




The nature and implications of informality in the South African funeral services and microinsurance markets

October 2012

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This work was carried out with the aid of a grant from the International Development Research Centre, Ottawa, Canada.



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Acknowledgements

This work was carried out with the aid of a grant from the International Development Research Centre, Ottawa, Canada. We would like to thank IDRC for its funding, guidance and inputs in this report. We would also like to thank our field researchers, Zanele Ramuse and Nokwanda Mahori, for their invaluable contributions and for the time and effort of our colleague, Sandisiwe Ncube, in helping to manage the fieldwork process. Most importantly, we wish to thank the funeral providers who gave us their valuable time to share their business information with us. Without the insights gained through these consultations, this report would not have been possible. Any mistakes and omissions are entirely that of the authors.

List of Abbreviations

CBD	Central business district
CC	Close corporation
CIPC	Companies and Intellectual Property Commission
EC	Eastern Cape
FAIS	Financial Advisory and Intermediary Services
FSB	Financial Services Board
FSP	Financial Services Provider
ID	Identity document
OCPIE	Office of Companies and Intellectual Property Enforcement
SAFPA	South Africa Funeral Parlours Association
SAPS	South African Police Services
SARS	South African Revenue Services
VAT	Value-Added Tax
VEFPA	Vhembe District Funeral Parlours Association

Executive summary

This paper explores the nature and implications of **informality** in the provision of **funeral insurance** (insurance to cover the cost of a funeral) by the **funeral service provider** industry i.e. for-profit businesses that transport, treat, store and bury the dead. While the concept of informality is typically viewed from different perspectives, this study is primarily concerned with informality in terms of *non-compliance with insurance regulation*, an activity-based definitional approach to informality.

Funeral insurance. Funeral insurance is the biggest driver of insurance usage in South Africa with 89.2% of South African adults who have risk cover having some sort of funeral cover. The drivers of funeral insurance usage include the demand for a dignified (often extravagant) funeral, the looming spectre of death in a country with high crime and HIV/AIDS rates, and the cost of a traditional funeral particularly relative to the income of many of the consumers which tend to be in the lower income brackets.

Formal funeral insurance products in South Africa tend not to be individually underwritten but rather underwritten on a group basis. Because no underwriting takes place, 6 month waiting periods are usually applied for death by natural causes to counter adverse selection, and persons over 65 are generally not eligible for cover.

Funeral service providers. Although there are no current figures relating to the number of funeral service providers in South Africa, a 2005 study estimated the number to be between 3,000 and 5,000. In addition to preparing the deceased for burial and burying the deceased, many funeral service providers in South Africa also provide and sell funeral insurance products, often to low-income South Africans. Funeral service providers provide funeral insurance on a for-profit basis to more than a quarter of those that have funeral insurance. While some funeral service providers intermediate the insurance products of formal insurance companies and comply with market conduct regulation, many provide insurance on an informal basis without being underwritten by a formal insurance company and/or without complying with market conduct regulation. Although accurate data has thus far not been available, indicators are that a significant number of funeral service providers offer funeral insurance on an informal basis.

Aside from some questionable practices such as using insurance premiums to fund day-to-day business requirements, many funeral service providers often offer insurance and other types of financial products (e.g. credit and savings) as a way to lock clients in to using their funeral services. They do this by paying claims in the form of a funeral service, the monetary benefit of which is most often not stated. This is contrary to legislation which requires a cash option to be granted and quantified.

Policy process. In 2003 the South African Parliament heard submissions regarding these and other abusive practices in the informal funeral insurance market. This resulted in the South African National Treasury issuing a discussion paper in 2008 on a proposed regulatory framework for microinsurance. In the paper the government proposed creating a distinct formalisation path, proportionate to the level of risk of microinsurance products, for funeral service providers (or any other provider) providing insurance on an informal basis. The proposal was formalised when the National Treasury issued a policy document on microinsurance during July 2011. This document forms the basis for draft legislation which is

intended to be developed during 2012 and which will likely be tabled in Parliament in 2013 with implementation to commence in 2013/14.

Current regulatory regime. The current insurance regulations applicable to funeral insurers can be divided into those that govern the underwriting of the product and those that govern the sales process, but both underwriters and intermediaries are regulated by the Financial Services Board (“FSB”). As regards the former, anyone that underwrites funeral insurance is required to register under the Long-Term Insurance Act of 1998 as a long-term insurer. This entails incorporating as a company, generally a public listed company (upon which tax registration is automatic), meeting minimum prudential regulations (capital of R10 million, reserves of 13 weeks expenditure and in 2014 Solvency II capital adequacy requirements), appointing a statutory actuary and auditor, meeting the governance requirements in the Long Term Insurance Act, Companies Act and King III Code of Corporate Governance, submitting all the required returns, and maintaining the insurance business separate from any other business.

Benefits under funeral insurance are capped at R18,000 per policy and pay-outs take the form of cash, a combination of cash and an in-kind benefit, namely a funeral service, or just a funeral service, although legislation require clients to be offered a cash alternative that must be quantified.

As to the sales process, this is governed by the Financial Advisory and Intermediary Services Act (FAIS) of 2002 and regulations issued thereunder and also by the Policyholder Protection Rules in the Long-Term Insurance Act. Together these contain detailed rules for intermediation of financial products including insurance products. In particular, no person may provide financial advice (essentially make recommendations) or intermediate financial products (act as administrator by, for example, collecting premiums) unless that person (which may be a natural or a legal person) is registered as a Financial Services Provider (“FSP”). The regulations relating to the Fit and Proper Determination of FSPs contain extensive rules as to the experience, qualifications, regulatory exams and continuous professional development requirements that an FSP must meet before being so registered. Other requirements regarding financial stability and operational set-up are also imposed, while the Code of Conduct for FSPs contains detailed instructions regarding the manner in which the sales process should be conducted.

The study. To date no extensive analysis has been conducted into the informal funeral service provider industry in South Africa. The qualitative and quantitative data collected as part of our study and presented in this document consequently presents us with an opportunity to understand the insurance operations of funeral service providers in greater detail. In the context of the broader microinsurance policy reform process in South Africa, the research question explored in this study is whether the provision of funeral insurance by funeral service providers can remain or be allowed to remain informal. If the answer is in the negative, what will be the impact on insurance clients and funeral service providers providing insurance?

The central pillar of our data collection approach was a survey of 72 funeral service providers that offer funeral insurance. The survey was conducted in both urban and rural areas in four provinces in South Africa. Four businesses in this survey were selected for “deep dives”, namely in-depth investigations into their management practices and financial affairs.

Although as stated above there is no recent data available on the exact number of funeral service providers in South Africa, this is unlikely to be a representative sample. However, the collected data still significantly contributes to our understanding of insurance and other dimensions of informality amongst funeral service providers.

We found that funeral service providers operate in a tight competitive environment with many being clustered in the same vicinity which leads to a number of dubious practices such as waiving waiting periods or paying out unproven claims to attract clients. Corruption in the hospital sector appears evident with some holding bodies for ransom and other operating an unofficial release schedule in terms of which bodies are rotated amongst funeral providers to ensure “fair” distribution. The taxi transport industry was also found to “control” the transport routes in once province requiring payment for transport of bodies on a popular corridor route.

Our findings show that the funeral service provider value chain is disaggregated, with funeral service providers falling into the categories “full servicers”, “transporters” and “project managers”. Full servicers have their own mortuaries and transport and transport, store, treat and bury the deceased. Transporters own their own transport and therefore transport the body but outsource the treatment thereof. Aside from providing funeral insurance, project managers outsource the entire value chain to third party providers. Although one would assume that providers without mortuaries would not be considered as funeral service providers, since the health legislation does not prohibit (or in any way deal with) outsourcing in regard to aspects of a funeral, we classify all three categories as funeral service providers for purposes of our report.

We found there to be a positive correlation between the age of the business, size of the business (in terms of number of insurance clients) and value chain category, with older, bigger businesses tending to be full servicers, and vice versa. We also found that there is an increase in the average monthly premium charged for funeral insurance across the value chain. However, the benefit to premium ratio (the average cash price of the most popular funerals divided by the average premium charged per month) actually decreases successively as one moves up the value chain for funeral service providers, meaning that project managers actually offer the best value for money (or say they do, as the price of the most popular funeral package is self-reported). Further, while the average monthly premium in rural areas is lower than in urban areas, the benefit is higher in rural areas, meaning that clients that purchase funeral insurance from funeral service providers in rural areas are getting more value for their money than clients who purchase such products from funeral service providers in urban areas.

Informal funeral service providers

We categorised the funeral service providers in our survey as formal or informal according to their compliance or otherwise with the underwriting and market conduct regulation. We verified this against public FSB websites, discussions with the FSB and discussions with insurers. Specifically, those funeral service providers that were underwriting their own products (and were not registered insurers) (60) were regarded as non-compliant and therefore informal, with the balance of the 12 that were underwritten by registered insurers being split into those that were not registered FSPs (5) and those that were so registered (7).

Since most of the analysis centred around informality in respect of underwriting, the 12 that were underwritten were classified as formal for purposes of this report.

We found that there was a positive relationship between informality and age, size of business and value chain category, with formal funeral service providers tending to be older, larger and higher up in the value chain, and vice versa. We also found that informal funeral service providers had less awareness and understanding of the FSB and FAIS than their formal counterparts, but that even formal funeral service providers lacked awareness in this regard.

It emerged that owners of informal funeral providers tend to be male and less well educated than their formal counterparts. We also ascertained that the majority of consumers of funeral insurance tend to be female, black and urban with no real distinction between consumers of formal and informal funeral products in this regard. However, we found that consumers of informal funeral risk insurance tend to suffer from lower employment and be less educated than their formal counterparts. Further, while consumers of funeral insurance tend to be in the lower to mid income brackets, consumers of informal funeral insurance tend to be in lower income categories than formal consumers. This paints a picture of a relatively vulnerable group of consumers of informal funeral insurance.

Risks relating to informal funeral insurance provision

We identified the following key risks in relation to the provision by funeral service providers of insurance on an informal basis:

- *Lack of management of risk pools points to prudential risk.* Lack of health or at the least age underwriting (i.e. not limiting the age of policyholders), lack of management of age distribution in the risk pools, over or under-pricing on premiums, failure to collect data of clients or poor data management, lack of requirements regarding insurable interest and lives covered, number of insured lives per policy exceeding requirements, lack of imposition of waiting periods to counter adverse selection, failure to generally manage the risk pool and often deliberate risk-taking particularly in the start-up years all point to poor insurance risk practices which place clients at extreme risk.
- *Lack of financial management.* Inadequate governance structure and often rudimentary book-keeping mean that many informal funeral service providers do not know their financial status and are not managing their financial risks. This in turn puts consumers at risk.
- *Non-separation of funeral business from insurance business.* The majority of non-compliant funeral service providers do not separate their funeral and insurance businesses as required by legislation. Instead, they use the insurance premiums to fund their general capital and day-to-day expenses. This is particularly the case with start-up business that embark on what can be termed a “start-up lottery” in respect of insurance premiums. This essentially constitutes consumer abuse as this practice may result in insufficient funds being available to cover claims.
- *Failure to comply with market conduct laws and best practices.* Failure to offer a cash option as an alternative to a funeral and other market conduct abuses place consumers, who tend to be in the more vulnerable demographic segments, at substantial risk.

These irregularities within the informal funeral service provider industry represent unacceptable levels of risk for consumers and point to the need for informal funeral service providers to be brought within the regulatory net. However, the consequences of this, aside from the cost of compliance, may damage the funeral service provider industry. In particular:

- *Risk pools too small for viability.* Many of the funeral service provider businesses are unviable given the small number of lives covered. This means that they would be unable to underwrite themselves and would have to obtain underwriting from a registered insurer, resulting in them having to pass premiums, currently used to fund their businesses, to insurers, leaving them with a commission only.
- *Many young funeral service providers loss-making.* Even without formalisation and the attendant costs and implications e.g. separation of funeral and insurance businesses, many of the young insurance companies are currently loss-making.
- *Formalisation requires separation of funeral and insurance businesses.* The requirement to separate the two businesses will mean that insurance premiums may no longer be used for general business purposes, which may mean that the funeral side of the business is not able to survive.
- *Cash option.* If consumers were to be given the option of taking cash instead of an in-kind funeral benefit, this would prejudice both the funeral and insurance businesses. The funeral business would no longer be assured of a captive client base, while the insurance business may have to pay a cash price in excess of the cost of providing a funeral.

The above implies that any government policy aimed at formalising the provision of insurance by funeral services providers needs to carefully balance the protection of vulnerable consumers with the policy goal of business development or not unnecessarily harming primarily black-owned micro, small and medium enterprises (MSMEs) in the funeral service provider industry. Should informal providers be forced to formalise through an effective enforcement strategy, many of them will most likely be unable to survive on their funeral service income only and, unless they find alternative financing mechanisms, will face bankruptcy in the absence of alternative financing mechanisms. Imposing a blanket requirement for formalisation may therefore lead to a much smaller and potentially much less competitive industry. It may furthermore be that, while informal funeral service providers are providing services at a price and in a manner that is not altogether consumer friendly, they are nevertheless honouring claims by providing a funeral service, meaning that it will not be desirable for them to close down. There is thus a need to balance consumer protection considerations against the likely consequences of enforcement.

1. Introduction

This paper explores the nature and implications of informality in the South African microinsurance market and in particular the provision of **funeral insurance** (insurance to cover the cost of a funeral) by the **funeral service provider** industry i.e. those that transport, treat, store and bury the dead.

The concept of informality is typically viewed from different perspectives. This is explored in greater detail in Section 2. This study mostly focuses on informality in terms of non-compliance with insurance regulation and, to some degree, non-compliance with health regulation. Compliance in terms of business and tax registration is also briefly explored (Section 6.1) but the implications of non-compliance are found to be less consequential than those of non-compliance with insurance regulations. Consequently, in this paper the term “informality” or “informal” refers to non-compliance with insurance regulation (unless otherwise stated) and “formal” (and any derivatives thereof) refers to the opposite.

Informal insurance markets play an important role in serving those not served by the formal sector, most often low-income households. Formal insurance companies may not have entered this market fearing an unviable business opportunity, or they may not have developed the distribution networks and infrastructure required to successfully serve these markets. Informal insurance providers’ physical and cultural proximity to their target market means that they are well placed to understand and respond to the financial needs of low-income households, even if they are not always able to do so in a cost-effective or best-practices manner.

On the other hand, from at least two perspectives the provision of insurance on an informal basis by for-profit businesses can be considered problematic. Firstly, the existence of informal insurance providers may contribute to an un-level playing field between compliant and non-compliant insurance providers. Compliant insurance providers incur regulatory costs whereas their informal competitors do not, which may discourage formalising. Secondly, the existence of informal insurance providers may result in certain social and consumer protection risks. Informal insurance providers have to be sufficiently financially stable to meet future obligations based on contracts made today, as well as be able to appropriately advise clients of the product that they are purchasing and follow appropriate marketing practices. Informality means non-compliance with legislated prudential and market practices designed to protect the consumer.

Policy process in South Africa

Funeral service providers in South Africa are also known as funeral undertakers or funeral parlours although the term funeral service provider will be used throughout this paper and will include any business providing all or some of the services associated with a funeral including transportation of the body, storage of the body, preparation of the body for burial and burial of the body. In addition to preparing the deceased for burial and burying the deceased, many funeral service providers also provide and sell funeral insurance products, often to low-income South Africans. While some funeral service providers intermediate the insurance products of formal insurance companies and comply with market conduct regulation, many provide insurance on an informal basis without being underwritten by a formal insurance company and/or without complying with market conduct regulation. As mentioned in the literature review (see Section 2.2 of this study), apart from a brief description in Roth (1999), very little has been done in terms of exploring the nature and implications of the provision of funeral insurance on an informal basis by funeral service providers in South Africa.

In 2003 Parliament heard submissions regarding abusive practices in the informal funeral insurance market. These related in particular to the increasing number of funeral service providers offering group schemes not underwritten by a registered insurer, thereby leaving the scheme's members vulnerable to under-payment of claims, over-charging of premiums and commission, and problems associated with payment-in-kind (rather than cash)¹. Instances of fraud were also reported, for example where an administrator or intermediary did not cancel a policy on request. This resulted in the South African National Treasury issuing a discussion paper in 2008 on a proposed regulatory framework for microinsurance (National Treasury, 2008). In the paper, the government proposed creating a distinct formalisation path, proportionate to the level of risk of microinsurance products, for funeral service providers (or any other provider) providing insurance on an informal basis.

