannesburg (Wynberg) single branch		
	Premium/month	Cover
<u>Main member and family</u>		
HH (42)		R 10,000
Spouse (41)		R 10,000
Child B (20)	R 65	R 5,000
Child C (17)		R 5,000
Child D (10)		R 2,500
<u>Parents</u>		
Parent A (66)	R 30	R 5,000
Parent B (65)	R 30	R 5,000
Parent-in-law A (72)	R 100	R 3,000
Parent-in-law B (59)	R 30	R 5,000
<u>Extended family members</u>		
Child A (22 - student)	R 30	R 5,000
Extended (sister) (40)	R 30	R 5,000
Extended (cousin) (33)	R 30	R 5,000
Extended (nephew) (17)	R 30	R 5,000
Extended (niece) (8)	R 30	R 5,000
Extended (aunt) (73)	R 40	R 3,000
Total premium and cover	R 445	R 78,500
Total cover/monthly premium	R 176.4	

Funeral Parlour C: Johannesburg: Three metropolitan branches		
	Premium/month	Cover
<u>Main member and family</u>		
HH (42)		R 10,000
Spouse (41)		R 10,000
Child B (20)	R 80	R 10,000
Child C (17)		R 10,000
Child D (10)		R 5,000
Child A (22 - student)		R 10,000
<u>Parents</u>		
Parent A (66)		R 3,000
Parent B (65)	R 60	R 3,000
Parent-in-law A (72)		R 3,000
Parent-in-law B (59)		R 3,000
<u>Extended family members</u>		
Extended (sister) (40)		R 3,000
Extended (cousin) (33)	R 25	R 3,000
Extended (nephew) (17)		R 3,000
Extended (niece) (8)		R 3,000
Extended (aunt) (73)	R 60	R 3,000
Total premium and cover	R 225	R 82,000
Total cover/monthly premium	R 364.4	

APPENDIX E: THE CO-OPERATIVES BILL, 2004

The Co-operatives Bill¹⁹¹, drafted by the dti will replace the Co-operatives Act, Act 191 of 1981. The Bill is expected to pass into law in 2005. The Bill seeks to promote a variety of co-operatives namely, agriculture and farmers co-operatives, housing co-operatives, transport co-operatives, medical co-operatives, worker co-operatives and financial service co-operatives. It provides for co-operatives to be legal entities with limited liability, to give them legislative status and to provide for their formal registration and administration. Provision has been made in the bill for the inclusion of burial societies as co-operatives¹⁹². A co-operative burial society is defined as a co-operative that “provides funeral benefits, including funeral insurance and other services to its members and their dependents”.¹⁹³

Registration: To register as a co-operative in terms of the Bill an application must be made to the Registrar of Co-operatives accompanied by a written constitution, a list of members, a list of directors and the prescribed fee.¹⁹⁴ Before submitting an application the co-operative must meet at least once, at which meeting the constitution must be adopted, the first directors elected and an initial plan of operation is presented.¹⁹⁵ According to the dti, the institutional regulation function presently carried out by the Registrar of Co-operatives in the Department of Agriculture will in due course move to the dti’s Company and Intellectual Property Registration Office (CIPRO) i.e. co-operatives will be registered by the dti. However, in certain cases, it is foreseen that *functional* regulation may remain with the department most appropriate to the nature of the co-operative. For example, banking co-operatives may be functionally regulated by the National Treasury. It has not yet been decided how burial societies (should they fall under the co-operative framework) will be regulated, although it is possible they will fall under the control of dti.¹⁹⁶

There is no requirement to submit a certificate by a valuator as to the financial soundness of the society (as for a friendly society).

Written constitution: The co-operative must have a constitution which must include provision relating to, amongst others, the name, description and main objectives of the co-operative, its registered address, powers and restrictions of the co-operative and its directors, requirements of membership including member entrance fees and subscriptions, and a number of other administrative and functional requirements to do with meetings, voting and decision making procedures and rights and obligations of members.¹⁹⁷ The dti has proposed the introduction of a *pro forma* constitution to ease the burden of registration.

¹⁹¹ At the time of writing the Bill was in draft form. This commentary is based on a version date 14 June 2004.

