



# Legal expenses insurance

July 2013

This presentation is incomplete without the accompanying oral commentary

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**Making financial markets work for the poor**



## Agenda

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*Project overview*




Product overview

Client value

The future



# The key objective of the projects is to understand the legal insurance environment in South Africa, its position under current and pending regulatory regimes and the value of the product to consumers

	<b>PRODUCT OVERVIEW AND KEY PROVIDERS</b> 	<b>REGULATORY OVERVIEW</b> 	<b>CLIENT VALUE</b> 
OBJECTIVES	<ul style="list-style-type: none"> <li>Identify available products and key components of the value proposition</li> <li>Identify key providers and explore various delivery models</li> <li>Explore underwriting models</li> </ul>	<ul style="list-style-type: none"> <li>Identify regulations that impact on the product</li> <li>Focus on market conduct as opposed to prudential regulation</li> <li>Explore impact of planned regulations</li> </ul>	<ul style="list-style-type: none"> <li>Assess client value based on supply-side data</li> <li>Assess client value based on demand-side data</li> </ul>
ACTIVITIES	<ul style="list-style-type: none"> <li>Market scan of products</li> <li>Mystery purchase of five products</li> <li>Review of policy documents</li> <li>Interviews with providers</li> <li>Discussions with panel attorneys</li> </ul>	<ul style="list-style-type: none"> <li>Review of regulations including ST Insurance Act, FAIS Act, Micro insurance proposals and TCF</li> <li>Interview regulators</li> </ul>	<ul style="list-style-type: none"> <li>Develop data request for key providers. Request data and analyse data</li> <li>Four focus groups conducted                             <ul style="list-style-type: none"> <li>Three groups of current / past legal insurance policyholders (Jhb, Pretoria, CT), one group without legal insurance (Jhb)</li> <li>Respondents profiles varied in terms of race, gender and age</li> <li>Household income slightly higher than the initial recruitment specification: 25% with household income &gt; R15 000 per month</li> </ul> </li> </ul>

***Develop recommendations for FinMark with regard to its engagement with the product in the future***

## Agenda

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**legal expenses insurance covers policyholders for potential costs associated with legal action. The offering typically comprises access to legal services, including advice and mediation as well as an insurance component covering large lump sum costs arising from litigation**

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### LEGAL SERVICES



- Provision of legal advice, mediation and basic legal services
- Typically provided by legally qualified individuals employed by the provider
- Services provided telephonically or by walk-in service centres
- Clients have 24 hour access to services

### LITIGATION BENEFIT

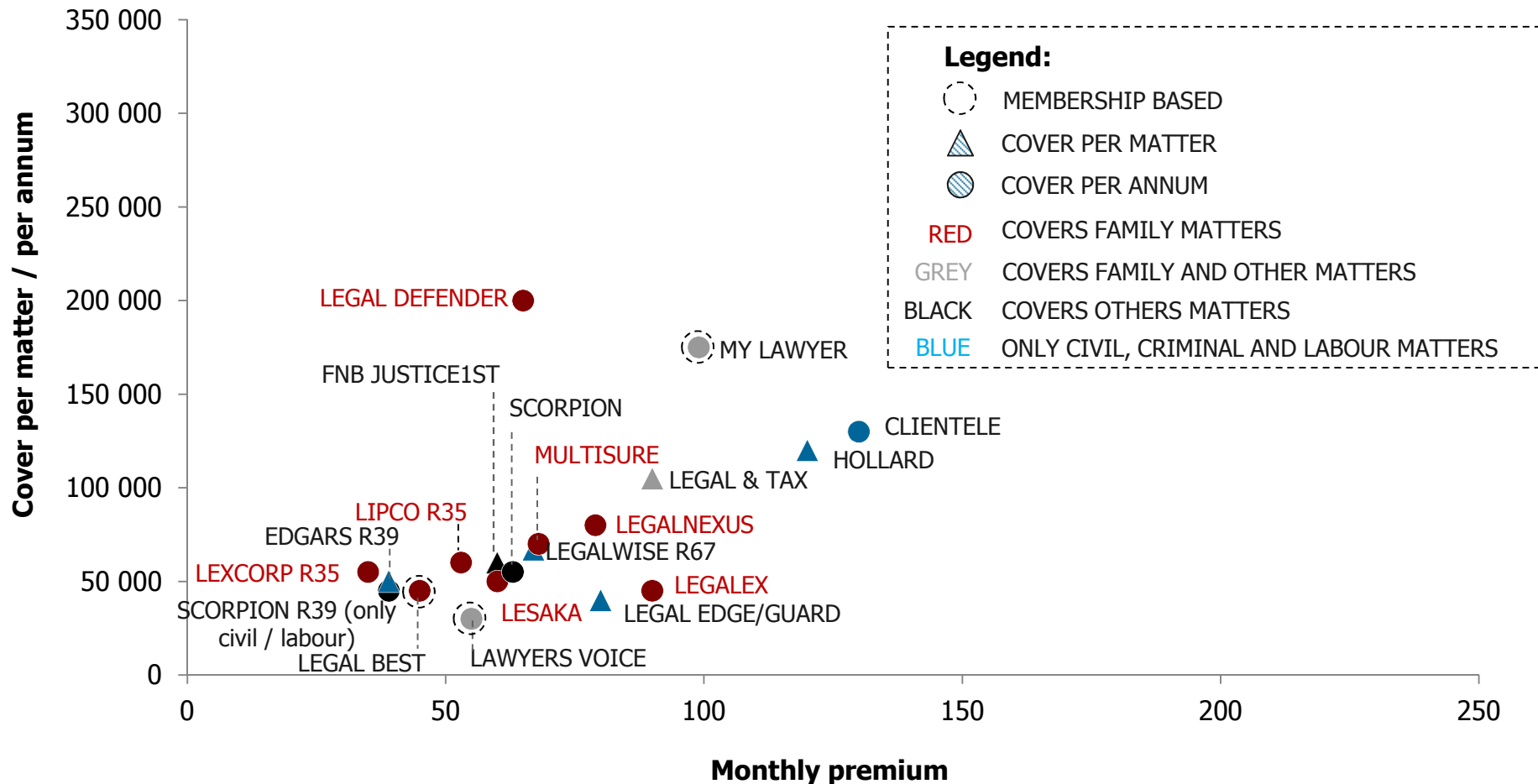


- Access to legal expertise provided by firms of attorneys
- Firms are typically selected and contracted by the legal expenses insurance provider
- Contract stipulates fees payable by the legal expenses insurance provider which are significantly discounted
- The attorney provides regular updates to the legal expense insurer and the client, and is usually paid directly by the legal expense insurer. Where the client uses his or her own attorneys the legal expense insurer reimburses the client in line with negotiated tariffs