We discuss in our policy note the key aspects of the proposed microinsurance regulatory framework. In summary the requirements to become a micro-insurer are less onerous than under the current regulations in order to lower the barriers to entry, while the product standard and benefit limits are designed to enhance consumer protection. Although the paper does not explicitly define what is meant by informality, it is clear from the text that insurance informality is viewed as insurance that is not underwritten² by a registered insurer. The proposal was formalised when the National Treasury issued a policy document on microinsurance during July 2011 (National Treasury, 2011). This document forms the basis for draft legislation which is intended to be developed during 2012 and which will likely be tabled in Parliament in 2013 with implementation to commence in 2013/14.

The purpose of this study is to provide information on informal insurance (in particular funeral insurance) provided by funeral service providers in South Africa to inform the legislation that is currently being drafted and to guide any enforcement strategies that are required to implement the legislation. Further, the findings of this study may also be used to inform government policy on the development of these businesses more broadly.

Document structure

We explore the question of the nature and implications of informal insurance, and in particular informal funeral insurance provided by funeral service providers in South Africa, in the following sequence:

- Section 2 provides a brief overview of the literature on informal insurance and, more specifically, funeral insurance and funeral service providers in South Africa;
- In Section 3 we present the research question and its sub-questions;
- In Section 4 we describe the data collection methodology;
- Section 5 describes the nature and drivers of the funeral insurance market in South Africa;
- In Section 6 we examine the various regulatory requirements that apply to funeral service providers in South Africa;
- Section 7 describes the structure and nature of the funeral service provider industry in South Africa;
- In Section 8 we examine insurance informality amongst funeral service providers; and
- Section 9 examines the various risks associated with the informal provision of funeral insurance by funeral service providers, while in Section 10 we conclude on the key study findings.

¹ FinMark Trust Case Study Strengthening Consumer Protection in the South African Microinsurance Market, 2011

² "...Illegal provision of funeral insurance, often through funeral parlours that self-insure" and "qualitative research suggests that there is a significant number of funeral parlours offering illegal (i.e. not underwritten by a registered insurer) insurance" (National Treasury, 2008).

2. Defining informality and informal insurance

2.1. Defining informality

Kanbur (2009) proposes that economic informality should be considered relative to whether “specified regulations” apply to an economic activity. He identifies four categories of interaction with regulations: a) regulations apply and the economic activity in question complies; b) regulations apply and economic activity in question does not comply; c) the regulations turn out to be non-applicable for the relevant economic activity after adjustment of the activity (in most cases with the purpose of avoiding regulation); and d) regulation does not apply to the activity.

In an attempt to reconcile and order different definitional approaches to informality, Heintz (2012) distinguishes between three definitional approaches:

- **Enterprise-based:** This is an institutional definitional approach and includes considerations such as the business’s registration status with government, the legal form of the business, the size of the enterprise, tax evasion or avoidance (often used as a proxy for other types of regulatory avoidance or evasion) and the nature of financial accounts.
- **Employment-based:** Employment-based informality refers to vulnerable and unprotected forms of employment as well as the degree to which labour laws are not complied with by the employers.
- **Informality based on the relevant economic activity (activity-based):** This definition refers to the category of the economic activity, with specific reference to hidden or underground activities. According to Heintz (2012: 6-7) these “individuals and businesses operate outside of the law because it is beneficial for them do so relative to the perceived costs”. It is important to emphasise that this definitional approach to informality may include informal economic activities that generate negative externalities, e.g. drug production and trafficking, human or other smuggling, etc., but also other activities that are viewed less negatively by society.

We argue that the major dimensions of informality considered in our study on the provision of informal insurance by funeral service providers in South Africa fall into a combination of Heintz’s (2012) last definitional category of informality (activity-based) and Kanbur’s (2009) second category. The provision of informal insurance implies non-compliance with a set of existing regulations that apply to a particular category of economic activity, namely insurance. The provision of this product outside of regulatory markers may generate significant negative externalities in the case of failure to pay out specific or all insurance claims which undermines the general stability of and confidence in the larger insurance market. Furthermore, non-compliance with the health regulations that apply to funeral service providers may also generate negative externalities as it puts the immediate community at risk of disease and generally unsanitary conditions.

2.2. Informal insurance

In this section, we tie our larger definitional approach to informality to a specific definition and wider literature on *informal insurance*.

A large proportion of global microinsurance is provided on an informal basis. The available literature on informal insurance has tended to focus mainly on “informal” risk-sharing arrangements *between households*, with this presented as the typical view of informal insurance. Furthermore, where the

literature has focused on informal risk-sharing groups and/or associations in developing countries, the discussion has mostly centred on their contribution to “social capital”, on development initiatives that operate through community-based health organisations or on the internal organisation and functioning of these structures (De Weerd, Bold & Pankhurst, 2006).

Dercon et al. (2006: 686) defines “informality” in the context of these community-based risk sharing mechanisms with reference to two dimensions: 1) these institutions typically function “outside the market place”; and 2) they are “‘informal’ in the sense that they were [are] not based on well-defined ‘formal’ associations, with formally defined, written sets of rules or regulations governing their operation”. Informality in this sense is thus defined by the total absence of, rather than the presence and non-compliance with, regulations or rules that apply to the operation of these organisations.

In our study, we explore the phenomenon of funeral service providers providing insurance on an *informal* (i.e. non-compliance with existing insurance regulations), *for-profit basis* to a client base that extends beyond a small group of households with intimate knowledge of each other’s lives to a larger community or even individuals living in different communities. This requires us to treat informal insurance differently than the literature to date has and to view it as a specific category of informal economic activity. In this context, rather than defining informality in insurance provision as the total absence of rules governing the functioning and operation of insurance providers, we define informality as *non-compliance* with the regulations that apply to their particular sphere of business operations.

The phenomenon of some funeral service providers selling funeral insurance on an informal basis is prevalent in South Africa. 89.2% of South Africans with risk cover have some sort of funeral insurance, while funeral service providers provide funeral insurance on a for-profit basis to almost 4 million people, or 27.5% of those who have funeral insurance (De Vos, 2012). Although accurate data has thus far not been available, the National Treasury discussion paper on microinsurance (2008) suggests that there are a significant number of funeral service providers offering funeral insurance that is not underwritten. The paper also explicitly states that this “has been noted as an area of concern” not only because of the insurance risk this entails but also because of the potential consumer abuse by “operators that do not comply with [insurance regulation]”. A regulatory review of formal and informal funeral insurance markets in South Africa done by Bester et al. (2005) also finds indications that “a large proportion of [funeral service providers offering funeral insurance] are fully or partially self-insured”³.

From a global perspective, South Africa is not unique in the provision of informal insurance by funeral service providers. Bester, Chamberlain and Hougaard (2008) describe the provision of microinsurance by funeral service providers in Colombia as a salient feature of the larger Colombian microinsurance market. They cite industry sources as estimating the number of users of this type of informal insurance as up to three million adults or 10% of the adult population. Similarly, in Brazil, microinsurance products are provided and distributed by funeral service providers on an informal basis (Bester et al., 2010).

Apart from a brief description in Roth (1999) of the insurance operations of one such business in South Africa, the nature and dynamics of informal microinsurance business operated by funeral service providers in South Africa has not yet been explored in any detail. The qualitative and

³ Amongst other methods, the study entailed a telephonic survey supplemented by on-site visits to funeral service providers, because respondents were reluctant to disclose information the telephonic survey.

quantitative data collected as part of our study and presented in this document therefore presents us with an opportunity to understand the insurance operations of funeral service providers in greater detail.

3. Research questions

In the context of the broader microinsurance policy reform process in South Africa, the research question explored in this study is whether microinsurance provision in general, and the provision of funeral insurance by funeral service providers in particular, can remain or be allowed to remain informal. If the answer is in the negative, what will be the impact on insurance clients and funeral service providers providing insurance?

We explore the problem statement from three core perspectives:

- **Prudential risk:** The fact that some insurance providers are currently not complying with insurance regulation begs the question whether this provides these non-compliant insurance providers with an unfair advantage. Further, leaving certain insurance providers unregulated and unsupervised may lead to prudential instability in the insurance sector.
- **Market conduct risk:** Here we consider the impact on the consumer where the design of the product and its sales process are unregulated.
- **Small business development/inclusive growth:** Economic development is a priority in South Africa and small businesses are essential to this. We explore the key barriers to business development and growth that funeral service providers face as well as those to formalising. We also examine the implications that formalisation will have on these businesses.

In particular, we explore the following research questions:

- The nature of insurance products and services provided by informal funeral service providers and the mechanisms employed to pool risk, collect premiums and make pay-outs to clients.
- Whether there is a typology of funeral service provider firms, by level of informality or other dimensions, and whether different categories of funeral service provider businesses exhibit distinct characteristics with regard to the soundness of their financial and marketing practices (or the implied level of potential consumer abuse).
- The nature and level of interaction between informality in insurance and other dimensions of informality (health, business and tax).
- The nature of consumer protection issues raised by informal insurance providers' (funeral service providers) operations.
- Informal funeral service providers' responses when things go "wrong" (e.g. multiple deaths in the community)
- The key reasons for funeral service providers operating in the informal rather than formal insurance sector.
- What the impact of formalisation on these firms would be.
- Whether the barriers to formalisation differ between categories of firms and whether there would there be different formalisation impacts on different categories of firms.

- Whether there are distinct gender dimensions to funeral service providers, their staff and clients.

4. Data and methodology

The information in this report is based on data collected through different qualitative and quantitative methodologies. Both primary and secondary data were used in this study. The central pillar of our data collection approach was a survey of funeral service provider businesses in South Africa, **all of whom offer funeral insurance**. Therefore, when we talk of funeral service providers in relation to our survey, it should be remembered that we are in fact referring to funeral service providers/insurance providers. The survey was designed using insights gained from pre-survey “exploratory” interviews (semi-structured, one-on-one interviews with the owners of funeral service providers) conducted between April and May 2011 in different towns within the same four provinces in which the survey was conducted. Interviewers were provided with a discussion guide for each interview and briefed to not systematically work through all the questions but rather to explore the questions where business owners chose to provide greater detail, i.e. to be guided by the respondent. The findings of the exploratory research have been integrated into our discussion on survey findings. We used the qualitative research findings to support or expand on the quantitative research findings.

Quantitative research through survey of funeral service providers. The survey broadly covered general business information; the nature of funeral service providers’ operations; compliance with various laws such as labour laws, business registration, tax; risk management practices; insurance business and the nature of products offered; and financial information. A sample of 80 funeral service providers was selected for the survey in low-income areas in four provinces of South Africa: the city centre and three townships⁴ of Durban⁵ (Kwazulu-Natal), Thohoyandou (Limpopo), the towns of Butterworth, King Williams Town and Willowvale (Eastern Cape) and four townships of Cape Town⁶ (Western Cape). A description of the socio-economic profiles of the municipalities in which sampling took place is provided in Appendix A.

The number and dates when surveys were completed can be found in Table 1 below. The survey data was collected from late-October to November 2011. The survey questionnaire was translated from English into three other local languages: isiZulu for Kwazulu-Natal, isiXhosa for the Western Cape and Eastern Cape and Sepedi for Limpopo. A combination of purposive⁷ and convenience sampling techniques were used to select funeral service providers in these areas. Due to data collection errors, the sample size was reduced to 72, for which the data is presented in this paper. We provide a summary of the key data points for these 72 providers in Appendix B. Although there is no recent data available on the exact number of funeral service providers in South Africa, this is unlikely to be a representative sample. However, the collected data still significantly contributes to our understanding of insurance and other dimensions of informality amongst funeral service providers.

⁴ Townships or locations refer to urban living areas that were reserved for non-whites during the Apartheid era. Townships were usually built on the outskirts of towns and cities, implying high travel costs for the township residents who are employed in business centres of formerly towns and cities.

⁵ Kwa-Mashu, Umlazi and Umbilo

⁶ Gugulethu, Khayelitsha, Langa and Nygana

⁷ All selected funeral service providers were required to offer funeral insurance. One of the objectives of sampling was to reach both formal and informal funeral service providers.

Location	Province	Surveys completed	Date of Surveys taken
Butterworth, King Williams Town and Willowvale	Eastern Cape	19	31 Oct 2011 - 11 Nov 2011
Durban	Kwazulu-Natal	20	21 Nov 2011 - 2 Dec 2011
Thohoyandou	Limpopo	20	31 Oct 2011 - 11 Nov 2011
Cape Town	Western Cape	13	31 Oct 2011 - 11 Nov 2011; 13 Feb 2012 - 17 Feb 2012
Total		72	

Table 1: Number and date of surveys taken

Source: Authors

Combination of qualitative and quantitative research through “deep dives”. The term “deep dive” is used to denote an in-depth examination of three informal funeral service providers who were revisited after completion of the survey. The funeral service providers included in this sample provided us with more detailed information on their business operations than we were able to collect through the survey. In particular, they provided financial statements, the number of insurance clients and basic demographic information and the average variable and fixed costs of providing a funeral service. This allowed us to form a more granular understanding of the operations of funeral service providers, particularly informing our perspectives on the risks and profitability of informal insurance providers contained in Section 9. Significant conclusions drawn from the deep dives have been incorporated into the main body of the report.

Literature review (secondary data collection). The primary data presented in this report is supplemented by secondary data from a literature review focused mainly on informal insurance the financial impact of funerals in South Africa and the relevant legislation and regulations that apply to the various aspects of business activity of funeral service providers that provide insurance. We also include secondary data from FinScope 20108, drawing on an analysis of the users of funeral insurance products. This data allowed us to understand which adults obtained their funeral cover from a funeral service provider. Although this data did not allow us to distinguish between funeral service providers that comply and those that do not comply with insurance legislation, the data on the users of funeral service provider insurance products provides us with a good idea of the profile of the likely users of informal insurance products. However, these users were not consulted to explore their experience as this document mainly considers the supply-side of informal insurance as this was the objective of our study. Future qualitative demand side research could therefore add value to the findings of this study.

⁸ An annual households survey that measures the usage and perceptions of financial services in South Africa.

5. The low-income insurance market in South Africa

5.1. Current funeral insurance usage

In this section we examine the usage of funeral insurance by South African adults by applying secondary data from an earlier demand-side analysis on the funeral insurance market in South Africa (FinMark Trust, 2012). As will be demonstrated, the most popular insurance product in South Africa is funeral cover and, although used by adults from all income groups, this insurance product is mostly used by lower income South Africans.

Funeral insurance the biggest driver of insurance usage in South Africa. Figure 1 shows that almost half (49.7%) of South African adults have some form of risk cover, of which funeral cover accounts for the largest proportion (89.2%). Based on FinMark Trust 2012, we are able to consider funeral cover purchasers in three different groups according to where they purchased their funeral cover: those that have funeral cover from a formal funeral insurance provider other than a formal funeral service provider, those with funeral cover obtained from a funeral service provider which may be either formal or informal, and those with funeral cover from an informal insurance provider other than an informal *funeral service* provider (for example a burial society or any other informal, not-for-profit group).

Figure 1 below indicates that almost 4 million adults (or 27.4% of all adults with funeral cover in South Africa) have funeral cover obtained through a funeral service provider. Based on government concerns (National Treasury, 2008) about non-compliance with regulation in this industry as well as indications from a previous qualitative study (Bester et al., 2005), it is assumed that at least a significant (if yet undetermined) proportion of this group holds insurance from an informal funeral service provider.

We explore the characteristics of the three groups identified in Figure 1 in greater detail in Section 5.5.