¹⁹² See sections 1 (1) and 4 (2) (e)

¹⁹³ Section 1 (1)

¹⁹⁴ Section 7 (1)

¹⁹⁵ Section 7 (2)

¹⁹⁶ Telephone interview with Ursula Titus, Deputy Director, Co-operatives Development Unit, dti, on 2 November 2004.

¹⁹⁷ Section 15

Legal personality: Once a co-operative is registered, it is incorporated as a legal person¹⁹⁸.

Compliance requirements: A co-operative must have a registered office¹⁹⁹ and must keep at its offices the constitution, the minutes of general meetings, an attendance register, a list of members and any membership fees paid, a register of directors, and “adequate accounting records”, including records reflecting the transactions between members.²⁰⁰ A co-operative must hold meetings and an annual general meeting, and minutes must be kept.²⁰¹ A board of directors, who are responsible for managing the affairs of the co-operative, must also be elected²⁰² and minutes kept of board meetings.²⁰³

Audit requirement: A co-operative must be audited once a year in accordance with generally accepted accounting practices. However, provision is made for the registrar to grant an exemption from full compliance with the audit requirements if he is satisfied that the costs of an annual audit would materially affect the financial sustainability of the co-operative, that the co-operative has maintained adequate financial records, and, having regard to the size and kind of the co-operative, that the interests of the members are adequately protected. The registrar may then require that the co-operative be audited only every two or three years rather than annually, and may permit a suitably qualified person other than an auditor to conduct the required audit.²⁰⁴ The Bill does not define a suitably qualified person, but it would probably be a bookkeeper or Commercial and Financial Accountant (CFA) or other person of lower qualification than an auditor.

Categories of co-operatives: The co-operative framework makes provision for a number of diverse, category-specific co-operatives. A financial service co-operative is defined as “a co-operative whose main objective is “to provide financial services to its members, and includes a credit union, co-operative bank, savings and credit co-operative, or any other financial service” (our emphasis). It is not clear why the draft doesn’t expressly include a burial society in this list, but section 2 (1) of this Part makes it clear that a financial services co-operative’s constitution may include the provision of funeral services and funeral insurance as financial services. It needs to be clarified whether burial societies are expected to be a standalone category of co-operative or fall under the broader category of financial services co-operative. The Minister also has the power to categorise specific kinds and types of co-operatives.²⁰⁵

Other legislation: There is an obligation on a financial service co-operative to which “legislation governing co-operative banks applies” to register under the Banks Act

¹⁹⁸ Section 9 (1)

¹⁹⁹ Section 24

²⁰⁰ Section 43

²⁰¹ Sections 35 and 36

²⁰² Section 45

²⁰³ Section 50

²⁰⁴ Section 70

²⁰⁵ Section 108 (e)

(Act 94 of 1990).²⁰⁶ The Bill also sets out that a financial services co-operative providing funeral benefits to its members is not required to register under the Friendly Societies Act.²⁰⁷ The Bill also makes clear that the Long-term Insurance Act does not apply in respect of activities in so far as the benefits afforded by the arrangement are not guaranteed.²⁰⁸ This is effectively a re-statement of the law as it stands.

Organisational structures: The Bill makes provision for different levels of co-operative: primary, secondary and tertiary co-operatives, as well as co-operative apex organisations.²⁰⁹ This multi-tiered system opens the way for self-regulating mechanisms whereby, for example, a secondary co-operative might regulate a group of primary co-operatives. In respect of financial services co-operatives, the Bill establishes that the registrar has the power to *direct* all financial sector co-operatives to belong to a secondary co-operative who would act as a self-regulatory body and has the power to deregister any co-operative who refuses to comply.

²⁰⁶ Section 3, Part 3, Schedule 1

²⁰⁷ Section 6, of Part 3 to Schedule 1

²⁰⁸ Section 107

²⁰⁹ Section 1. A primary co-operative is formed by a minimum of five members and is the lowest level of co-operative. A secondary co-operative is formed by two or more primary co-operatives. A tertiary co-operative is formed by two or more secondary or primary co-operatives, and a co-operative apex organisation is formed by a combination of primary, secondary and/or federal co-operatives to represent the interests of the co-operatives within a specific sector or region.