**There are a number of offerings with fairly affordable monthly premiums. Most products offer cover for civil, criminal and labour matters. Cover is provided for the main member, spouse and children under 18**

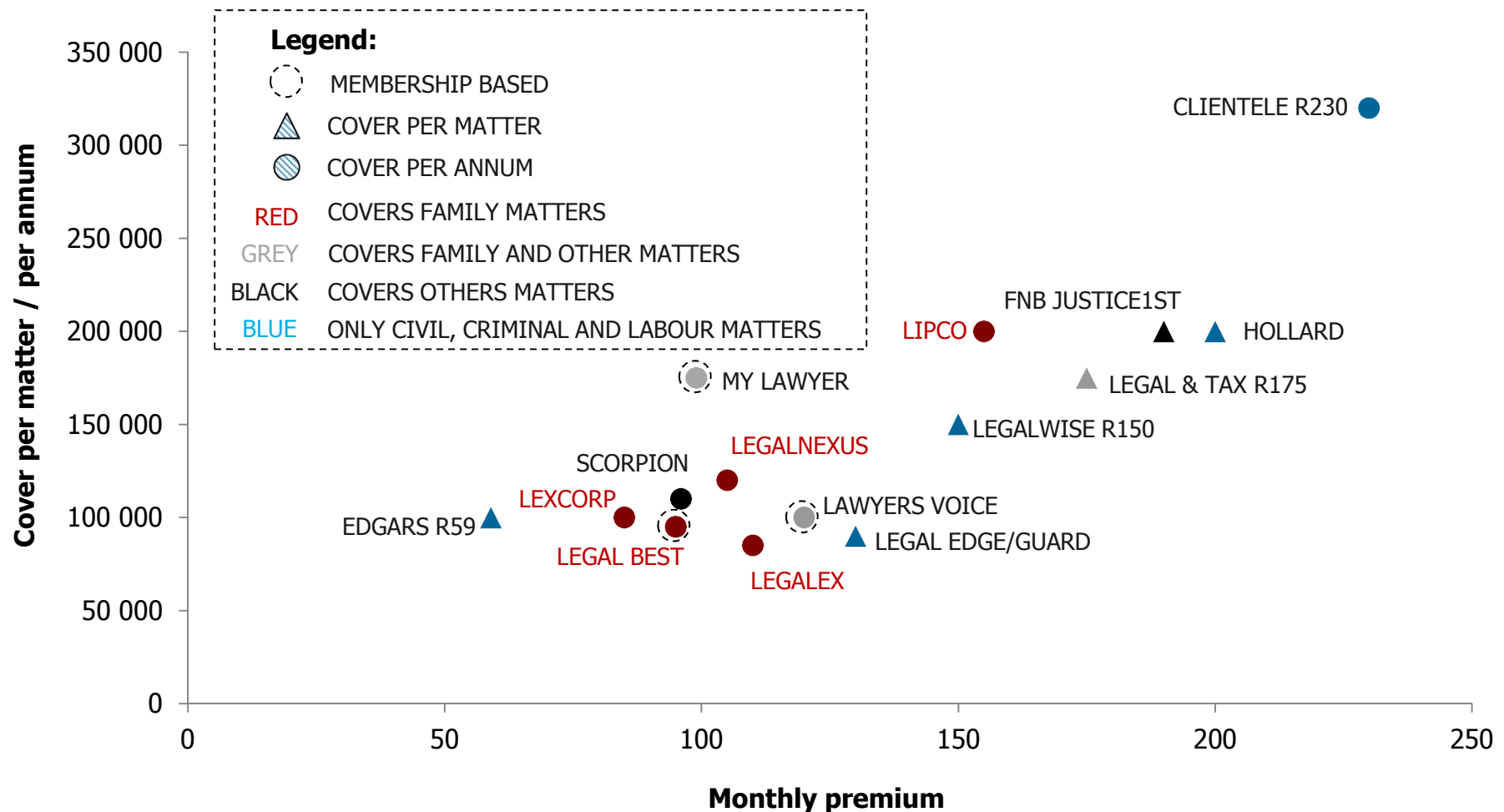
**LEGAL INSURANCE PRODUCT OVERVIEW:  
ENTRY LEVEL PRODUCT OFFERED BY PROVIDER**



Source: Provider marketing material and websites

## Most providers also have a premium product offering a higher level of cover and in some cases additional