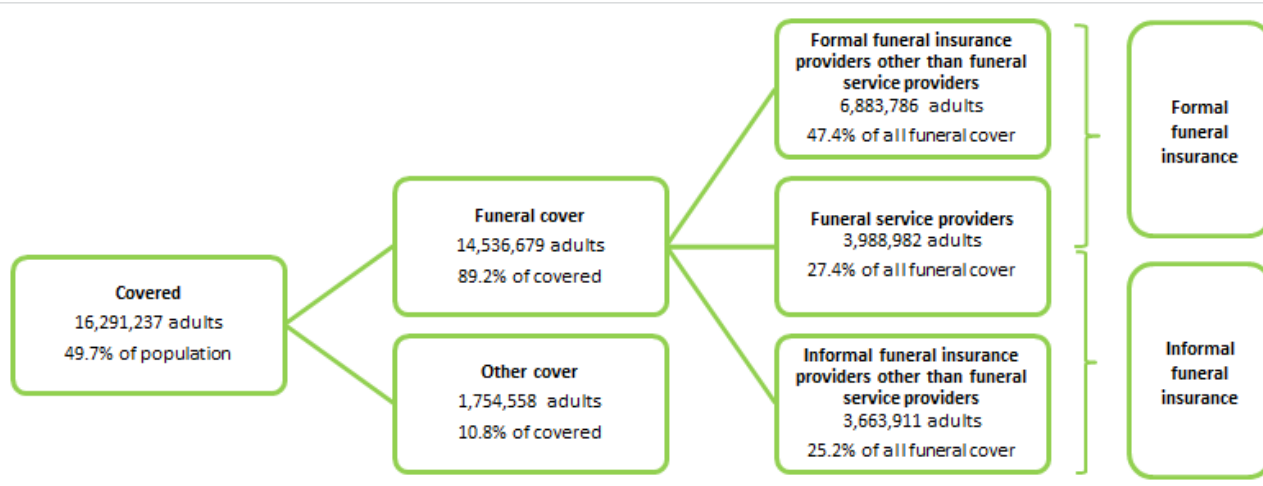


Figure 1: Funeral insurance usage in South Africa

Source: FinMark Trust, 2012

5.2. Drivers of the demand for funeral insurance

The relatively high demand for funeral insurance in South Africa can be attributed to different cultural, social and economic factors. This section explores these factors.

The importance of a dignified funeral in Black⁹ culture in South Africa leads to large expenditure on funerals. In traditional Black culture, it is believed that the deceased become spirit ancestors who influence the destiny of those who stay behind; it is therefore important to honour the ancestors with a dignified funeral (Roth, 1999). The dignity of a funeral in South Africa is typically measured by the extravagance of the event; a more expensive casket, tombstone and hearse increases the perceived dignity of a funeral (Bester *et al.*, 2005: 8 & Roth, 1999). Funerals furthermore provide an opportunity for relatives and extended family to keep in contact and to strengthen ties, while they are also viewed as an opportunity to mark the deceased's status (and that of his/her family) in the community (Case *et al.*, 2008). For the reasons mentioned above, funerals of black South Africans are typically elaborate and lengthy events, commencing with prayer meetings at the deceased's house every day until the funeral, and ending with *Umkhululo* – the ceremony that accompanies the shedding of funeral clothes – several months after the funeral (Collins *et al.*, 2009).

Confrontation with the everyday reality of death drives expenditure on death. In a country with high levels of HIV/AIDS and crime, the spectre of death looms large. This, coupled with the fact that the cost of funerals is often borne not only by immediate relatives but also by extended family and sometimes the community, drives the demand for insurance against the cost of death. In response to a question from a series of focus group discussions on spending habits, funerals, burial societies and death-related expenses were often afforded higher priority than education or everyday expenses such as food and water (Bester *et al.*, 2005: 6). These findings are supported by the FinScope 2010 data where the main vulnerability (or risk) to income cited amongst lower-income adults is death of the main income earner and funerals (Ncube *et al.*, 2011: 18-19).

Demand for funeral insurance is also driven by the financial impact of a funeral on a low-income household. In the unique Finance Diaries data-collection project, Collins *et al.* (2009) found that in the sample of 181 households studied, funeral costs were equal to up to seven months of household income. Case *et al.* (2008) analyse the funeral arrangements following the deaths of 3,751 people in the Umkhanyakude District in northern KwaZulu-Natal¹⁰ and find that households spend, on average, the equivalent of a year's income¹¹ on a funeral.

Households use a variety of financial instruments to cover the costs of a funeral. Covering the costs of a funeral is difficult for lower-income household and a variety of instruments are used to deal with these costs, including savings, loans and funeral insurance (Collins *et al.*, 2009). In one study it was found that even though households used a variety of insurance instruments, 61% of the sample remained under-insured against the cost of a funeral (Collins & Leibbrandt, 2007). An example from the Financial Diaries study (Table 2 below) shows the number of coping mechanisms used by one of the diarists, Xoliswa (pseudonym used in original text), to supplement her insurance pay-out when her mother passed away.

⁹ As opposed to the culture with regards to funerals amongst the white, Coloured and Indian populations in South Africa. The Coloured population is a group of South Africans of mixed race with their own unique cultural heritage. It was one of the four race groups used during apartheid for racial classification.

¹⁰ This area includes both a township and a rural area administered by a tribal authority.

¹¹ Income is measured at median per capita African (Black) income.

Table 2 below shows that Xoliswa’s funeral plan covered the cost of the coffin, undertaker’s fee and cost of collecting the body (this totalled about \$465), as well as paid out \$464 to cover the cost of the funeral feast. Despite Xoliswa’s foresight in buying funeral cover, she was still underinsured against the cost of her mother’s funeral and consequently had to rely on a number of different funding sources.

Sources of funds	US\$	Uses of funds	US\$
The funeral			
13 goats from relative	906	Slaughtered 10 goats for funeral	697
Cash contributions from relatives	279	Bought and slaughtered 1 cow	
Cash payout from burial society	155	for funeral	310
Cash payout from funeral parlour	464	Food for funeral	449
Funeral parlour provision of coffin and funeral fees	465	Coffin and funeral fees (provided by funeral parlour)	465
Saving club payouts	155	Saved 3 goats for <i>umkhululo</i>	209
		Save for <i>umkhululo</i>	279
Total	\$2,424		\$2,409
The <i>umkhululo</i>¹²			
3 goats saved from funeral	209	Repaid store owner	108
Additional cash contributions from relatives	280	Slaughtered cow (exchanged for 5 goats)	348
Saved money from relatives funeral contributions	279	Bought 2 goats (for exchange for cow)	139
		Bought food for <i>umkhululo</i>	170
Total	\$768	Total	\$765

Table 2: Sources and use of funds for Xoliswa’s mother’s funeral

Source: Collins *et al.*, 2009

It is clear that a single solution, such as funeral insurance, is rarely comprehensive, but does assist in providing much needed funding at critical times.

5.3. Drivers of the supply of funeral insurance

Apart from the demand factors explored above a number of factors have, in recent years, driven the supply of funeral insurance. Here we specifically consider drivers of supply as considered in Ncube *et al.* (2010).

Rise of alternative distribution channels. In recent years the South African insurance industry has launched a number of innovative distribution channels and products specifically aimed at the low-income market (see Smith *et al.*, 2010 for an overview of case studies). Innovation has mainly been concentrated in funeral insurance, although products such as building and household contents insurance have also been designed. Easily accessible retail outlets are increasingly being used as distribution channels and insurance products have been commoditised into products that can be sold off the shelf (Ncube *et al.*, 2011). Innovation in the low-income insurance market has been driven by a number of market factors and by the policy and regulatory movements on two fronts:

¹² A ceremony traditionally held after a death of a family member, literally meaning “to remove mourning clothes”.

- *Financial Sector Charter fast-tracked the insurance industry's engagement with the low-income market.* The Financial Sector Charter is a Black Economic Empowerment (BEE) voluntary charter negotiated between industry, government and labour constituencies. The Charter promotes the transformation of the financial sector through, amongst others, the provision of financial services to the low-income black population and industry is subject to access targets set out by the Charter. The Financial Sector Charter is to be replaced by revised (more stringent) targets that will become part of the Department of Trade and Industry Sector Codes drawn up under the Broad Based-Black Economic Empowerment Act (Act No. 53 of 2003) and which are compulsory.
- *Proactive engagement by the policymaker.* For the past few years the National Treasury, as financial sector policymaker, and the Financial Services Board (FSB), as non-bank financial services regulator, have been actively engaging on the topic of microinsurance development. As discussed in Section 1 above, in 2008 the National Treasury published a microinsurance discussion paper for public comment which, following public consultation, led to the publication of a policy document in 2011. The intention of the discussion paper and the policy document is to ultimately produce legislation conducive to the supply of microinsurance products.

5.4. Features of funeral insurance products

In this section, we briefly describe some of the key characteristics of formal funeral insurance, as provided in South Africa. Funeral insurance policies are primarily underwritten on a group scheme basis meaning that individual lives are not underwritten but that the insurer underwrites the average risk of a group of people who would not be known to the insurer until after purchase of a policy. Apart from being intermediated by insurance agents, these policies are often sold off the shelf e.g. in retail outlets. In the latter case instead of individual policies being entered into between the insurer and each policyholder, a master policy is entered into between insurer and administrator of the group which will contain, inter alia, the premium amounts. The individual that purchases the policy will provide basic identification details to the intermediary which will then furnish these to the insurer as required by law (See Section 6). There are typically no medical questions, so that no health underwriting takes place. It is therefore possible for individuals with poor health to receive funeral insurance benefits although this will, ultimately, lead to a deterioration of the risk profile of the group and to an increase in insurance premiums. Further, age underwriting generally does not take place but individuals older than 65 are generally excluded from cover.

As stated in Section 6 below, only registered long-terms insurers may underwrite funeral insurance policies and most funeral service providers would not qualify to themselves underwrite funeral insurance policies.

Funeral insurance policies are usually issued on a term basis, 12 months or less, and typically include so-called grace periods for non-payment of premiums i.e. the policy will not lapse if premiums are unpaid during the grace period, as well as six month waiting periods for death by natural causes to counter adverse selection given that no health underwriting take place. Waiting periods for accidental death are reduced, often to nought, because there is no risk of adverse selection in this case. Benefits may take the form of an in-kind funeral service, a mix of in-kind and monetary benefits or monetary benefits only. Legally, as discussed in Section 6 below, a monetary benefit is required to be offered in the alternative to an in-kind benefit.

5.5. Profiles of funeral insurance users

Now that we have some understanding of the drivers of funeral insurance usage and supply in South Africa, we explore the different profiles of adults who obtained their funeral cover from three different categories of providers:

- Formal funeral insurance providers other than funeral service providers (e.g. registered insurance companies, banks etc., hereinafter referred to as formal funeral insurance providers);
- Funeral service providers which may be formal or informal; and
- Informal funeral insurance providers other than funeral service providers (e.g. burial societies) (hereinafter referred to as informal funeral insurance providers).

Use of formal vs. informal insurance shifts along demographic descriptors including gender, geography, employment status, income, and education. Table 3 contains a number of demographic descriptors for each of the three categories of users of funeral cover highlighted above. As can be viewed in the table, the gender distribution of insurance clients differs substantially between the three categories of funeral cover providers. There are only slightly more females (51.0%) than males (49.0%) having purchased their funeral cover from only a formal funeral insurance provider¹³, in contrast to the majority of the users of only purely informal funeral cover (burial societies) being female (66.5%). Black South Africans are the dominant race amongst all three categories of funeral cover users. In Table 3 it can, however, be seen that the proportion of black clients increases as one moves from formal funeral insurance providers (59.7%) towards informal funeral insurance providers (88.9%). Most users of products from formal funeral insurance providers are urban dwellers (78.3%), while informal funeral insurance providers' clients are more or less equally distributed between urban (50.5%) and rural locations (49.5%).

Another important finding is the relationship between the employment status of funeral insurance clients and the formality of their funeral insurance provider. 54.6% of insurance clients of formal funeral insurance providers are employed on a full-time basis while 9.8 % are unemployed, in contrast with insurance clients of informal funeral insurance providers, 14.2% of whom are employed full-time and 27.4% of whom are unemployed. The proportion of social grant recipients also increases substantially as one moves from the users of formal funeral insurance providers' products (11.9%) to informal funeral insurance providers' clients (39.6%). Finally, the data reveals a relationship between levels of education completed and formality of funeral insurance provider. 25.9% of formal funeral insurance providers' clients completed some form of tertiary education, in contrast with 6.9% of those of informal funeral insurance providers.

¹³ This group of people do not use cover from any other provider, i.e. do not use cover from a funeral service provider or from a burial society.

	Users (%) of products from only formal funeral insurance providers	Users (%) of products from only funeral service providers (formal and informal)	Users (%) of products from only informal funeral insurance providers (e.g. burial societies)
Gender			
Female	51.0	54.1	66.5
Male	49.01	45.92	33.5
Race			
Africans	59.7	82.7	88.9
Other ¹⁴	40.31	17.26	11.11
Metropolitan area			
Urban	78.3	66.0	50.5
Rural	21.68	34.05	49.5
Employment status¹⁵			
Full time formal sector	54.6	30.0	14.2
Unemployed	9.8	20.3	27.4
Source of income			
Social grant recipients ¹⁶	11.9	26.2	39.6
Highest level of education			
Primary school	2.1	7.3	12.6
High school	34.4	25.1	18.4
Some form of tertiary ¹⁷	25.9	12.7	6.9

Table 3: Profiles of insurance clients of different funeral insurance providers

Source: Adapted from FinMark Trust, 2012

Users of cover from formal funeral insurance providers have highest income; users of funeral insurance from informal funeral insurance providers have lowest income. Figure 2 shows that income decreases as we move from users of formal funeral insurance providers to users of insurance from funeral services providers to, ultimately, users of informal funeral service providers. The users of funeral insurance purchased from a formal funeral insurance provider appear to be from higher income groups than the other users with the majority (85.6%) falling within or above LSM 6¹⁸. For clients who purchased their cover from funeral service providers, the proportion per LSM increases gradually until it reaches a maximum at LSM 6 (30.3%), whereafter it decreases again, with a slight increase at LSM 9. Users that have cover from informal funeral insurance providers are clustered in the lower LSMs, with the majority of users falling within or below LSM 6 (71.5%).

¹⁴ Coloured, Indian or Asian and White

¹⁵ Please note that these two employment categories do not add up to 100%. The descriptors merely serve to highlight vulnerability and not to provide an exhaustive description of the users of these insurance products according to employment category.

¹⁶ Includes recipients of child grants, disability grants and government old age pensions.

¹⁷ Includes university; any post-graduated qualification; any other post-matric qualification; apprenticeship/technical training.

¹⁸ In the South African context, the Living Standards Measure (LSM) index is widely used as a market segmentation tool, using living standards indicators such as degree of urbanisation and asset ownership as criteria. In effect, the LSM index is a proxy for wealth based on standard of living rather than income. As there is a high level of correlation between income and living standards, we use the LSM measure as proxy for income. LSM 1 is the lowest (or poorest) living standards measure, while LSM 10 is the highest (or richest) living standards measure).

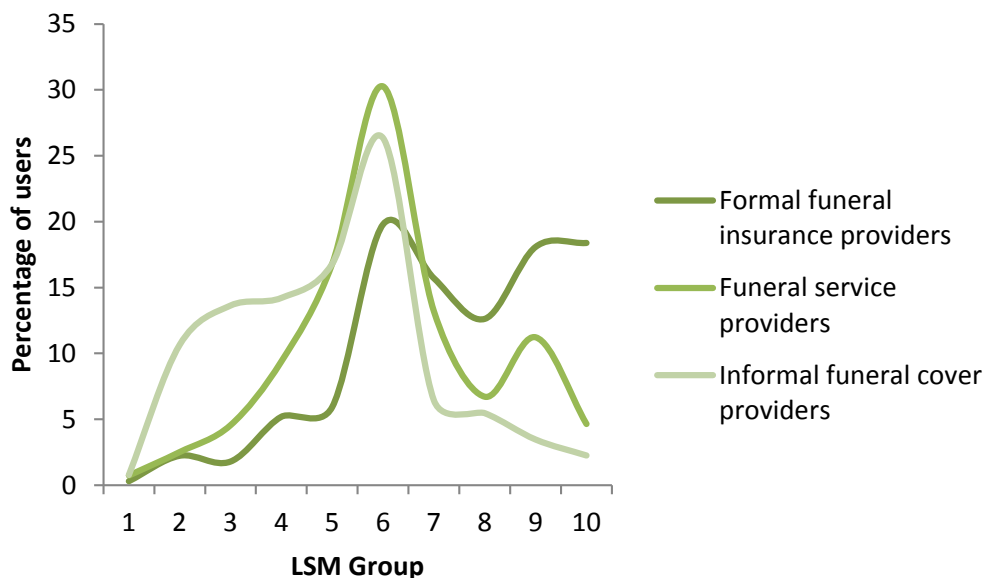


Figure 2: LSM distribution of different funeral cover clients

Source: Adapted from FinMark Trust, 2012

6. The regulatory environment for funeral providers

In this section we examine legislation and regulations (executive rules made in terms of empowering legislation) governing the funeral service provider industry in general and those that provide funeral insurance in particular. Although as explained in Section 2 we measure non-compliance with insurance regulations as a proxy for informality of funeral service providers providing insurance, we also examine below other legislation and regulations governing the funeral service provider industry and measure compliance against these, for purposes of ultimately determining the reasons for and barriers to non-compliance, and the costs of total compliance.

