

Making insurance accessible for low-income earners

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The first insurance company in South Africa was founded in 1835. It was called the Zuid-Afrikaansche Brand en Levensversekering Maatschappij (South African Fire and Life Insurance Company), now known as Old Mutual. A decade after its inception, many other prominent insurance companies were established.

Over the years, the insurance industry has been instrumental in the development of South Africa's financial sector. However, there is increasing concern about the availability of relevant and affordable financial products and services for vulnerable groups who earn less than the minimum wage.

Insurance mitigates the impact of first-order basic risks, such as the loss of a motor vehicle due to an accident or theft or damage to property caused by a fire. Without comprehensive insurance cover, individuals are likely to be left in distress when unexpected, life-altering events occur.

On 18 January 2018, the president of South Africa approved the Insurance Act 18 of 2017. The Act aims to broaden access to insurance products for both low- and high-income earners. It provides a legal framework for regulation and supervision of the insurance business that is consistent with the Constitution. It aims to ensure the insurance industry is fair, safe, stable and inclusive.

Binder fee limits - In December 2016, before this Act was approved, the National Treasury, with the support of the Financial Services Board, published a draft regulation under the Long Term Insurance Act and

Short-Term Insurance Act of 1998 for public comment. The regulation was introduced to broaden consumer access to suitable insurance services and products. One of the suggested measures under the regulation was to adjust the remuneration limit on binder fee agreements. A binder fee agreement is an agreement between the insurer and the binder holder or non-mandated intermediary. The draft regulation stipulates that binder holders authorised to give advice under the Financial Advisory and Intermediary Services Act may now receive a maximum of 9% instead of 20% remuneration.

A binder fee cap reduces conflict of interest between binder holders and insurers when binder holders perform a binder function on behalf of the insurer. It ensures that binder holders and insurance companies provide an unbiased and fair financial service to the client.

A conflict of interest in the context of binder fee agreement is when a provider or a representative has an actual or potential interest that may influence the objective performance of the provider's obligations to the client. An example is when the binder holder performs their binder holder duties with less circumspection and due diligence because they are receiving a lower remuneration.

If binder remuneration fees are not reasonable and commensurate with the cost of performing the binder function, financial services providers such as insurance companies will constantly increase fees without taking the interest of policy holders into account. Alternatively, they will outsource binder functions to parties that charge lower fees to secure distribution instead of improving efficiency.

Fee consequences - One of the concerns about the introduction of a binder fee cap of 9% is that financial

institutions will have to change their business models to ensure that outsourcing arrangements do not compromise the interest of policy holders. Another concern is that brokers or administrators performing binder functions may decide to limit their involvement to administration.

In response to the concerns of industry players, the National Treasury and the Financial Services Board submitted that an exemption mechanism has been provided to justify the higher fees. Insurers can apply for exemption in cases where the proposed cap is not reasonable and commensurate with the actual cost of performing the binder function – due to the low value of the premiums. But the problem with the exemption mechanism is that it is the insurer's responsibility to apply to the registrar for exemption.

It was also submitted that a conflict of interest is created instead of managed, because it is now the duty of insurers who may be receiving higher income as a result of the (capped) binder fee to apply for a higher fee for binder holders. However, this argument is misguided, given that the purpose of the cap is to curb unreasonable fees for policy holders.

We live in a time where people often prepare for the worst rather than hoping for the best – and this makes insurance essential. Whether the cap of 9% will increase the accessibility of insurance products will depend on the remodelled policies of insurance companies. The policies will also have to be based on economic conditions.

The crux of the matter is that the regulation was not introduced to frustrate financial providers and brokers. It must ultimately protect policy holders and reduce the risk of them receiving advice that is not in their interest.