benefits

### LEGAL INSURANCE PRODUCT OVERVIEW: PREMIUM PRODUCT OFFERED BY PROVIDER

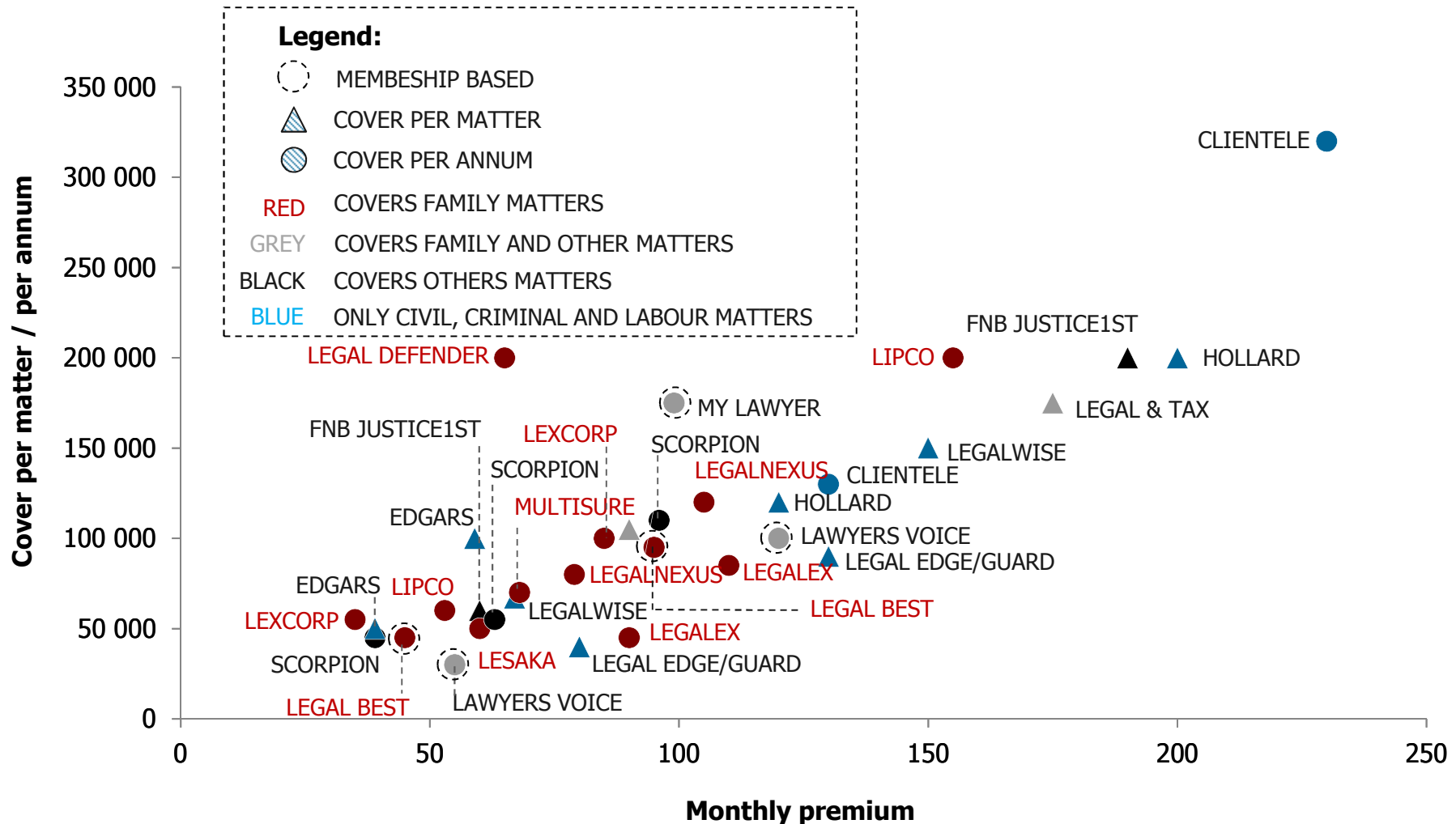


Source: Provider marketing material and websites

**Lexcorp has the most affordable offering at R35 for R55 000 cover per annum. The most comprehensive product in terms of cover is offered by Clientele, R230 for R320 000 cover per annum**



**LEGAL INSURANCE PRODUCT OVERVIEW**



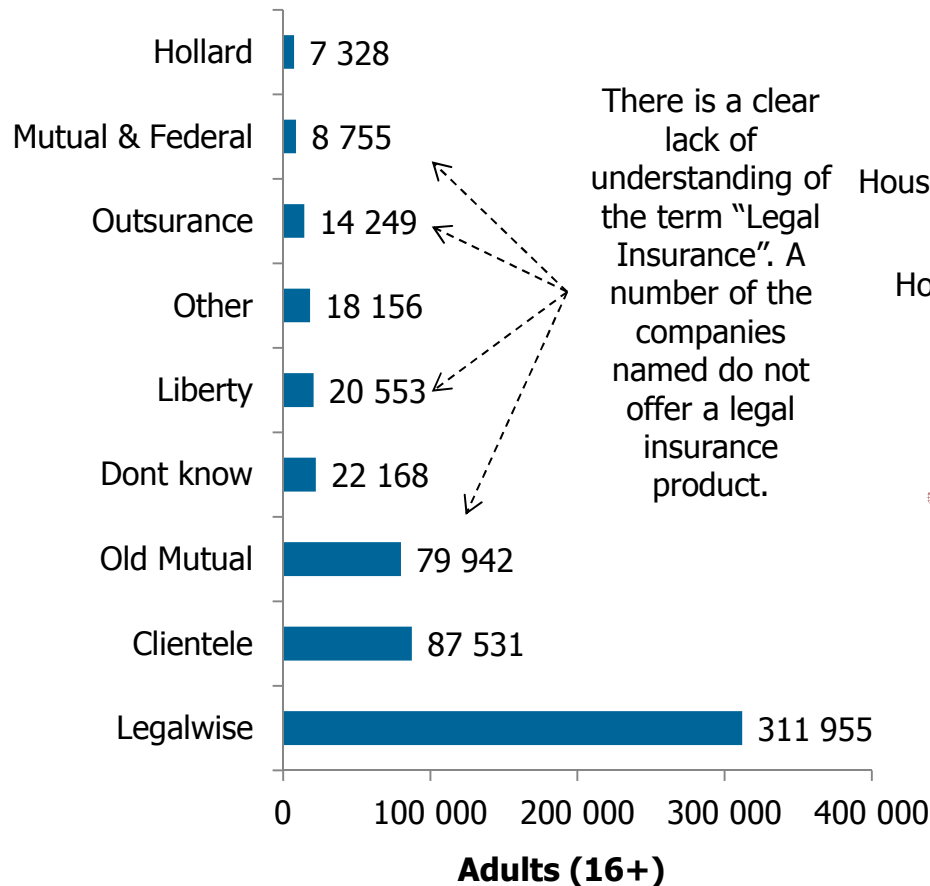
Source: Provider marketing material and websites