6.1. Business registration and tax

Business registration

Funeral service providers may be sole proprietors or form partnerships, neither of which is required to be registered. They can also incorporate as limited liability companies which do require registration and compliance with the Companies Act 2008. The previous Close Corporation or CC regime which enabled registration as a separate legal entity with lighter regulation than a company has been abolished although CCs in existence can continue to operate as such.

The presence or absence of business registration therefore does not become a particularly useful construct through which to understand informality amongst funeral service providers in general, although from an insurance perspective it becomes more important. In the remainder of the document we therefore treat it as a descriptor rather than a determinant of informality although we do address it in the context of compliance or otherwise with insurance regulation.

Tax

Anyone who receives taxable income as defined is required to register as a taxpayer and pay tax. Individual taxpayers with an annual income of less than R63,556 (\$8,200)¹⁹ (2012/2013 tax year) are exempt from paying income tax. All other individual tax payers pay tax according to a graduated tax rate, starting at 18% of every Rand earned above R63,556 (\$8,200) with a maximum rate of 40%. Where the corporate form of the enterprise is a limited liability company, tax registration is automatic upon company registration. Companies pay tax at the rate of 28%. In addition to income tax, a person (natural or legal) which makes taxable supplies in excess of R1 million per annum (\$130,000) is required to register as a value-added tax ("VAT") vendor. VAT is an indirect consumption tax levied at the rate of 14% on most goods and services. Funeral insurance is exempt from VAT. A tax regime introduced for SMMEs of any corporate form from 1 March 2009 enables businesses with an annual turnover of less than R1 million (\$130,000) to pay Turnover Tax, a simplified tax system that incorporates income tax, capital gains tax and VAT.

6.2. Health

Basic regulations

All funeral service providers in South Africa are required to comply with the Funeral Undertakers' Premises Regulation (Regulation 237, 8 February 1985), a schedule to the National Health Act of 1977 (Act 63 of 1977). These regulations state that: "no person shall prepare any corpse except on funeral undertaker's premises in respect of which a Certificate of Competence has been issued and is in effect". The regulations delegate the ability to issue a Certificate of Competence to the municipal level of government, commonly referred to as the local authority²⁰. A Certificate of Competence is only awarded if the undertaker has following facilities in place:

- A separate preparation room for the preparation of corpses at the business site;
- Changing rooms, separate for each sex, for the use of employees at the business site;
- Refrigeration facilities for the refrigeration of corpses;
- Facilities for the washing and cleansing of utensils and equipment inside the building;
- Facilities for the cleansing of vehicles on such premises; and
- Facilities for the loading and unloading of corpses.

Further, a Certificate of Competence will only be issued if the selected business is correctly zoned for conducting funeral undertaking business.

Before issuing the Certificate of Competence, the local municipality's Department of Health will inspect the premises and ensure that it is suitable for the preparation of corpses for burial, that it complies with all health regulations and that it will not be offensive to any occupant of neighbouring business premises. They will also set a limit on the number of corpses to be stored at the facility, but from discussions with City Health officials it became clear that this number is exceeded frequently.

¹⁹ Throughout this document, unless direct USD references are quoted, an average year to date exchange rate of R 7.75 per USD on 1 June 2012 (as obtained from www.oanda.com) is applied to convert South African Rand (R) amounts to USA Dollars (\$).

²⁰ South Africa has a three-tier government system: national, provincial and municipal levels of government all have legislative and executive authority in their own spheres.

Enforcement or continued compliance

In order to ensure that the premises of funeral service providers continue to comply with national health requirements, the Health Act stipulates (Republic of South Africa, 1991) that inspections are required to be carried out on a quarterly basis. These inspections are unscheduled. At least one of the metropolitan municipalities in our sample areas indicated that they do not view it as their responsibility to find non-compliant funeral service providers, but merely to ensure that those funeral service providers that have a Certificate of Competence continue to comply. While non-compliance with the regulations or non-rectification of identified offences can result in revocation or suspension of the Certificate of Competence, this rarely happens (at least in metropolitan municipalities like the City of Cape Town).

Transport of corpses or sub-letting of mortuary space

There are currently no health regulations on the transport of corpses and there are also no regulations prohibiting or supporting the sub-letting of refrigeration facilities. However, the Certificate of Competence does limit the maximum number of corpses that can be legally stored in a compliant refrigeration facility.

6.3. Insurance

Any business providing or selling insurance in South Africa is subject to a number of different regulatory requirements. The regulatory requirements for the selling ("intermediation"), provision ("underwriting") and certain basic consumer protection requirements that apply to the aforementioned are discussed below.

Intermediation

South Africa's Financial Advisory and Intermediary Services ("FAIS") Act, no 37 of 2002, requires that anyone that provides advice or intermediary services with regards to any financial product (including insurance) register as a Financial Services Provider ("FSP") with the Financial Services Board ("FSB") and comply with the requirements of the FAIS Act and its supporting regulations. An FSP is not required to take any particular corporate form and sole proprietors can also be FSPs. The FAIS Act defines advice as any recommendation, guidance or proposal in respect of buying a financial product (including a funeral insurance policy) irrespective of whether such advice results in such purchase, while an intermediary service is defined as an act other than advice, performed by a person for and on behalf of any client or product supplier, with a view to buying, selling, administering, managing or otherwise dealing in a financial products purchased by the client from a product supplier, or collecting or accounting for premiums or other moneys payable by the client, or receiving, submitting or processing the claims of a client (Section 1, Republic of South Africa, 2002). It should thus be clear that a funeral service provider selling a funeral insurance product will generally fall within the ambit of the FAIS Act.

Funeral service providers that provide either financial advice or intermediary services as defined may, in the alternative to registering as an FSP, register as a representative of the FSP if the FSP allows this. "Representative" is defined in the FAIS Act to mean any person who renders a financial service to a client for or on behalf of a financial services provider, in terms of conditions of employment or any other mandatory agreement. This option of registering as a representative rather than an FSP implies reduced compliance and cost requirements, as the reporting

requirements fall on the FSP. The FAIS Act also makes provisions for 'representatives under supervision' i.e. those representatives that fail to meet the requirements for an FSP set out below and require to be supervised by an FSP. However, in this case, the insurance company is held responsible for the conduct of all its representatives and thus takes on significant liability when it registers funeral service providers as such.

In addition to FSPs, representatives and supervised representatives, provision is made for the registration of 'Assistance Business FSPs.' These are FSPs that render intermediary (as opposed to advisory) services in relation to the administration of assistance or funeral policies on behalf of the insurer. These would include intermediaries that collect premiums on behalf of insurers. Registration as such also entails reduced compliance and costs.

The FAIS Act requires each FSP or representative to appoint a "key individual", namely a natural person responsible for managing or overseeing, either alone or together with other so responsible persons, the activities of the FSP or representative.

FSPs, representatives and key individuals are required to comply with regulations issued under the FAIS Act regarding "Determination of Fit and Proper Requirements for Financial Services Providers, 2008". These regulations contain requirements regarding the following:

- personal character, namely honesty, required of an FSP, representative and key individuals;
- competency requirements, namely qualifications, practical experience, regulatory exams and continuing professional development. The qualifications required for the intermediation of funeral insurance are lower than for the intermediation of other financial products including other insurance products. As regards experience, key individuals and representatives that advise on or intermediate funeral insurance are required to have at least six month's advisory and/or two month's intermediary experience (depending on the type of service provided) and, in the case of a key individual, at least one year's experience in the management and oversight of a business similar to that of the FSP is required. Like the qualifications requirements, experience requirements for the advice/intermediation of funeral insurance are lower than for all other categories of financial products. An Assistance Business FSP or its representative must have at least one year's practical experience, whether supervised or not, in the provision of administration assistance gained not more than five years prior to the application, and key individuals of such FSP or representative must have at least one year's practical experience in the administration and/or oversight of a business similar to that of the FSP/representative. Representatives that render services under supervision may be exempted from these requirements by the Registrar for Financial Services Providers. Further, representatives in relation to funeral insurance are not required to undertake regulatory exams;
- operational ability – applies to FSPs only - including:
 - a fixed business address, adequate communication facilities, adequate storage and filing facilities, an account with a registered bank and a separate account for deposits of client funds;
 - internal controls, including segregation of duties where required, access controls, data protection, physical protection of client records, documentation relating to business policies, processes and controls and technical requirements, system application testing and data recovery procedures where applicable, appropriate training for key individuals and representatives, business continuity plans;

- system controls and compliance measure;
- recording of financial and system procedures;
- general administration processing, accounting transactions and risk control measurements in place;
- financial soundness – applies to FSPs only - namely that assets must exceed three times liabilities and, in the case of FSPs that handle client funds, assets must exceed liabilities, current assets must be sufficient to meet current liabilities and liquid assets must be equal to 8 weeks of annual expenditure.

FSPs and representative are further required to comply with a Code of Conduct, which includes the requirement to record verbal information provided to a client and retain this for a period of five years after termination of the contract, furnish in writing within 30 days to the client details of the FSP /representative and insurer as well as the obligations of the respective parties and explain to the client the contract in general including the “nature and extent of benefits to be provided, including details of the manner in which such benefits are derived or calculated and the manner in which they will accrue or be paid.” The furnishing of advice further requires a financial needs analysis to be conducted and in the case of long-term insurance policies the notification of such advice to the insurer where the policy issued is a replacement policy. An FSP that receives client funds on behalf of the insurer must issue a written receipt, pay the funds into a bank account that is designated for this purpose only and pay the interest on such funds to the client/insurer. An internal complaint resolution system is also required to be maintained by the FSP or representative which must meet the requirements contained in the Code of Conduct. All requests by a client to terminate a contract must be honoured immediately.

The following registration and on-going fees are imposed on FSPs:

- On registration, FSPs are required to submit fifteen forms, nominate a key individual and, where there is more than one key individual or one or more representatives, appoint a compliance officer to monitor compliance with the FAIS Act. Fees are as follows: R1,690 licence fee, R1,060 for a compliance officer, R935 per key individual, no fee for approval of representatives.
- On-going fees: In terms of the FAIS Act, an annual compliance report in the required form must be submitted, as well as annual financial statements within four months of financial year end. An FSP that is a sole proprietor or close corporation and that does not collect premiums or hold clients’ money, is not required to submit audited financial statements while an FSP that is a company must submit audited financial statements as required by the Companies Act (companies with only one director are not required to be audited) (FSB Board Notice 96 of 2003). Any FSP that receives client funds and /or premiums is required to submit an auditors’ report. Excluded are FSPs that are licensed to intermediate funeral insurance only; they are required to submit a report signed off by an accounting officer (unless a company compelled by the Companies Act to do so) (FSB Board Notice 85 of 2004). Further, annual fees are payable as follows: annual levy for FSPs providing only assistance benefits is calculated as $R2,741 + A \times R250$ where $A = \text{number of key individuals} + \text{number of representatives}$, annual ombud fee of $R625 + A \times R234$ where A is the same as before.

Underwriting

The Long-Term Insurance Act no. 52 of 1998 (“the Long-Term Act”) provides for the registration and control of long-term insurers. The FSB is the regulator for long-term insurers.

In terms of the Long-Term Act, no person may carry on any long-term insurance business unless that person is registered as a long-term insurer. Long-term insurance business means the business of providing policy benefits under long-term policies, namely assistance, disability, fund, health, life or sinking fund policy.

Funeral insurance can be written under either the life or assistance business policy categories. A life policy means a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits upon a life event, being the event of the life of a person or an unborn having begun, *continuing* or having ended, while an assistance policy means a life policy in respect of which the aggregate of the value of the policy benefits, other than an annuity, does not exceed R 1,0000, or another maximum amount prescribed by the Minister. The Minister of Finance has, in terms of Regulation 459 of 25 April 2008, prescribed a maximum value of R18,000 in respect of assistance business.

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 a life/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. Under common law the value of the funeral benefit provided must be set out in the contract or contractually *guaranteed* (Bester, *et al*: 2005).

There are a number of differences between assistance and life policy categories:

- The benefits payable under an assistance policy are limited to a maximum of R18, 000. No such cap applies to the life category (except for minors);
- Unlike with life policies, there is no limitation on the commission that may be paid to an intermediary in respect of an assistance policy;
- The Long-Term Act specifically requires that insurers give assistance policyholders the option of a monetary benefit, even in cases where the terms of the policy contract specify that payment will be in kind (i.e. the provision of a funeral). The monetary value must be equal to the cost the long-term insurer would have incurred had the policy benefit been provided on-kind;
- The experience, qualification and examination requirements under the FAIS Act to advise on and intermediate assistance policies are, as evidenced above, less onerous than those required in respect of life policies.

Long-term insurers are required to be incorporated as public companies, essentially listed companies, and restrictions are imposed on ownership and control of long term insurers (note the proposed microinsurance regulatory framework also permits private companies and registered co-operatives to be micro-insurers – this is dealt with in detail in the policy note). The FSB requires minimum capital at registration of R10 million irrespective of the type of policy underwritten. Long-term insurers are required to appoint an auditor and a statutory actuary.

Once registered, a long-term insurer (of whatever category) 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, 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. Furthermore, the Solvency Assessment and Management Regime (SAM), or Solvency II as it is referred to internationally, will be implemented with effect from January 2015 to ensure that insurers hold capital to adequately cover underlying risks and that governance procedures are sufficient to mitigate risk. Micro-insurers registered under the new framework will not be required to comply with Solvency II.

The Long-Term Act requires long-term insurers to appoint an audit committee. Since all long-term insurers are required to be public companies, they would also be required to comply with the Johannesburg ("JSE") Stock Exchange Listings Requirements and specifically the King Report on Governance for South Africa, or King III. King III contains governance recommendations for all corporate entities, compliance with which is compulsory for JSE listed companies. Further, long-term insurers would also be required to comply with the Companies Act, 2008.

Friendly societies registered under the Friendly Societies Act, 1956 are excluded from compliance with the Long-Term Act insofar as they enter into long-term policies whose benefits do not exceed R7,500 per member.

Consumer protection

The Long-term Act imposes on long-term insurers requirements designed to protect consumers. These include:

- when a premium is paid in cash, the recipient (whether the insurer or its intermediary) is obliged to give a written receipt;
- 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
- the insurer is obliged, within 60 days of transacting, to provide to the policyholder with a summary of the policy, including information on agreed premiums and benefits, the events in respect of which benefits are to be provided and any exclusions;
- if the policyholder fails to pay the premium, the insurer is obliged to notify the policyholder of non-payment.

Policyholder Protection Rules (PPR) issued in terms of the Long-Term Act provide further protection to consumers of long-term insurance policies by imposing conditions on the relationship between insurers and intermediaries. These include:

- the insurer must furnish the intermediary with a written mandate and the intermediary must be registered as an FSP or representative; and
- the above mandate in relation to an assistance business group scheme (one in which two or more persons are sold a policy that is not individually underwritten) must set out the premium and the period within which premiums will be paid over to the insurer as well as commission payable to the intermediary. The intermediary must furnish the insurer with the names of all policyholders and beneficiaries, and identity numbers of all policyholders. 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. In this case the terms of the policy (apart from premiums) may only be changed with the consent of each individual policyholder.

Note that a long-term policy is not void merely because it is entered into in contravention of the Long-Term Act for example because the insurer is not a registered long-term insurer.

6.4. Department of Home Affairs

The Births and Deaths Registrations Act, 1992 (Act No. 51 of 1992) governs the notification and registration of births and deaths in South Africa which is carried out by the Department of Home Affairs. While the Certificate of Competence is issued on a business level, Section 4 of the Births and Deaths Registrations Act applies to individuals. A person with authority under Section 4 would be legally authorised to do the following:

- To receive and open a notification of death and complete the death registry for submission to the Department of Home Affairs for issuance of a death certificate;
- To issue a burial notice to cemeteries.

Authorisation of service providers in terms of Section 4 is carried out by regional offices of the Department of Home Affairs. Applicants would be required to submit proof of tax registration and registration as a funeral service provider or proof of employment by such provider.

Specific requirement may vary between regional departments. For instance, in Cape Town, applicants also need to provide a clearance certificate, showing that the City has inspected the business premises. Additionally, if the applicant (or the business where the applicant is employed) does not own its own refrigeration facility it needs to provide confirmation of the use of such facilities from a funerals services provider that does own its own refrigeration facilities. However, officials are of the opinion that it is very easy to get around this requirement as the funeral director can pay a business with a Certificate of Competence to state that it is using their facilities and that would be sufficient to obtain Section 4 approval.

Interviews with municipal officers indicate that there are far more funeral service providers that have authorisation under Section 4 than there are funeral service providers with their own refrigeration facilities and that comply with the health requirements. This is because being able to obtain access to cemeteries is viewed as more important than obtaining a Certificate of Competence as the ability to bury in cemeteries ultimately determines business success.

7. Structure of the funeral services provider industry

In this section, we provide information from the exploratory interviews and survey on the funeral services industry in South Africa in terms of the different types of funeral service providers that were identified. We also present information on the business context, and on the types of funeral services and financial products provided and the costs thereof.

In 2005, the funeral services industry in South Africa was estimated to consist of 3,000-5,000 funeral service providers (Bester et al., 2005).

7.1. The funeral service provider value chain

A consistent theme which emerged from both the exploratory interviews and the survey data is the disaggregated nature of the funeral service provider value chain and the many sub-contracting arrangements into which funeral service providers have to enter to deliver funerals. At the most extreme, some funeral service providers operate without any equipment or assets like “project managers” where each funeral is managed on a project-by-project basis. These funeral service providers outsource components of the value chain required to deliver a funeral to other funeral service providers or even to other more general sub-contractors who, for example, only transport the body and fulfil no other function in delivering the funeral service (See Table 4: below).

This leads to the question of what it means to be a funeral service provider. Although not an explicit prerequisite to the definition, it can be argued that one of the underlying assumptions under the funeral service provider health regulations is that funeral service providers own their own refrigeration equipment or mortuaries. In reality, only 38 of the 72 survey respondents (52.8%) own their own refrigeration equipment. The remainder rent space from state or private mortuaries owned by other service providers, but still view themselves as funeral service providers. Although the requirement of owning refrigeration equipment and providing the full set of services typically associated with a funeral is also used as a membership criterion by the National Funeral Directors Association, the largest representative of formal funeral service providers in South Africa, for the purposes of this analysis the definition of a funeral service provider will include any business providing all or some of the services associated with a funeral including transportation of the body, storage of the body, preparation of the body for burial and burial of the body. The focus of the study will, however, be on those funeral service providers that also offer funeral insurance which, as explained in Section 4 above, is provided by all survey participants.

Below we describe the different categories of funeral service providers identified and their relative prominence in our sample of funeral service providers:

- **Full servicers:** Slightly more than half our sample (38 of 72 or 52.80%) provides the full funeral service, namely removal, transportation, storage and treatment of the body. They own facilities and assets needed to provide the funeral service including refrigeration facilities and own transport.
- **Transporters** 30.55% of the sample do not own refrigeration facilities but offer removal and transportation services. To be a transporter requires significant capital expenditure. Transporters that do not have mortuary facilities may outsource the treatment of the body or they may treat the body without the necessary permits and permitted facilities, implying minimal capital expenditure in this regard.
- **Project managers** 12 of the 72 respondents (16.67%) act merely as ‘project managers’ in that they only offer funeral insurance and outsource everything else. They use the insurance policy sold as a way of tying in funeral business and then provide or ‘stage’ the funeral by contracting in services from various different providers. They therefore require no capital equipment

In the above value chain typology, all the value chain categories sub-contract at least one type of service to another provider with the exception of full servicers. In a study on the financial portfolios of a small sample of South African small businesses, the risk associated with these types of sub-contracting relationships is highlighted (Bankable Frontier Associates, 2009). This risk proved true in the case of one funeral service provider in our sample that relied on a hearse driver and rental agent

for the equipment used to lower coffins into graves which contractors then failed to deliver their services at the time and quality level required, damaging the reputation of her business in the Cape Town township in which she operates.

Table 4 below illustrates the number of funeral service providers in the different categories in the value chain as well as the components of the value chain that each category offers:

Value Chain Category	Value Chain Components				No of service providers	% of sample
	Transport	Treatment	Storage	Funeral Service		
Project managers ²¹				x	12	16.67
Transporters	X	X		x	22	30.55
Full servicers	X	X	X	x	38	52.78

Table 4: The funeral service provider value chain

Source: Authors

When we consider the survey data through a “value chain” perspective, we find that there are three relationships that emerge:

Firstly, as indicated in Figure 3, there seems to be a relationship between the age of businesses surveyed and the type of value chain category as defined above. For instance, project managers make up 31% of funeral service provider businesses that are five years old or younger but only 5% of those that are older than ten years. Conversely, full servicers make up 41% of funeral service provider businesses that are five years old or younger but 70% of businesses that are older than ten years, including businesses of up to 32 years old. The majority of transporters are in the six to ten years old category.

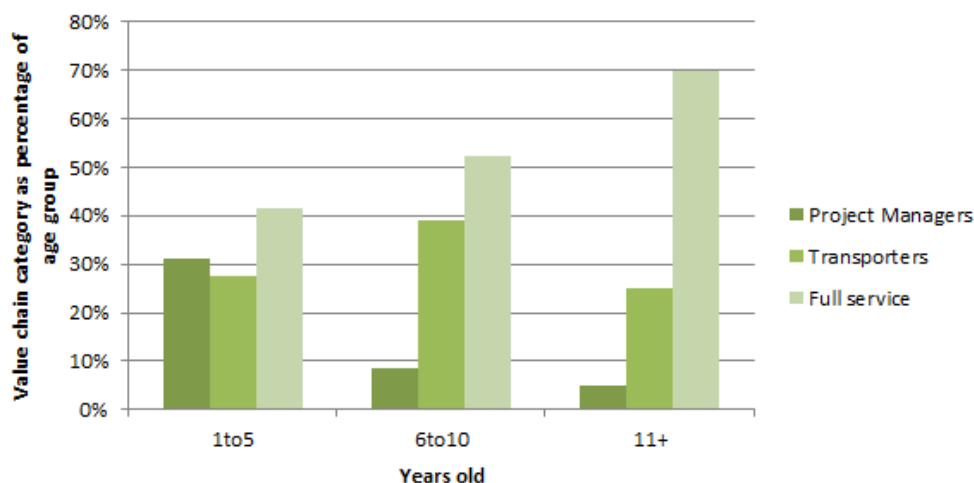


Figure 3: Value chain category relative to age of business

Source: Authors

While the table indicates that there is a propensity for older funeral service provider businesses surveyed to be in a higher value chain category, this does not necessarily mean that businesses

²¹ Project managers who outsource all components of the value chain like to refer to themselves as “Funeral Directors”

evolve from lower categories to higher categories with time. It could instead mean that higher value chain category businesses are simply more likely to survive over time.

Secondly, as indicated in Figure 4 below, there appears to be a relationship between the size of the funeral service provider business²² (defined in terms of number of insurance clients) and the value chain category. Project managers are mostly micro-sized (0-150 insurance clients) while most medium (1001-3000 insurance clients) and large (3000+ insurance clients) funeral service provider businesses are full servicers.

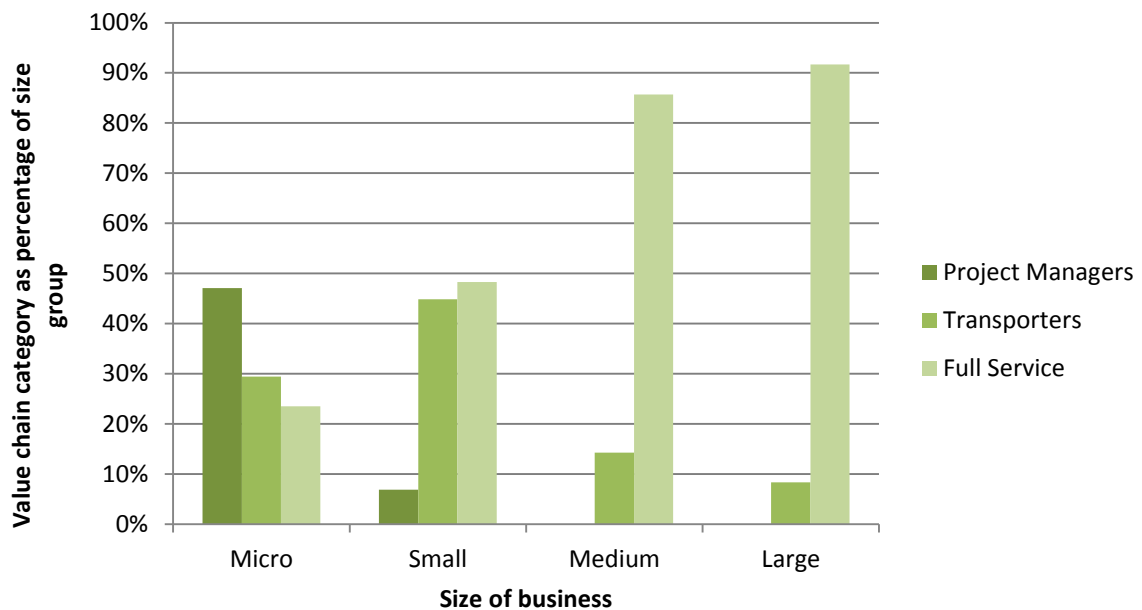


Figure 4: Value chain category relative to size of business

Source: Authors

Thirdly, as indicated in Figure 5 below, there is a relationship between the age of a funeral service provider business and its size as measured in terms of number of insurance clients. Most of the micro business respondents in our sample (76.5%) are five years old or younger, while small, medium and large businesses are six years or older. There were also no micro businesses older than 15 years in the survey.

²² While data on both the number of funerals provided per year and the number of insurance clients were indicators of business size, the relationship between the number of funerals provided per year and the value chain category is not as strong as the one between the number of insurance clients and the value chain. This may be because insurance as a funding mechanism plays a more important role in allowing the business to evolve across the value chain or move into different value chain categories than purely the number of funeral provided does. We therefore use the number of insurance clients as an indicator of business size.

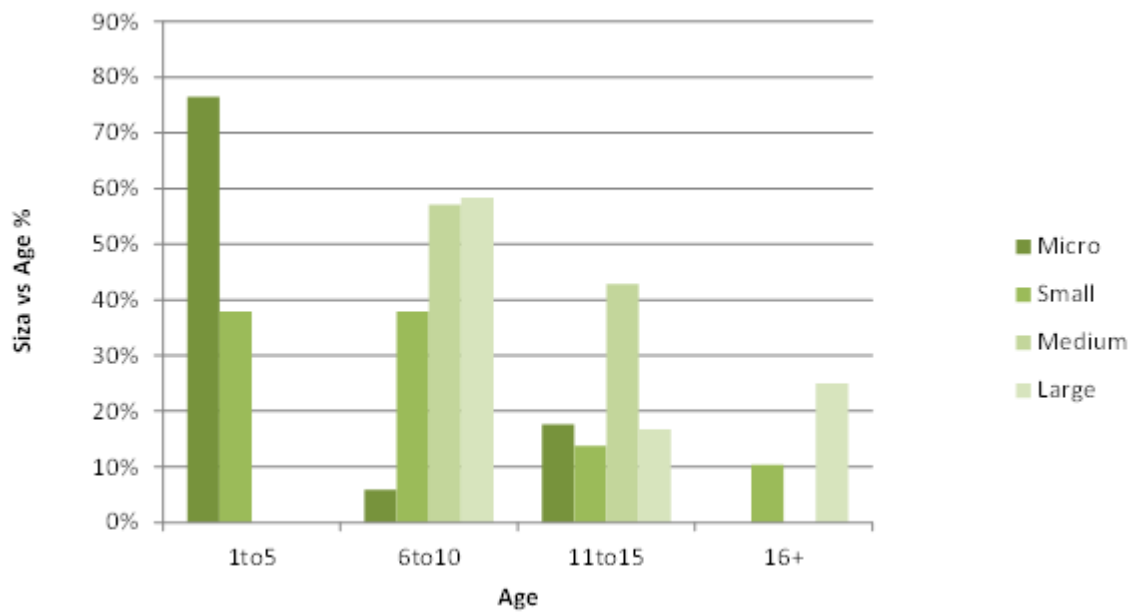


Figure 5: Business size relative to business age

Source: Authors

In summary, it appears that funeral service providers entering the sector are micro-sized and low in the value chain. As the businesses grow older they grow in size and move up the value chain. As explained above, not all businesses will evolve in this way, e.g. some businesses enter the industry as full servicers, but the model presented in Figure 6 below provides us with a framework for thinking about development in this sector.

Interestingly, the owners of funeral service provider businesses that outsource all components of the value chain are the highest educated, with 66.7% of owners in this group having indicated that they have some form of tertiary education.

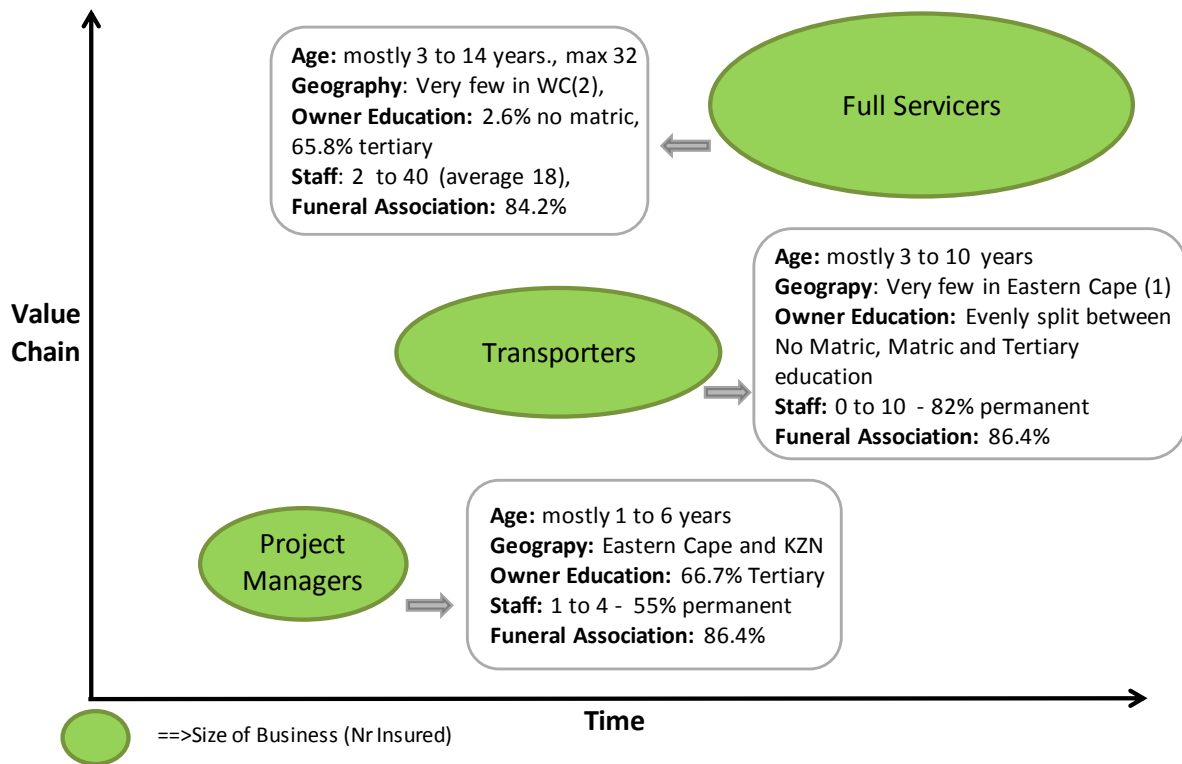


Figure 6: Value chain evolution model

Source: Authors

7.2. Business context

A number of interesting business context factors emerged through consideration of our survey and exploratory interview data.