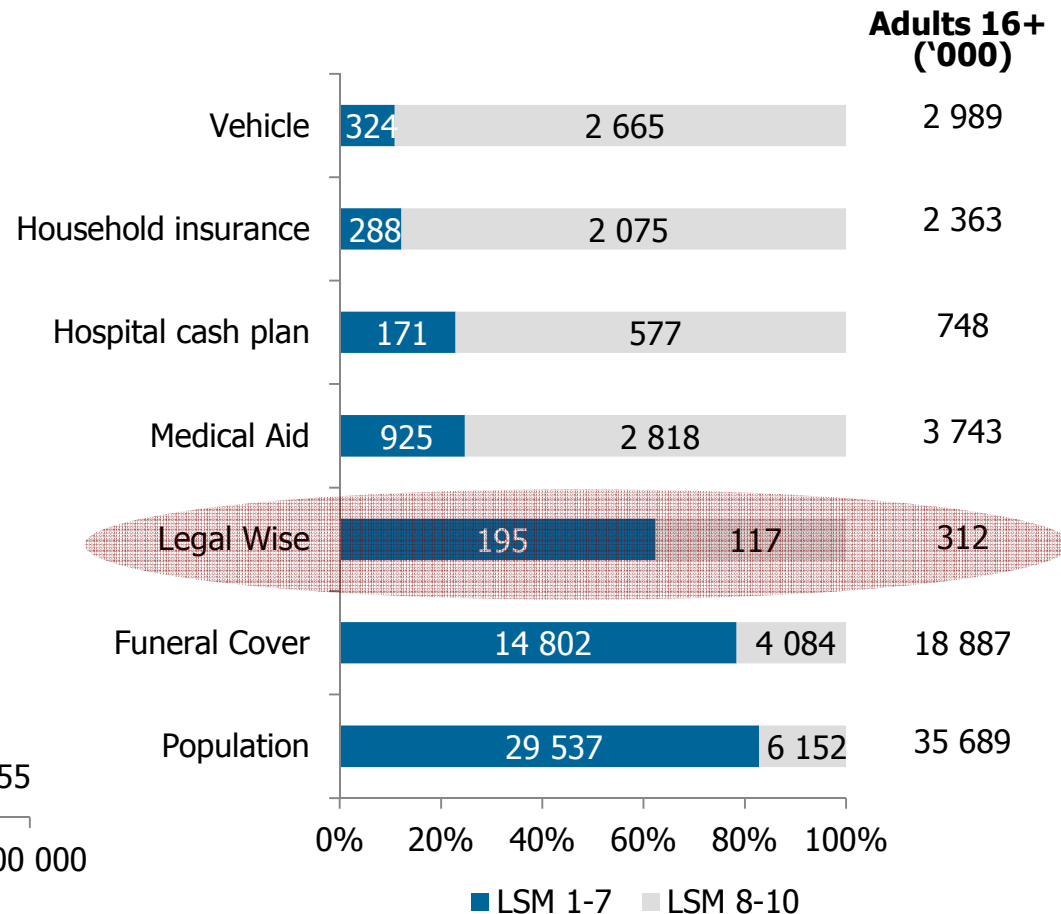


# According to FinScope 2012 there are 571 000 adults who have legal expenses insurance in SA. A sizeable proportion are in LSMs one through seven

## LEGAL INSURANCE PROVIDERS



## SHORT TERM INSURANCE PROFILE BY LSM








Source: FinScope 2012: Adults 16+ who responded "Have it in my name" or "covered by somebody else".



**There is no comprehensive data on the true size of the industry. Based on regulatory returns and discussions with providers we estimate a total of around 1.5 million policyholders**

### ESTIMATED POLICYHOLDERS / DEPENDENTS

Provider	Main members	Dependents	Total individuals covered
 Legal Wise (including Scorpion)*	700 000	800 000	1 500 000
 Clientele	120 000	137 143	257 143
 Lipco (including Foschini book)	80 000	91 429	171 429
 Legal & Tax	80 000	91 429	171 429
 Lexcorp	80 000	91 429	171 429
Other providers	300 000	342 859	642 859
<b>Total</b>	<b>~1 360 000</b>	<b>~1 554 289</b>	<b>~2 914 289</b>

Source: Legal insurance providers & FSB Statutory returns (for those marked with \*). Assumed 1.14 dependents per main member

**Policy documents typically list a series of exclusions. Common exclusions are listed below but these vary depending on the provider and the product**

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## COMMON POLICY EXCLUSIONS



Pre-existing matters



Cases that are not deemed to have a reasonable prospect of success



Cases where the costs are high relative to the value of the settlement



Business matters



Collective or group action



Any matter that could be resolved by paying an admission of guilt fine



Tenant and landlord related matters (where the client is the landlord)



A dispute between the member and the legal insurance provider

## Aside from regulations relating to financial services, the provision of legal expenses insurance must comply with the requirements of the legal profession

### OFFICERS OF THE COURT



- Governed by a code of conduct
- Self regulated but accountable to the high court

#### Attorneys



- Fall under the Law Society of South Africa (LSSA)
- Attorneys typically form professional companies and firms and practice in partnership with each other
- Insurers cannot own legal firms
- Legal insurance employees cannot be articulated

#### Advocates



- Fall under the General Council of The Bar
- Advocates have no direct contact with clients but are specialists who are briefed as needed by attorneys (referral profession)
- Advocates are individuals practitioners and never form partnerships

Legal practices bill seeks to consolidate attorneys and advocates under one piece of legislation

## Legal Aid South Africa provides professional legal advice to individuals who cannot afford it. It derives its mandate in terms of Section 35 of the constitution

### KEY FACTS



- Legal Aid SA has 32 Justice Centres across the country that **assist approximately 250 000 individuals each year**
- In the 2011-12 financial year the centres **finalised 402 459 matters**
- The Justice Centres are usually near courts and each centre serves between 10 and 20 courts
- The organisation is the largest single employer of candidate attorneys in the country (over 600 recruited each year)
- In total the **organisation employs 1700 attorneys**

### QUALIFICATION CRITERIA



- Means test to determine what individuals and households earn
- Household assets are also taken into consideration

The means test

- Individuals:** Must earn **less than R5 500** per month after tax
- Households:** Must earn **less than R6 000** per month after tax
  - If a household owns their dwelling, its total value must not be more than R300 000. The household must also live in this dwelling and no one in the household may own other dwellings.
  - If the household does not own the dwelling then the total value of their belongings must be below R75 000.
- Automatically qualify
  - Individuals receiving grants
  - Children and the elderly
- Legal Aid is also available to non-citizens if it is a criminal case or the case involves a child

### FINANCIALS



Income statement	Year ending 31 March 2012 (Rm)
<b>Revenue</b>	<b>R1 159</b>
Grants	R1 137
Other income	R22
<b>Expenses</b>	<b>R1 130</b>
Personnel	R844
Administrative	R78
Other expenses*	R206
<b>Surplus from operations</b>	<b>R29</b>



## Because the product is an insurance product providers are regulated under the Short Term Insurance Act as well as the FAIS Act

### SHORT-TERM INSURANCE ACT

*(Short-Term Insurance Act No. 53 of 1998)*

#### OVERVIEW

Provides for the registration of short-term insurers and prohibits any person from carrying on any kind of short-term insurance business unless such person is registered

Section 8 of the Short-Term Insurance Act prohibits an entity, without the approval of the Registrar, from including in its business or undertaking a name or description which includes words "*insure*", "*assure*" or "*underwrite*", or any derivative thereof, unless such entity is a registered insurer

Extensive regulations have been promulgated by the FSB in terms of Section 70 of the Act which are increasingly focused on regulating the relationship between insurers and intermediaries as well as outsource service providers rendering services to the insurance industry

The Act also defines certain types of policies but does not define legal expenses insurance. The product is regarded as a miscellaneous product

#### OUTSOURCING DIRECTIVE

Acts as a complementary measure to the Binder Regulations to deal with matters other than the performance of binder functions. The Directive applies to all aspects of the insurance business of insurers which may be outsourced to another person, but specifically does not apply to intermediary services. The Directive sets out the general "*over-arching requirements*" that an insurer must comply with when outsourcing any aspect of its insurance business

As a key principle the Directive requires that the Board of Directors and managing executives of an insurer remain responsible for the insurance business of the insurer, regardless of any outsourcing.

An insurer may not outsource any function or activity if the outsourcing may materially cause risk to the insurer, materially impair the quality of the governance framework of the insurer, impair the ability of the Registrar to monitor the insurer's compliance with its regulatory obligations or comprise the fair treatment of and satisfactory service to policyholders.

The insurer has an obligation to ensure that the level and standard of service rendered to the insurer and its policyholders in terms of any outsourcing arrangement with a third party are appropriately monitored, managed and reviewed regularly

*DOES THIS APPLY TO LEGAL EXPENSES INUSRANCE AND THE USE OF PANEL ATTORNEYS? WHAT ABOUT OTHER LEGAL SERVICES?*



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#### POLICY HOLDER PROTECTION RULES

Aimed at the protection of the interests of the policyholders  
Introduced to provide similar protection to consumers as are provided by the FAIS Code of Conduct, where policyholders interact with direct marketers rather than through intermediaries or brokers.

The rules govern, inter alia, claims processes. Insurers must adjudicate a claim within a reasonable time period. Where claims are rejected policyholders are entitled to reasons and can appeal within 90 days. The insurer must notify policyholders of the right to lodge a complaint under the FSOS Act (which provides for access to a voluntary Ombud) in plain in understandable language.

Policyholders can institute legal proceedings within 6 (six) months after the insurer finally informs the policyholder of its decision in relation to the matter

Provides for a 15 day grace period to protect the policyholder



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### BINDER REGULATIONS

Introduces the concept of a mandated intermediary, a non-mandated intermediary and an underwriting management agent ("UMA"). Intermediaries previously functioning as "administrators" for insurers have now had to choose whether they wish to function as a non-mandated intermediary or a UMA

An "underwriting manager" is a person that performs one or more of the binder functions. These functions are:

- the entering into, variation or renewal of a short-term policy, other than a short-term re-insurance policy, on behalf of an insurer or Lloyds Underwriters;
- the determination of the wording of a short-term policy;
- the determination of premiums under a short-term policy;
- the determination of the value of policy benefits under a short-term policy;
- the settlement of claims under a short-term policy

The non-mandated intermediary can perform binder functions on behalf of an insurer in terms of a binder agreement whilst at the same time rendering intermediary services to clients. The underwriting manager ("UMA") however can only perform binder functions on behalf of an insurer as if they were the insurer, but may not deal directly with policyholders

An insurer is entitled to pay to a binder holder a reasonable fee for services rendered under the binder agreement

An underwriting manager is entitled to share in the profits of the insurer attributable to the type and kind of policies covered by the binder agreement but an intermediary is not





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## FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT

(FAIS Act No. 37 of 2002)

### OVERVIEW

Governs the activities of financial services intermediaries and brokers

Introduces statutory obligations on the part of the financial services intermediaries which are to be regarded as minimum standards aimed at the protection of consumers

Intermediaries and advisors in the financial sector legally obliged to act with reasonable care, skill and diligence as well as good faith in their dealings with clients. "Good faith" entails the obligation to act in the best interests of the client, to be open and honest in dealing with a client and not to make a secret profit out of the mandate entrusted by the client.

**LICENSING OF FINANCIAL SERVICES PROVIDERS:** An applicant for authorisation must satisfy the Registrar that he / she complies with the requirements for fit and proper status for financial services providers in respect of personal character qualities of honesty and integrity, financial soundness and the competence and operational ability to fulfil the responsibilities imposed by the FAIS Act.

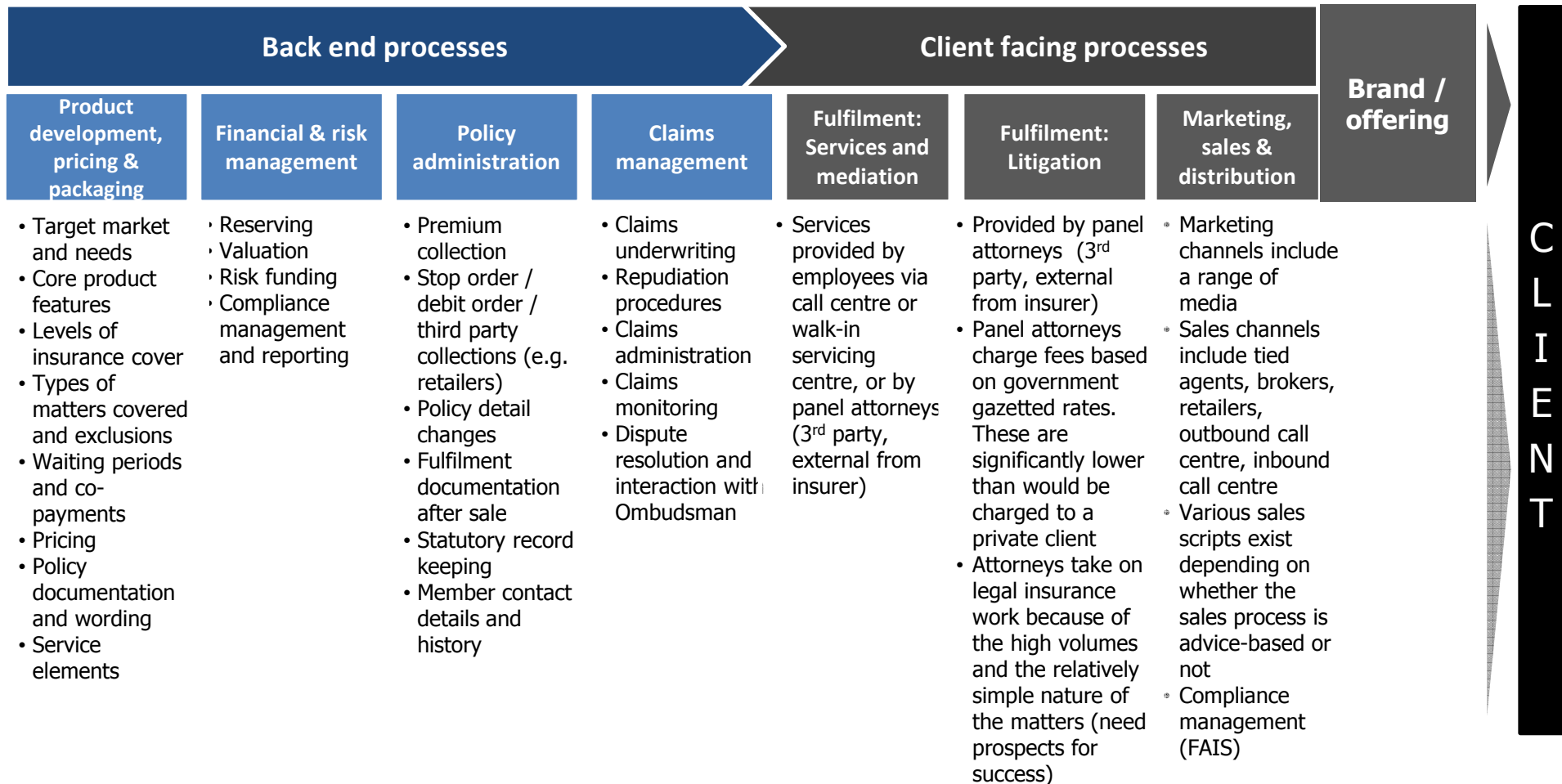
**NO ADVICE SALES:** Where factual information is given relating to for e.g. in relation to the description of any financial product or when answering to routine administrative queries, or information disseminated through the display or distribution of promotional material, this does not constitute advice (as defined) and such activities fall outside of the scope of the FAIS Act

**EXEMPTION:** The Registrar is empowered to exempt certain activities from the provisions of the FAIS Act. This provision allows some flexibility in relation to the implementation of the provisions of the FAIS Act in certain areas.