Perceived high level of competition a business threat. Many of the funeral service providers that we interviewed for the exploratory interviews mentioned perceived high levels of competition amongst funeral service providers in the local community. Our survey data shows that 62 of the 72 funeral service providers (79.1%) stated they have as many as nine or more competitors in a five-kilometre radius from their businesses. This places strong pressure on funeral service providers to offer competitive rates and service packages in order to attract clients and encourages them to engage in risky behaviour such as paying dubious claims or waiving waiting periods or age limits on their insurance policies. We explore this in Section 9 below as well as in our policy note.

Some of the funeral service providers in the Western Cape also mentioned competition from the minibus taxi (transportation) industry who “control” certain transport routes by coercing funeral service providers to use their vehicles or who charge a ‘release fee’ to allow for the transportation of a body out of a specific township. This threat however seems to be limited to Cape Town and the Western Cape and is particularly prevalent on the main transport routes between the Western and Eastern Cape. It may therefore be as a result of the fact that many - Western Cape funeral service providers serve a Xhosa population that migrated to the Western Cape from the Eastern Cape and these funeral service providers often having to transport bodies back to the Eastern Cape for burials in the deceased’s local community.

Funeral service provider industry is the source of many underhanded business practices. Through our exploratory interviews we were able to identify a number of less than scrupulous business practices in the funeral services provider industry. Although it is unclear how rampant these malpractices are, the fact that Parliament heard submissions in 2003 on abusive practices in the funeral service provider industry which led to the policy process regarding a microinsurance regulatory framework as discussed in Section 1, indicates that these practices are widespread. Interviewees in the Eastern Cape and Kwazulu-Natal mentioned stories of corpses being held for ransom by competitor funeral service providers. In the Eastern Cape, specifically, some interviewees mentioned the deduction of insurance premiums from state grants (old age pensions, child grants, foster care grants and disability grants) at the pay-points for these grants. Although not being illegal, in the aforementioned case funeral service providers go to great lengths to ensure that they are first in line to receive money due from the old age grant. In Kwazulu-Natal, funeral service providers mentioned having to negotiate with or bribe hospital clerks of local hospitals in order to “procure” or “hijack” bodies thereby securing the right to deliver the funeral. Some hospitals also have (unofficial) schedules for the distribution of bodies to different funeral service providers to allow for a “fair” distribution of bodies and funerals between funeral service providers in the community. While it is hoped that the new microinsurance policy framework discussed in our policy note will help to reduce the incidence of these abuses, greater co-operation between the FSB and other departments, for example health, is clearly required, as discussed in our policy note.

7.3. Provision of financial services

As discussed in Section 5.2, low-income households use a variety of financial instruments to cover the costs of a funeral. In order to secure a market for their services, funeral service providers typically offer a number of financial services in addition to their core business of providing funeral services. These financial services include insurance, pre-payment for funerals (savings) and credit. For the client, a financial arrangement with a funeral service provider means that they do not have to be confronted with the additional burden of finding a funeral service provider when death occurs. These financial agreements place funeral service providers in a strong bargaining position relative to their clients because these funeral service providers often pay out claims in the form of in-kind funeral services rather than in cash (notwithstanding that the Long-Term Insurance Act requires a cash option to be provided). This means that insured clients often have no option but to use the funeral services of the provider with which they are insured.

In addition to individual clients having financing arrangements with funeral service providers, burial societies also often have financing agreements with funeral service providers. We explore these relationships in Box 1 below. It should be noted that while we explore informality of funeral service providers – in terms of the definition in Section 2- and the risks these pose in Sections 8 and 9 below, funeral service providers that sell savings and credit products are required to comply with the FAIS Act in addition to other legislation. We do not canvass this in this document but draw readers’ attention to the fact that funeral service providers that sell financial products and services may be flouting legislation in addition to health and insurance-related legislation.

- **Funeral insurance:** As discussed in Section 5.1, funeral insurance (formal and informal) is a popular means of providing for funeral expenses in South African. All the funeral service providers in our sample offer funeral insurance as a financing mechanism as this was part of our sampling criteria. The nature of insurance products offered by the surveyed providers is discussed in more detail in Section 7.4 below.

- **Pre-paid funerals:** Members save towards a funeral by paying money to the funeral service provider at defined or undefined intervals. Typically, the funeral service provider will issue a coupon and insert it into a booklet (owned by the client) for each payment made. If a client or one of his/her beneficiaries dies, the funeral service provider will assess whether sufficient money has been paid for the requested funeral; if not, the client or his/her family will have to pay the balance. Clients do not earn interest on money that is 'saved' with a funeral service provider, but funeral service providers typically offer a 'discount' on the cost of the funeral (Bester et al., 2005: 25). Nearly a fifth of our sample (14 of the 72) indicated that they offer their clients the option to pre-pay for a funeral; it is furthermore found that all of those that offer pre-payment as financing method reside in rural areas.
- **Credit:** Where customers do not plan financially for a funeral in advance, or where funeral insurance or pre-payment/savings are not sufficient to cover the cost of the funeral, households may obtain credit from the funeral service provider. 43 of the 72 (59.7%) of the funeral service providers in our sample offer credit as a payment option. The majority of those who offer credit indicated that the rates and duration of credit repayment differ from client to client. 28 of the 43 (65.1%) respondents that offer credit explicitly stated that the terms and conditions of repayment are negotiated according to a client's affordability constraints; some indicated that they take clients' employment status, salary and expenses into consideration when determining the rate and duration of repayment. One respondent indicated that he only gives credit to clients he knows, while another said that his clients often pay back credit in kind (cow, furniture, fridge etc.). It is important to point out that while we did not explore credit provision as an indicator of informality, it is likely that the majority of funeral service providers that are offering credit are not registered for credit provision with the National Credit Regulator.

Box 1: The financing relationship between burial societies and funeral service providers

Burial societies are often informal associations of people who pool savings for purposes of providing members with funeral cover. They often have some form of financing agreement with funeral service providers. This relationship is typically beneficial to both parties: for the funeral service provider it secures business, and for the burial society it creates a preferred-buyer status (Bester *et al.*, 2005).

The relationship typically takes on one or a combination of the following two forms:

- *Funeral service providers offer insurance cover to the members of the burial society.* The funeral services provider and burial society would typically agree on the number of lives covered, the premium paid by each member and the structure of the funeral package. The burial society would be responsible for the collection of premiums, while the funeral service provider would be in charge of administration. 13 of the 72 funeral service providers in our sample (18.1%) indicated that they offer 'insurance' to the members of burial societies. Survey data shows that nine of those who have an 'insurance' type relationship with a burial society are not underwritten by a formal insurance company; this implies that the funeral services provider carries the full mortality risk of the burial societies' membership pool (Bester *et al.*, 2005: 49).
- *Funeral service providers offer burial societies the option to pre-pay for a number of funerals.* The burial society pays a proportion of its monthly premiums to the funeral service provider. In order to prevent fraud or theft by the funeral service provider, the burial society generally does not pre-pay more than two or three funerals. A pre-payment agreement secures a strong relationship with a funeral services provider which typically results in a discount for the burial society's members. It furthermore increases the funeral service provider's willingness to provide funerals on credit when the burial society does not have sufficient funds. In a pre-payment agreement the burial society carries the full mortality risk of its members (Bester *et al.*, 2005). We did not ask survey respondents whether they offer pre-payment as an option to burial

7.4. Cost and structure of funeral service products

As stated above, funeral service providers provide funeral services and many (all of those in our survey) provide funeral insurance. More often than not the funeral service is provided to an insured client as payment under the policy. We examine below the cost implications for clients of both of these services.

7.4.1. Funeral services

Although we found that funeral service providers rarely attach a monetary benefit to the funeral services provided, we have ascertained the core elements and prices of two standard funeral packages, one very basic and one very extravagant package, as described in Table 5 below.

	Core elements:	Cash price of funeral:
Basic funeral package:	<ul style="list-style-type: none"> • Storage and treatment of the body • Hearse • Coffin • Lowering device • Flowers/coffin spray • Tents • Chairs • Black and white pamphlets 	R2,500 (\$322.50)
Extravagant package	<p>Everything that is included in the basic package plus:</p> <ul style="list-style-type: none"> • Casket instead of coffin • Family cars • Busses for the mourners • Catering • Radio announcement • Choir • Colour pamphlets • 1 Flush toilet 	R70,000 (\$9032)

Table 4: Summary of components of a funeral package

Source: Authors

It is generally found that while all funeral packages include the same basic services, the main driver of cost is the quality of the hearse and tombstone and the use of a comparatively expensive casket versus a coffin.

Some respondents indicated that they do not have fixed cash packages, and that each funeral is tailored according to the client's specific needs and the price is determined accordingly.

7.4.2. Funeral insurance products

Table 6 below shows there is an increase in the average monthly premium charged for funeral insurance across the value chain from R79.80 (\$10.29) per month for project managers to R96.70

(\$12.48) per month for full servicers. However, the benefit to premium ratio (the average cash price of the most popular funerals divided by the average premium charged per month) actually decreases successively as one moves up the value chain for funeral service providers, meaning that project managers actually offer the best value for money (or say they do, as the price of the most popular funeral package is self-reported).

	Number of respondents	Average cash price of funeral service	Average premium charged (per month)	Benefit to premium ratio
Project managers	12	R8454.5	R79.8	105.92
Transporters	22	R8084.3	R82.6	97.85
Full Servicers	38	R8896.2	R96.7	91.97
Total	72	R8562.06	R89.98	95.15

Table 5: Funeral packages across value chain categories

Source: Authors

In Table 6 below, the survey respondents are split into rural and urban funeral service providers. This is done at the province level, as survey participants from the Eastern Cape (EC) and Limpopo mostly resided in rural areas, while those from Kwazulu-Natal and the Western Cape were all located in urban areas. When viewing the survey data in this manner it can be seen that while the average monthly premium in rural areas is lower than that of urban areas (R171.2 vs. R192.5 or \$22.09 vs. \$24.84), the benefit (average cash price of a funeral service package) is higher in rural areas (R19,617.40 vs. R17,340.60 or \$2531.28 or \$2237.50). This means that the benefit to premium ratio is 27.2% higher in rural areas than in urban areas which means that clients that purchase funeral insurance from funeral service providers in rural areas are getting more value for their money than clients who purchase such products from funeral service providers in urban areas.

	Number of respondents	Average cash price of funeral package	Average monthly premium charged	Benefit to premium ratio
EC & Limpopo (Rural)	39	R19617.40	R171.20	R114.60
KZN&WC (Urban)	33	R17340.60	R192.50	R90.10
Total	72	R9142.40	R90.30	R101.20

Table 6: Rural and urban funeral insurance premiums and benefits

Source: Authors

7.5. Employment

Given the high unemployment levels in South Africa and the priority given to reducing this, the findings below may be important for policymakers.

Five largest employees responsible for almost two thirds of employment opportunities. Our sample of 72 funeral service providers is responsible for 1,509 employment (permanent and temporary) opportunities. However, of the 72, one funeral service provider (with a number of branches) is responsible for 700 (almost half) of the employment opportunities. This particular business is one of the two largest funeral service providers surveyed in terms of number of policyholders with more

than 20,000²³. Furthermore, the five biggest (in terms of insurance clients) employers in our sample are responsible for 970 or almost two thirds (64.3%) of the employment opportunities. On average, smaller employers employ only 8.2 employees per business. 46.9% of employees are female, 24.6% are temporary workers and 39.2% have a verbal rather than a written contract with their employees.

Smaller businesses likely to employ more temporary workers than larger businesses. Smaller funeral service provider businesses (by insurance clients) employ a larger percentage of temporary workers than larger businesses. For micro and small funeral service provider businesses, the average percentage of temporary workers (as a proportion of total employment) is 30%, compared to 9.5% for medium and large businesses. Micro businesses state that they have a written contractual relationship with 41.1% of their employees in contrast to 30.8% of medium and large businesses. This finding is counter-intuitive and contrasts with the finding of a larger percentage of temporary workers employed by micro and small businesses. It is not clear why smaller funeral service provider business would have written contracts with their employees than larger businesses. We were unable to verify the contractual nature of the employment relationship with workers and it is possible that this question led to response bias.

8. Funeral service provider informality

The survey included questions that ultimately allow us to categorise the sample of funeral service providers as formal or informal with respect to compliance with insurance regulation. The responses to these questions were then verified against a number of different sources.

Figure 7 below summarises our findings.

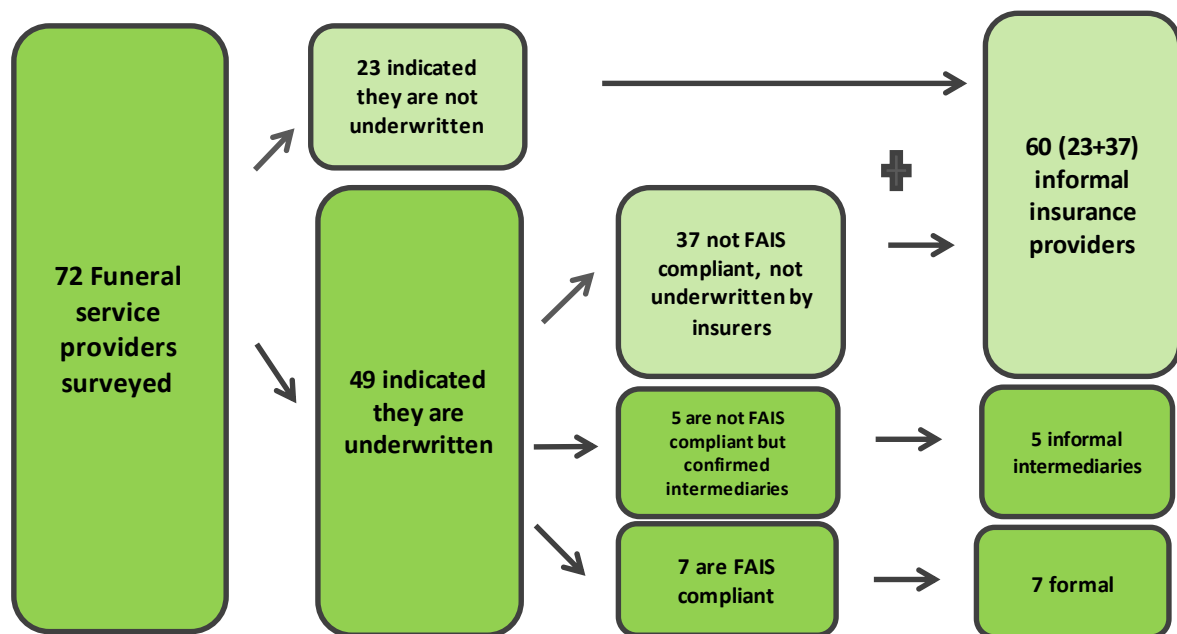


Figure 7: Classification of insurance informality based on verified compliance with insurance regulation

Source: Authors' own

²³ In contrast, the other funeral provider who has 22,500 policyholders only has 113 employees.

Funeral services providers in our sample were classified as formal or informal (with reference to the definition in Section 2 above), according to the following:

- As only those registered under the Long-Term Insurance Act may underwrite funeral insurance, and as none of the funeral services providers are so registered, those (23) that indicated their insurance product is not underwritten by any insurance company (implying that they do their own underwriting) were classified as informal.
- The majority of funeral service providers indicated that they are underwritten. In this instance, in selling funeral insurance they would be providing financial advice or intermediation as defined in the FAIS Act and consequently would need to be a registered FSP or a representative of an FSP.

For the majority of funeral service providers that claimed to be underwritten (37 out of the 49), we could find no proof of underwritten status after checking with the insurance companies. Further, for 42 of the 49 that said they are underwritten, we could find no proof on the FSB website that they have registered as either an FSP or representative. We contacted the FSB which confirmed that it would be highly unlikely that the respondents are FAIS compliant if their website indicates otherwise. These funeral service providers were therefore classified as informal with regards to insurance compliance.

8.1. Key dimensions of insurance informality

In this section we examine the relationship between informality as defined in Section 2 above and other aspects of the funeral service providers surveyed for this study.

Specifically, we identify three key relationships:

Formality and value chain category positively related. Figure 8 shows that formal funeral service providers are more likely to be full services with two-thirds or 66.67% of the formal funeral service providers in our survey not outsourcing any component of the value chain to another funeral service provider. Although the number of formal funeral service providers in our sample is small, it is interesting to note that only one of the twelve formal funeral service providers outsources all of its business services to other funeral service providers.