**GENERAL CODE OF CONDUCT:** Lays down minimum standards for the rendering of advice and associated services between financial services providers and their clients. The general duty of the provider in terms of the Code is at all times to render financial services honestly, fairly with due skill, care and diligence and in the interests of clients and the integrity of the financial services industry.

When a provider renders a financial service any representations made or information provided to a client must be factually correct, must be provided in plain language to avoid uncertainty or confusion and not be misleading, must be adequate and appropriate in the circumstances of the particular financial service taking into account the factually established or reasonably assumed level of knowledge of the client and must be provided timeously so as to afford the client reasonably sufficient time to make an informed decision about the proposed transaction

## There are several activities or processes that underpin the delivery of the product



## Various providers offer the product under different underwriting arrangements

	Back end processes			Client facing processes			Brand / offering	
	Product development	Financial management	Claims management	Fulfilment: Legal services and mediation	Fulfilment: Litigation	Marketing, sales & distribution		
Short term insurance licence	Clientele						Clientele call centre	Clientele
	Hollard			LegalWise			Hollard call centre Edgars/ Jet	Hollard Edgars/ Jet
	LegalWise						Worksite agents, LW call centre	LegalWise Scorpion
Intermediary	FNB Life	RMB Structured Insurance	FNB Life				FNB Life	FNB Justice 1st
UMA	Lexcorp	Santam	Lexcorp	Outsourced attorneys			Brokers	Lexcorp
	Lipco General	Absa Insurance	Lipco General				Lipco Business Agents Foschini Absa	Lipco
Cell captive	Legal & Tax	Centriq	Legal & Tax				L&T call centre, worksite agents	Legal & Tax

*Outsourced to a firm of attorneys*

CLIENT

## Agenda

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Project overview

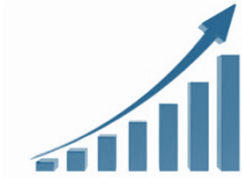
Product overview

***Client value***

The future

## There are a number of elements that can be used to assess value

### KEY RATIOS



- The claims ratio is the cost of members benefits and claims as a percentage of the net written premium (net of reinsurance)
- The management expense ratio includes expenses for the acquisition of insurance contracts as well as other expenses. These are as a proportion of the net written premium

### OTHER USAGE INDICATORS



- The claims ratio does not always reflect the true benefit of all services provided to the member i.e. it excludes free telephonic advice and in some cases the value of services rendered
- Other usage indicators include:
  - Percentage of members who have contacted the provider
  - Percentage of claims rejected
  - Reasons for claims rejection
  - Lapse rates

### PERCEIVED VALUE



- Perception of value based on feedback

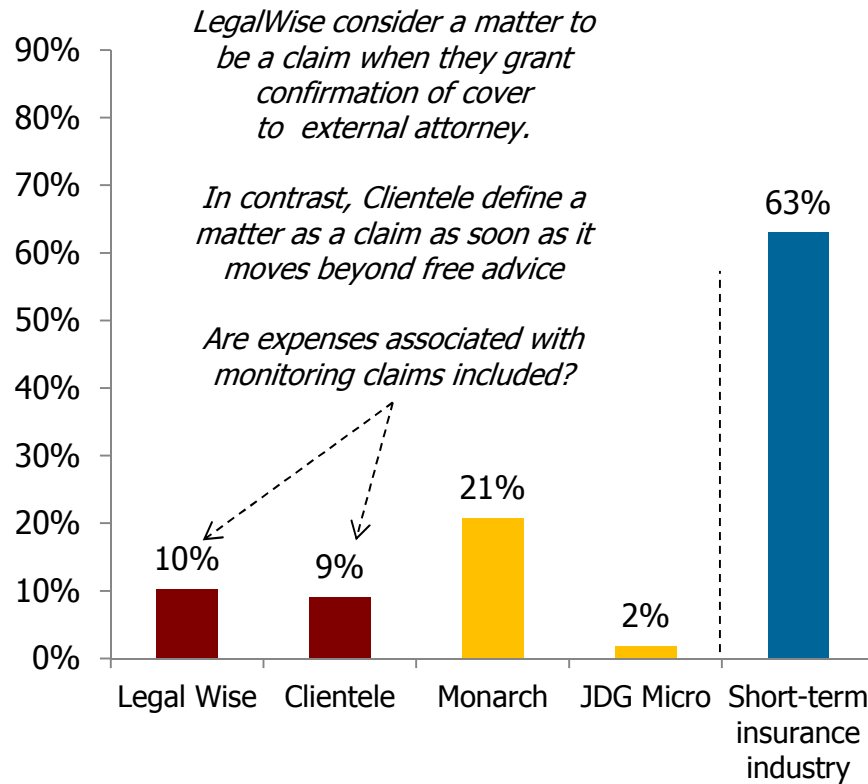


# The legal insurance business model is very different to that of the typical short-term insurer. While the claims ratios are lower, expenses are much higher

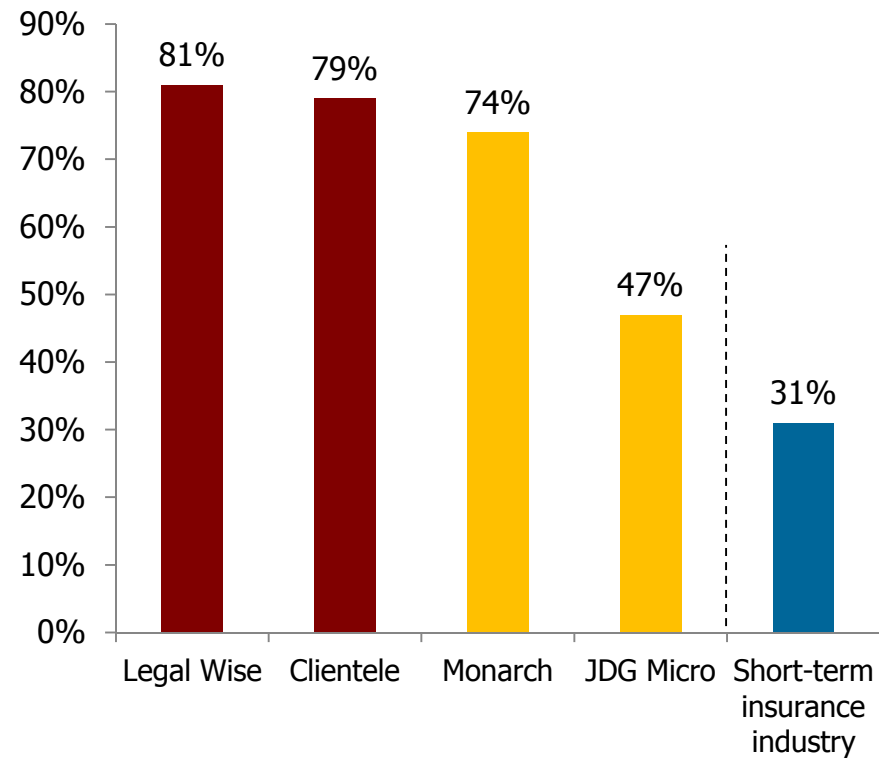
## INDUSTRY RATIOS

(2012, Legal insurance providers and other mono line insurers, Rand value)