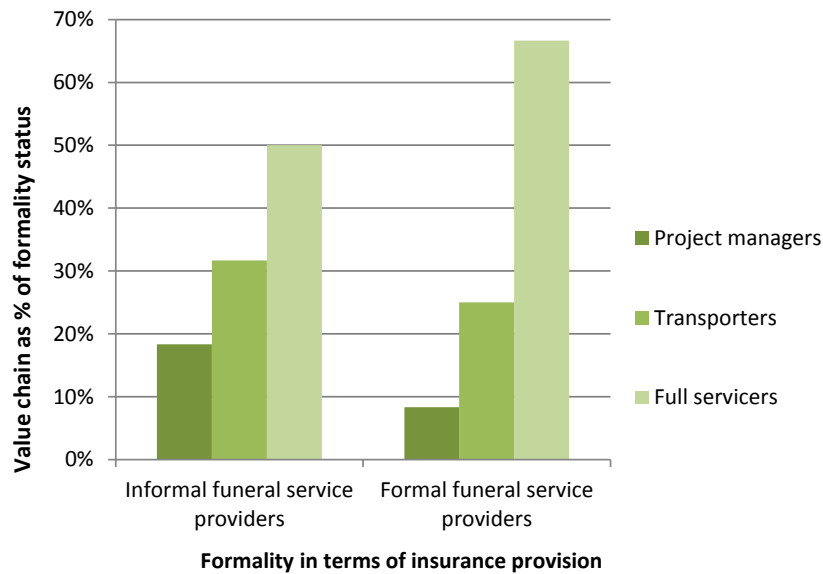


Figure 8: Informality and the value chain

Source: Authors

Formality and age also positively related. Age of the funeral service business also seems to have a positive relationship with formality **Error! Reference source not found.** shows that 10 out of the 12 formal funeral service providers (83.3%) are older than five years. Conversely, a larger proportion of businesses that are informal are five years old or younger (27 out of 60 or 45%).

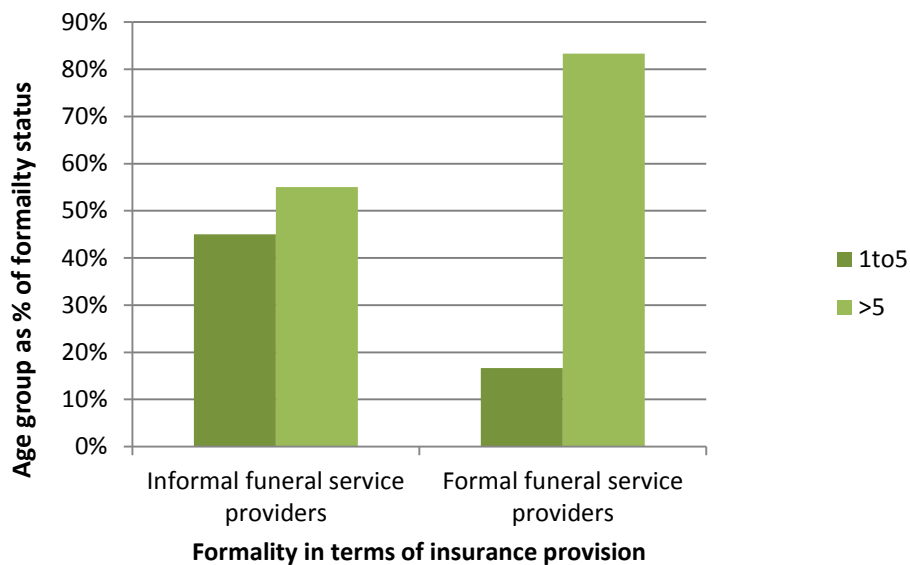


Figure 9: Informality and business age

Source: Authors

Formality and business size also positively related. There is also a positive relationship between formality and the size of the funeral service provider business in terms of number of insurance clients. **Error! Reference source not found.** shows that the majority of informal businesses in our survey are micro or small while the majority of formal funeral service providers are medium or large (66.67% or 8 out of 12). Thus, either formal funeral service providers have more insurance clients, or the larger number of insurance clients the greater the propensity to formalise.

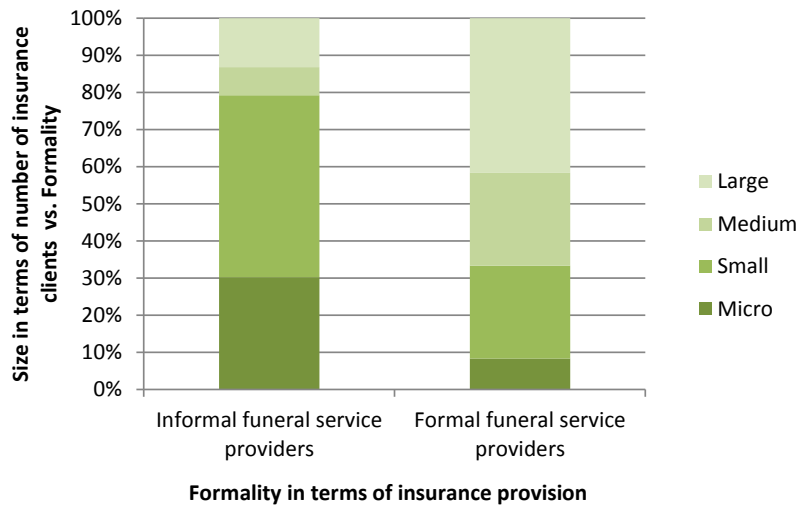


Figure 10: Informality and business size

Source: Authors

The positive nature of these additional three relationships between formality and value chain category, age and size of the funeral service provider business (in terms of number of insurance clients) allows us to fit insurance informality/formality into our previous funeral service provider evolution model (as indicated below in **Error! Reference source not found.**), with formal funeral service providers being more likely to be older, bigger (in terms of insurance client base) and higher up the value chain. We examine in Section 9 below the implications of these findings.

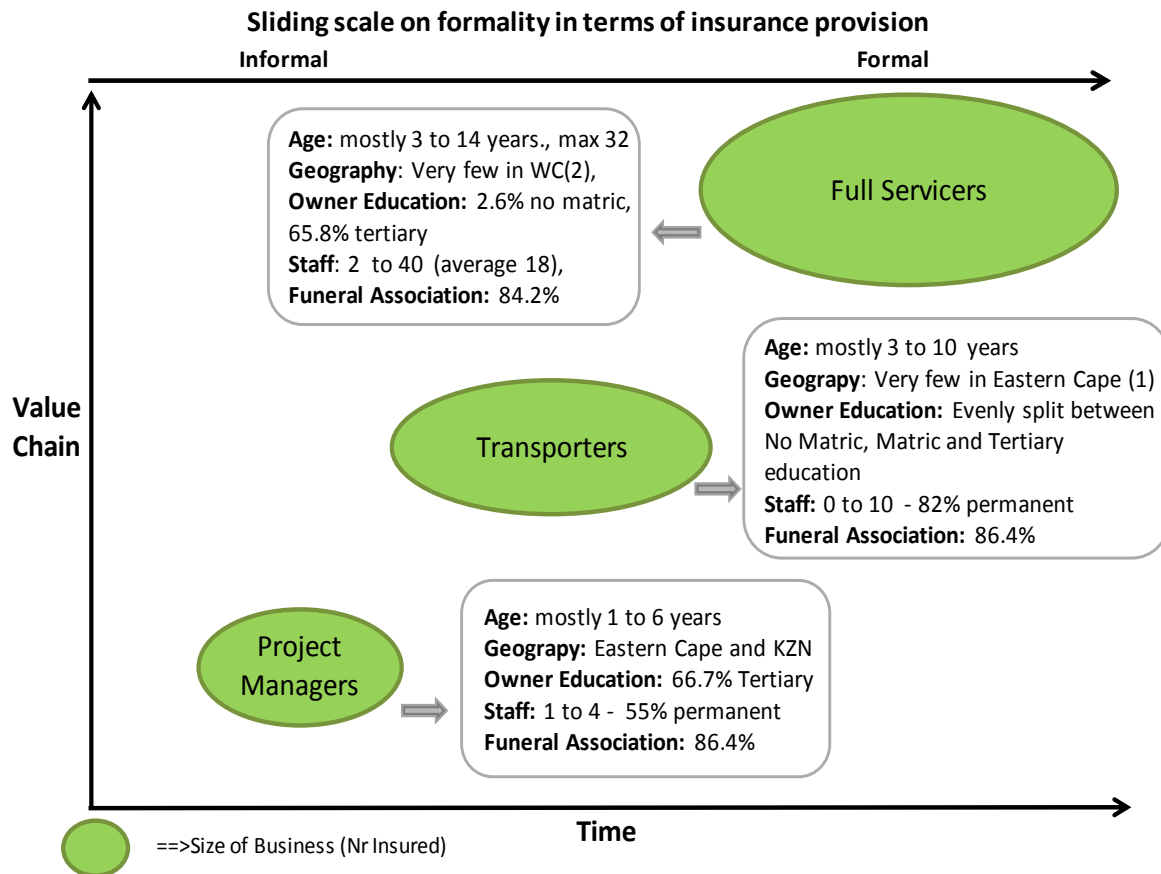


Figure 11: Value chain evolution model including insurance informality

Source: Authors

8.2. Informality and awareness of legislation/regulations

Although high levels of awareness of FSB amongst informal respondents, much lower levels of awareness of FAIS and its implications. We attempted to find explanations for informality of funeral service providers other than the relationships between value chain category, age and size explored above. We therefore asked respondents whether they know and are aware of both the FSB as the regulator of insurance and the FAIS Act and its implications for their businesses. Of the 59 *informal* funeral service providers who answered these questions, 50 (84.8%) indicated that they have heard about the FSB while only 14 said they have heard about FAIS (23.7%). 79.6% of respondents that knew about the FSB seemed to have some knowledge or awareness of how it relates to their businesses, while only 3 of the 14 (21.4%) respondents who indicated that they know about the FAIS Act seemed to know what the intention of the Act is and how it applies to them.

All 12 *formal* funeral service providers responded that they have heard about the FSB and eight said they have heard about FAIS. Eight of the 12 who indicated they know about the FSB had some understanding of what the FSB does, while only four of the eight respondents who indicated they have heard of FAIS understand what the implications of the FAIS Act are.

There therefore seems to be a generally higher awareness of the FSB amongst respondents than of FAIS and formal funeral service providers seem to have more knowledge and awareness than informal funeral service providers. While lack of knowledge therefore correlates to informality, the

fact that even formal respondents lack FAIS knowledge is concerning as all purveyors of funeral insurance products are required to be FAIS compliant. We explore this in greater detail in our policy note.

8.3. Informality and compliance with other regulations

Although we define informality in Section 2 as non-compliance with insurance-related regulations, we also explored the degree to which informal funeral service providers comply with health, business registration and tax laws.

Majority of informal and formal funeral service providers that have fridges state that they are health compliant. Of the 30 informal funeral service providers that own refrigeration equipment, 24 stated that they have a Certificate of Competence. Of the eight formal funeral service providers that own refrigeration equipment, six (75%) stated that they have a Certificate of Competence. The majority of both formal and informal funeral service providers therefore claim to be legally compliant with health requirements, but we were unable to confirm this with the health authorities.

Further, funeral service providers that do not have refrigeration facilities are not necessarily non-compliant with health regulations as the outsourcing of this aspect of the funeral does not appear to be prohibited and is not regulated. In particular, no guidance is provided to funeral service providers that do sub-let space from other funeral service providers on whether the funeral service provider they sub-let from should be compliant with the health regulations. In the remainder of the document we therefore use ownership of a refrigeration facility as an indicator of value chain category rather than as a descriptor of informality.

Lack of proof of business registration more prevalent for informal providers. We were unable to find confirmation of registration with the Companies and Intellectual Property Commission (“CIPC”) for 19 of the 54 informal funeral service providers that claim to be registered CC’s or companies. Conversely, of the 11 formal funeral service providers that indicated that they are registered CC’s or companies, only one could not be confirmed with the CIPC. Please note however that funeral service providers are not required to be incorporated, unless they underwrite (as opposed to intermediate) funeral insurance, in which case they are required to be public (i.e. listed) companies (or friendly societies that meet the requirements for sales of funeral products). Since company registration is only relevant to underwriters, and since we have already classified those not underwritten (i.e. that do their own underwriting) as informal, we do not explore lack of registration as a separate descriptor of informality.

Tax compliance not significant descriptor of insurance informality. 93% of funeral service providers of the sample claim to be registered for income tax, while 56.9% indicated that they are registered VAT vendors. Unfortunately, there was no way in which this feedback could be verified without potentially revealing their non-compliance to the tax authorities. Since we believe these questions elicited an overly positive response (response bias) we do not use tax compliance as a descriptor of informality.

8.4. Other features of informality

Here we explore the correlation between informality and owner and client descriptors.

Majority of formal and informal funeral service providers are male-owned. Table 7 shows that eight (75%) of formal funeral service providers are male owned while 36 (60%) of informal funeral service providers are male owned.

	Male owned (%)	Female Owned (%)	Female & Male Owned (%)	Undetermined (%)	Total
Formal insurance providers	75.0	16.7	8.3		12
Informal insurance providers	60.0	33.3	5.0	1.7	60
Total	62.5	30.6	5.6	1.4	72

Table 7: Gender of business owners

Source: Authors

Owners of formal funeral service providers have higher levels of education. 75% of owners of formal funeral service providers have a tertiary education with all such owners having completed high school (Grade 12). Conversely, nine out of the 60 (15%) informal funeral service providers did not complete high school while 20 (33.3%) only completed high school. Interestingly, that leaves 31 (51.7%) informal funeral service providers who indicated that they have some sort of tertiary education.

Majority of both formal and informal funeral service providers' insurance clients are female. 52 of the 72 respondents (72.2%) indicated that the majority of their insurance client base is female. This includes 73.3% of informal funeral service providers and 66.67% of formal funeral service providers. A further 18 respondents (25%) indicated that their insurance clientele are equally split between male and female clients while only two respondents (2.8%) said that the majority of their insurance client base is male. Both of these are small project managers, one in Limpopo and one in the Western Cape. There appears to be no correlation between insurance client income and the formality or informality of insurance service providers. The responses in terms of client gender and client income (from the business owners' perspectives) therefore did not vary significantly across formal and informal funeral service providers, perhaps indicating that insurance clients are unable to distinguish between formal and informal insurance providers or are unconcerned about whether they purchase funeral insurance from either of these types of funerals service providers. Given the risks to clients of purchasing funeral insurance from informal funeral service providers as explained in Section 9 below, there is an urgent need to educate these clients about such risks and we canvass this in our policy note.

Unable to find geographic dimension in insurance informality. We found no evidence of a distinct distribution of informality by province.

No clear relationship exists between employment and informality of funeral service providers. We found no evidence of a distinct relationship between informality and employment.

In summary, therefore most funeral service providers are male owned, while most of their clients are female. Informal funeral service providers tend to have lower levels of education than formal funeral service providers.

9. Risks and financial viability of informal funeral service providers

In this section we explore the various risks relating to **funeral service providers that are informal in that they underwrite their own insurance** businesses in contravention of the Long-Term Insurance Act. We do so using two main data sources: data from four deep dives contained and data relating to informal funeral service providers from our survey.

For the deep dives we are able to evaluate the risks associated with informal funeral service providers' businesses using qualitative and quantitative analysis. For the survey data we analyse the available financial and client data using two approaches. We first construct scenarios to determine the solvency of the insurance business ("funeral insurance scheme") and funeral services business. We then analyse the sample's performance with regards to a number of variables that can be considered indicators of their ability to manage financial data, reporting and overall financial risk in a way that minimises risk to the business and its clients.

9.1. Exploring risks in the deep dive sample

In this section we consider the practices that our deep dive sample of informal funeral service providers use in managing the membership profile of their funeral schemes as well as their broader financial management approach to the funeral schemes and their funeral businesses.

9.1.1. Managing the membership profile

We have summarised the key information on how the four different funeral service providers (Alpha & Omega as one entity, Delta, Beta and Epsilon) on who we conducted deep dives manage their membership profile in Table 8 below and discuss these membership profile management practices and what they imply for business and client risk in the remainder of this section.