### CLAIMS RATIOS



### MANAGEMENT EXPENSE RATIOS



Source: FSB statutory returns 2012, FSB - Special report on the results of the short-term insurance industry. Clientele annual report 2012.

\*The short-term industry includes typical insurers who offer most types of policies to, mostly, the general public.

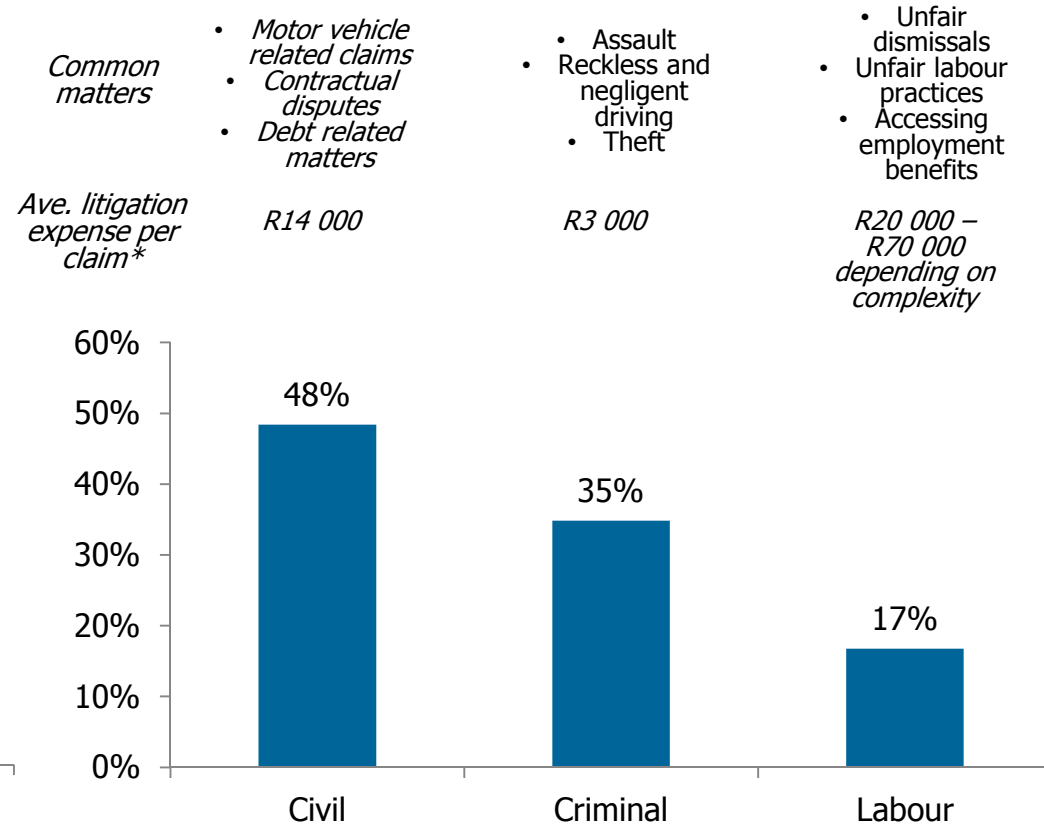
\*\*Clientele's management expense ratio is for 2011.

**Aside from claims, members receive on-going legal services which are not classified as claims. Approximately 20% of members utilise these benefits in any year. Providers estimate that if these costs were included claims ratios would be between 45% and 55%.**

**Percentage of members who claimed**  
*(2009 member cohort)*



**Distribution of claims by type of matter**  
*(Number of claims, 2012)*



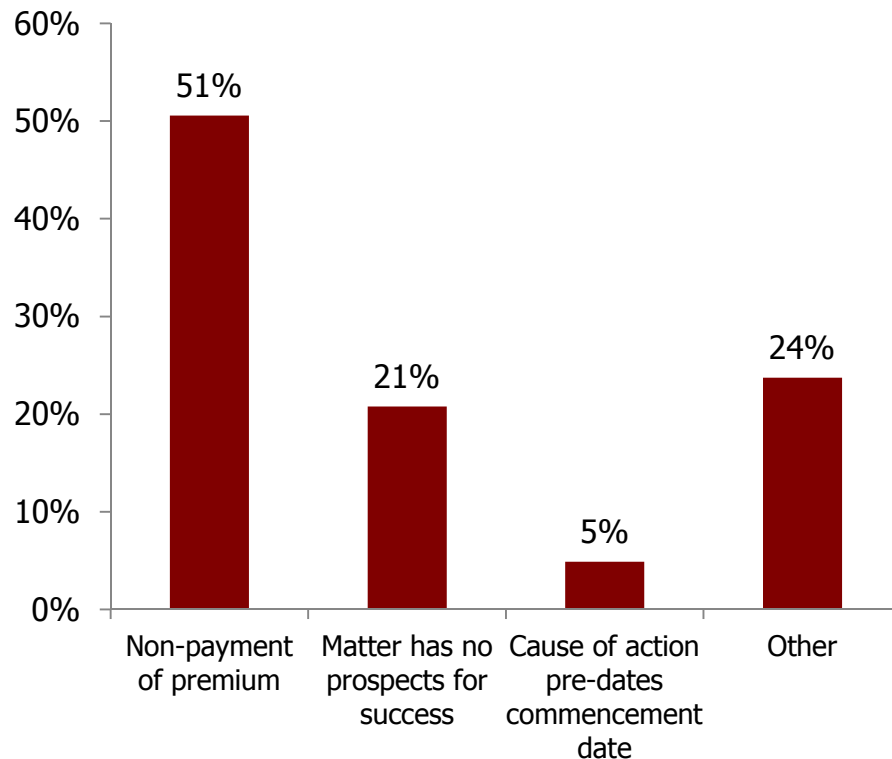
Source: Three providers supplied data. Where possible this data has been consolidated and aggregated percentages have been used.  
Note: An active member is someone who claimed in a given year. For one provider disbursements to attorneys have been used as a proxy for claims. \*Average litigation expenses are based on data from one provider and are calculated after a matter is finalised.



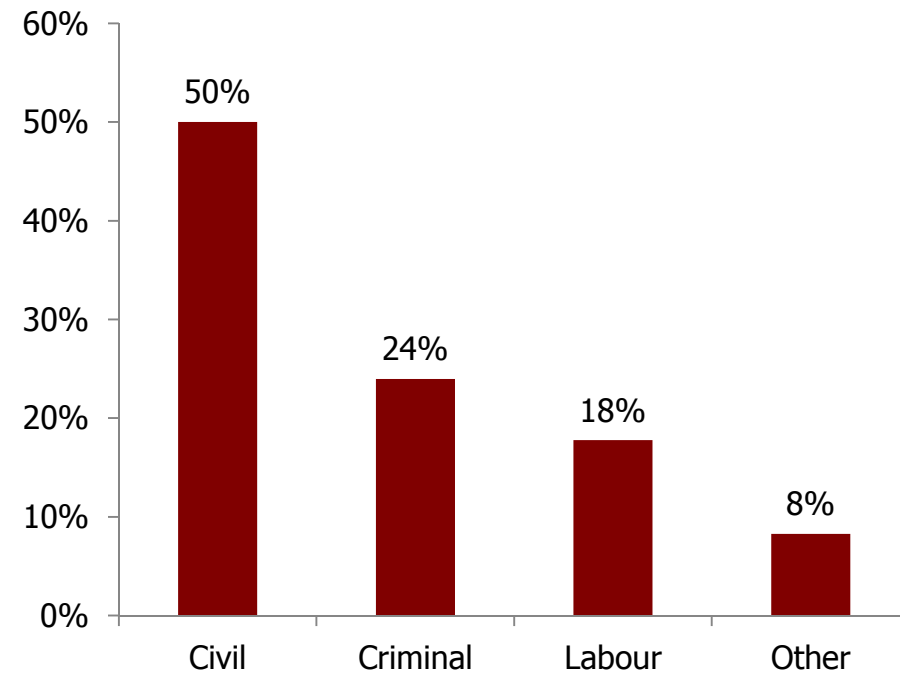
**On average, 12% of claims are rejected per year. In most cases this is due to non-payment of premiums. There is no data to assess whether this rejection rate is high or low relative to the industry as a whole**

### Rejected claims (Number of claims, 2012)

**Distribution by reason for rejection**



**Distribution by type of matter**



Source: Three providers supplied data. Where possible this data has been consolidated and aggregated percentages have been used. For one provider disbursements to attorneys have been used as a proxy for claims.



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## Two additional regulatory interventions could impact on the legal expenses insurance industry

### MICROINSURANCE REGULATIONS



- Accessed by the low-income population
- Objectives are to extend access /enhance inclusion, to formalise informal provision, to encourage competition while protecting consumers through prudential and business conduct regulation, improved enforcement and consumer education
- Proposed benefit caps; R50 000 per insured life, per insurer for death, R100 000 per person, per insurer, per contract period for asset insurance, R50 000 per insured life, per insurer for all other risk events - "This can for example include a legal policy"
- Binder regulations apply. No exclusions for pre-existing conditions. Policies must be in plain language. Minimum capital adequacy requirement of R3 million with a build up over 3 years
- Separate micro insurance Fit and Proper requirement

### TREATING CUSTOMERS FAIRLY



- TCF initiative is principles based rather than rules based. It has six customer outcomes that should apply throughout the process / all stages of interaction with the client:
  1. Customers are confident that they are dealing with firms where the fair treatment of customers is central to the firm culture
  2. Products and services marketed and sold in the retail market are designed to meet the needs of identified customer groups and are targeted accordingly
  3. Customers are given clear information and are kept appropriately informed before, during and after the time of contracting
  4. Where customers receive advice, the advice is suitable and takes account of their circumstances
  5. Customers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and what they have been led to expect
  6. Customers do not face unreasonable post-sale barriers to change a product, switch provider, submit a claim or make a complaint
  7. These outcomes will apply throughout the process at all stages of interaction with a client

*Will these help?*

## A number of issues were highlighted during the course of the research

### REGULATION



- Regulation: One size fits all
- Membership-based organisations that are technically not insurers
- Prudential requirements are onerous given risk profile
- FAIS: Accreditation not aligned with product and its specifics
- FAIS: Accreditation not transparent to end user – and can provide a veneer of authenticity
- Overlap between PPR and FAIS
- Binder regulations: confusing, unintended consequence is that intermediaries can earn more than before
- Binder regulations: UMA cannot be intermediary – this means that the product must be distributed by brokers who will not be interested in small premium products
- Outsourcing directive: does it apply to panel attorneys?
- Micro insurance regulation / TCF – might have an impact on LEI but will not solve key problems
- Definition of a claim. Also data gathered by regulator is not compiled into any useful industry measures

### PROVIDERS



- Product standardisation – what is covered / excluded varies
- Terminology is complex – sometimes unnecessarily
- Insurers have clear vested interests when assessing reasonable prospects for success
- Some practises not aligned with TCF (e.g. bank details before submission of policy documents, disclosure of all exclusions during sales process, assessment of prospects of success)

### CLIENTS



- Low levels of financial literacy
- Low levels of legal literacy
- Inability to assess quality of legal services
- High fear factor which can easily be exploited
- Limited knowledge of rights and avenues for recourse

### LEGAL PROFESSION



- No integration with the legal profession, industry operates outside the profession
- No recognition of challenges of having two clients
- Legal profession concerned with protection of rights of existing clients rather than access to services
- Legal aid – and alignment with insurance
- Significant impact of legal expenses insurance on creating viable firms of attorneys



**With regard to engagement going forward, this must be underpinned by a clear vision for the product**

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**VISION FOR LEGAL EXPENSES INSURANCE**

**OPTIMISE EXISTING**

**NICHE 'MISCELLANEOUS' PRODUCT**

***OR***

**JUSTICE FOR ALL**

**CIRITICAL MECHANISM TO ENABLE SOUTH AFRICANS  
TO ACCESS THEIR CONSTITUTIONAL RIGHTS**



## Way forward – areas of focus

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RAISE PRODUCT  
PROFILE WITHIN THE  
LEGAL PROFESSION

ALIGN OFFERING  
WITH LEGAL AID

DEVELOP LEGAL  
EXPENSES  
INSURANCE  
FRAMEWORK

ENCOURAGE  
CREATION OF A  
REPRESENTATIVE  
INDUSTRY BODY

DEVELOP A  
CONSUMER  
EDUCATION  
STRATEGY



## Questions / comments

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