Absence of health underwriting means that deep dive funeral service providers do not understand the health risks of the insured pool. None of the funeral service providers in our deep dive sample apply any explicit health underwriting. This means that these funeral service providers do not consider the health status of their policyholders and insured lives in a nuanced way to arrive at a price that considers the health status of the insured lives. This is not unusual for funeral insurance, but formal insurers usually apply a number of measures to assist in managing and understanding the health risk profile of the overall pool. In some cases, health risks are filtered through waiting periods (to avoid adverse selection). In others, differentiated pricing is applied for higher health risks (e.g. pricing based on age as age is correlated with health profile). In all cases, the risk profile and claims experience of the group are closely monitored and pricing adjusted accordingly or other management measures taken to avoid further deterioration of the risk pool. As will be noted below, the deep dive cases do not apply such management practices.

Detailed data on policyholders and covered lives not always collected and recorded. The level(s) of member data collected and recorded is important because it allows an insurer to know exactly who it is insuring and to price its product accordingly. The more detailed the information the better. The first concern to note from Table 8 is that membership data is limited (and where it is available it is not used to inform risk management or pricing). For example, funeral service provider Beta collects the identification documents of its main members (the policyholders) but only the names and surnames of the additional lives covered (as many as 13 per main policyholder). This practice will encourage anti-selection and also means that it is impossible for the provider to assess and manage

the risk of its portfolio. The remaining three providers, however, have more detailed descriptions of who they are covering. They require copies of the identification documents or birth certificates of all the lives covered by them.

Client information managed through paper-based administration system. All four funeral service providers in our deep dive sample have paper-based systems of recording client information. This makes it difficult to monitor or analyse the member profile on an on-going basis (even where the data is available), evaluate and settle claims and monitor premium payments. Such paper-based systems also do not facilitate good data management practices such as retaining back-ups in case of fire or another disaster which may destroy paper-based information. None of the deep dives evaluate its member profile on an on-going basis.

Short or no waiting periods applied. In the absence of health underwriting, the use of waiting periods is a key measure to manage anti-selection. Of the four deep dive profiles, Beta and Epsilon have no waiting period. Delta has now progressed to a waiting period system following a claim within 3 months of the policyholder commencing the policy. This reflects the trend for such providers to introduce risk management measures after the fact without a clear risk management framework or strategy and without the ability to tailor these approaches to accurate measures of risk. Most of the funeral service providers in our deep dive sample simply copy these measures from competitors (whether formal or informal) without considering the differences in risk pools between themselves and their competitors. As no health tests are applied to their policyholders and other insured lives, sickly individuals are more likely to insure themselves with funeral service providers that have no waiting periods.

Limited age underwriting and minimal restrictions on maximum age of entry. A key and simple element of underwriting is managing the age(s) of the risk pool, which includes managing the age of entry, managing the overall age profile of the insured group of lives and pricing according to age. Delta and Epsilon have considered the higher risk of having elderly scheme members in their client pools and have priced for the risk. Delta requires members who are 65 years and older to be placed on a premium plan specifically tailored for the elderly, while Epsilon requires an additional R55 to be paid by each individual over 66 years of age. Beta does not take age into consideration when pricing. Accordingly, it is not adjusting pricing to manage risk and also faces the risk of anti-selection as it is likely to attract older members. Alpha does not apply age restrictions or pricing accordingly but does not allow an individual older than 60 to be the main member on a policy. In this way it attempts to ensure that there are some younger lives covered by the policy, but it is possible that 9 out of 10 covered lives allowed per Alpha policy could be older than 60.

No restrictions on covered individuals and no insurable interest required to cover a life. A typical feature of funeral policies is to restrict cover to those lives in which the policyholder has an insurable interest (e.g. immediate family and dependents). This is not only to protect the insured individuals but also to avoid anti-selection. All four deep dive cases permit the main members the freedom to insure individuals who are not immediate family members. This increases the risk substantially as there is no control over who is added to the policy. This is exacerbated where the information on who is covered is not properly captured and monitored by the funeral service provider.

Replacement of nominated beneficiaries once death occurs. Alpha and Delta allow the policyholder to replace someone who has passed away with a new person. This effectively means that the policy will cover far more people than the stated maximum and this should, at a minimum, be factored into pricing. Neither of the two takes this into account for pricing purposes. Alpha applies a waiting

period on new lives added but Delta does not. Where there is no restriction on who can be added and no additional charge for additional lives added, there is every incentive for the policyholder to fill the maximum number of lives allowed on their policy without any consideration for the risk (or worse, they may have the incentive to add the sick and dying as they may benefit from claiming on their death).

High risk behaviour by funeral service providers approximates start-up lottery. Of particular concern is that poor risk management as outlined above may, in some cases, be deliberate. Our interactions with the deep dive providers and the funeral service providers surveyed in the larger sample (see Sections 0 and 9.2.2) suggest that they are mostly not able to quantify the risks in their risk pools. While they are aware of this and may theoretically know that this needs to be managed, they deliberately decide to take risks on their risk pools and other business aspects for short-term gain. Examples of this behaviour include avoiding waiting periods to gain members quickly and hoping that the risk does not materialise. Some providers use premium income to fund other business activities or capital expenditures at the risk of needing the money to pay claims. This risk is exacerbated in cases where the funeral service providers do not know who they are underwriting. While the providers may think they are able to judge the risks of the policyholder at face value, they have no real way of judging the risk of additional lives added to the policy. In total, therefore, the above behaviours amount to high risk at the cost of the client whose premiums are used to fund business start-up costs and who will be left without any cover if the provider is unable to settle claims.

Membership profile and size of pool needs to be carefully managed. If we apply quantitative analysis to three of the four funeral service providers in our deep dive sample (Alpha, Beta and Delta), it is evident that there is great need for the overall profile and size of the insurance risk pools to be carefully managed. During the last financial year, Delta’s claims experience, measured as the number of deaths per main member, was significantly higher than the other two funeral insurance schemes (Table 8 below). This is despite Delta’s funeral insurance scheme having a less risky profile (fewer lives were covered per policy and at a younger average age). However, Delta is based in KwaZulu-Natal which is one of the provinces with the highest HIV prevalence rates in South Africa. This can partly explain the high claims rate which Delta experienced, but not completely because Alpha, also situated in KwaZulu-Natal, has a claims rate nearly half that of Delta’s despite a riskier client profile. Delta’s adverse experience can further be explained by two factors:

- The Delta risk pool is significantly smaller than the other two funeral insurance schemes (251 lives compared to 5,130 for Beta and 4,356 for Alpha) which results in higher variability of claims.
- Delta commenced business in 2011 while the other two funeral insurance schemes have existed for a longer period (Beta started in 2010). It is usual for an insurer to experience some anti-selection from new members. Delta does not have an existing member base across which the extra claims cost can be spread. The impact of anti-selection is exacerbated by Delta taking an aggressive approach to grow the funeral insurance scheme. For example, Delta applies shorter waiting periods than Alpha.

	Delta	Beta	Alpha
Claims rate*	211.5	91.9	113.7
Number of lives per policy	4.8	11.5	8.7
Average ages of main	46	48	51

	Delta	Beta	Alpha
members			
Province	Kwazulu-Natal	Limpopo	Kwazulu-Natal

Table 8: Membership profile of deep dive sample

Source: Authors

This intuitively indicates that younger, smaller (in terms of insurance client base) informal funeral service providers are at greater risk, and hence so are their clients.

Change in risk profile over time could increase risks for funeral service providers. An important factor that influences an insurance fund's risk profile is the change in age distribution over time. Mature insurance funds are often in a situation where new entrants do not offset the impact of the ageing of existing members. The fund's claims experience will then tend to increase each year as the fund grows older (mortality increases with age) and this will cause losses if premiums are not increased.

The average age of main members of Beta's funeral insurance scheme was 51 in 2010, 50 in 2011 and 48 in 2012. We only have this data available for Beta. As can be seen, the average age in Beta's insurance risk pool is reducing which implies that there are a healthy number of new entrants who are younger than the average age of the existing members – a healthy situation for Beta. However, as we do not have the same detailed information for the other funeral service providers we are unable to arrive at the same conclusion. The mere fact that they do not have such client data for multiple years available indicates that they are not monitoring age distribution in their risk pools.

Inadequate or over-pricing by two of deep dive sample. Table 9 below analyses the adequacy of the premiums charged by Delta and Alpha relative to the risk profile of their insured lives (Beta's member data was not detailed enough to enable a similar analysis). In the table, the "theoretical premium" represents the premium required per month to cover only the cost of claims (i.e. no contribution to expenses), considering the risk profile of the funeral insurance scheme and the number of deaths over the most recent financial year. The theoretical premium is then compared to the monthly premium actually being charged. A ratio of less than 100% implies the premium being charged is sufficient to cover the risk underwritten. It is important to emphasise that this ratio does not consider any overhead, distribution or compliance costs. From the table, it is clear that the monthly premium for Delta's Plan C is *too low* for the level of risk it is covering. Plan C is the Parent Plan, which provides cover to lives over 65. Delta has significantly under-estimated the increase in premium required to cover older lives. We can also see that Alpha's family premium is very high relative to the risk it is covering, which raises concerns about the value that this particular policy is offering to clients, i.e. clients are over-paying.

		Delta		Alpha	
		Plan A	Plan B	Plan C	
Theoretical premium	Family	R56 (\$7.2)	R70 (\$9)	R243 (\$31.4)	R23 (\$3)
	EF ²⁴ member	R27 (\$3.5)	R30 (\$3.9)	-	R8 (\$1)
Current premium	Family	R60 (\$7.7)	R80 (\$10.3)	R100 (\$12.9)	R100 (\$12.9)
	EF member	R45 (\$5.8)	R60 (\$7.7)	-	R15 (\$1.9)
Ratio of theoretical premium to current premium	Family	94%	88%	243%	23%
	EF member	61%	50%	-	56%

Table 9: Premium adequacy for deep dive sample

Source: Authors

9.1.2. Financial data, reporting and management

Knowledge of the financial status of any company is essential but even more so for a complex business like insurance. Appropriate financial record keeping, reporting and management are critical risk management tools and are consequently requirements of the Long-term Insurance Act. We have summarised the financial management practices of our deep dive sample in Table 10 below. We discuss what this implies for business and client risk in the remainder of this section. Where possible, we also include quantitative data from the deep dive analyses to demonstrate the implications of financial management for overall sustainability.

	Alpha & Omega	Delta	Beta	Epsilon
Governance	President, vice-president, secretary, treasurer, & board members	Owner is manager	Owner is manager	Owner is manager
Annual Financial statements available	Yes	No	No	Yes
Who prepares financial statements (Administrative employee- no accounting qualification	No financial statements; simple records of income and expenditures written in a book.	No financial statements; simple records of income and expenditures written in a book.	Outsourced
Paper-based/ electronic financial records	Financial information captured electronically	Financial information kept in files (paper-based)	Financial information kept in files (paper-based)	Financial information captured electronically
Separation of Funeral and Insurance business	Yes	No	No	No

Table 10: Summary of financial management practices of deep dive sample

Source: Authors

²⁴ EF member: Extended family member

Governance generally limited to oversight by owner-manager. Given that insurance is a credence good, it is difficult for policyholders to evaluate the value of the product. Claims may be incurred only after several years as a policyholder and it is, therefore, difficult for policyholders to take corrective action if they are unsatisfied. All of this emphasises the need for good governance as required by regulation. Of the four funeral service providers in the deep dive sample, three are owner-managed with no board or separate management. It is only Alpha & Omega's company structure that consists of a president, vice-president, secretary, treasurer and board members. This structure potentially allows for better governance than the other three funeral service providers.

Questions about reliability of annual financial statements. Delta and Beta have only rudimentary book-keeping systems (e.g. capturing income and expenses in a book) and do not prepare any annual or periodic financial statements. As a result, they have almost no information on what their financial positions are at any point in time and tend to conduct their businesses on the balance available in their bank accounts. In contrast, Alpha & Omega and Epsilon prepare financial statements. However, Alpha & Omega's financials are prepared by an administrative employee who has no training in accounting. This brings into question the reliability of its financial statements. Only Epsilon's financial statements can be considered reliable as they are prepared by an outsourced qualified accountant.

All deep dive funeral service providers rely on paper-based financial administration. As is the case for the management of funeral insurance scheme member data, all four funeral service providers have paper-based systems of recording and managing financial information. Apart from the data risks noted above, this makes it very difficult to monitor financial performance and risks even where financial record-keeping is done and reports are prepared.

Separation of funeral and insurance business rare. With the exception of Alpha & Omega, none of the other funeral service providers separate their insurance premiums from their funeral service revenue in contravention of the relevant legislation (Section 6). Insurance premiums are treated as income for the business and spent on capital and operational requirements without consideration for the liabilities that premiums received need to cover. This particular practice, as we shall explore later in the section, raises concerns about the ability of funeral service providers to continue operating as insurance providers. It is a basic requirement of an insurer to have sufficient funds available to cover claims at any point in time. It is possible to argue that funeral service providers who use this approach in managing their funeral insurance schemes are, in fact, running pyramid schemes.

Sustainability of the funeral insurance schemes on a standalone basis is questionable. If we apply quantitative analysis to our deep dive sample, we are able to arrive at conclusions on the sustainability of the funeral insurance schemes or insurance revenue on a standalone basis as would be required if these businesses were to formalise their insurance businesses. If the funeral insurance schemes are separated from the funeral service businesses, it is clear that from Table 11 below that two of the three deep dive funeral insurance schemes were very close to break-even point over the most recent financial year, while the third was very profitable. In the case of the two funeral insurance schemes (Delta and Beta) that barely broke even, we assumed funeral services, which were provided as a pay-out in respect of the funeral claim, were provided at cost²⁵ and that the funeral service business (rather than the funeral insurance scheme) carries all overhead costs. If these two almost unviable funeral insurance schemes were to offer any type of cash pay-out (which

²⁵ To derive this we used the total of variable and fixed (overhead) expenses incurred and divided it by the total number of funerals (both cash and insurance funded) delivered. This reflects the all-in cost of delivering a funeral service.

usually exceeds the cost of a funeral by a substantial margin) as an alternative to the in-kind funeral service offered (this choice is required by current and the proposed microinsurance regulation) these funeral insurance schemes would become financially unsustainable. Alternatively, premiums will have to increase to offset the increased cost raising questions about the value of these products to clients.

	Delta	Beta	Alpha
Income	R69,840 (\$9,011.6)	R235,110 (\$30336.8)	R910,140 (\$117,437.4)
Expenditure	R68,115 (\$8,789)	R237,334 (\$30623.7)	R540,980 (\$69,803.9)
Profit/Loss	R1,725 (\$222.6)	R-2,224 (\$-287)	R369,160 (\$47,633.5)

Table 11: Profitability of funeral insurance schemes if separated from funeral services provider business in deep dive sample

Source: Authors

Funeral service business substantially more profitable than the funeral insurance scheme. When the funeral service businesses (as opposed to insurance business) are assessed on a standalone basis, it is clear that they are more profitable than funeral insurance schemes. This is the case even if they carry all the overhead costs for both the funeral insurance scheme and the funeral service business (Table 12 below). This is likely explained by significant mark-ups on the cost price of *cash funerals* i.e. those where clients pay cash for the funeral as opposed to buying funeral insurance from the funeral service provider to cover the funeral cost (with a 128% mark-up over cost, including fixed costs, for Delta and 259% for Beta), as well as the additional tombstone sales and upgrades on services for insured funerals²⁶. This begs the question why the funeral service providers sell insurance at all when they generate more revenue and profit from cash funerals than from the funeral insurance scheme. The most likely reason is that insurance provides a captive client base for their funeral services. In addition, as explained above, the cash flow generated by premium income is used as an inexpensive financing mechanism to cover day-to-day expenses. If it is the latter reason, serious questions arise around the risk this presents to their insurance clients. When premiums are used to cover day-to-day costs, there is a real possibility of insufficient cash flow to provide the pay-out/funeral services when a death or multiple deaths occur.

	Delta	Beta	Omega
Income	R200,500 (\$25,871)	R259,000 (\$33,419)	R308,980 (\$39,868.4)
Expenditure	R175,545 (\$22,651)	R131,920 (\$17,021.9)	R261,420 (\$33,731.6)
Profit/Loss	R24,955 (\$3,220)	R127,080 (\$16,397.4)	R47,560 (\$6,136.8)

Table 12: Profitability of funeral service business (if separated from funeral insurance scheme) in deep dive sample

Source: Authors

²⁶ When an "upgrade" occurs, the funeral services provider requires the client to pay an additional cash amount to, for example, receive a better coffin or transport than covered by the policy.

9.2. Mapping risks in the survey sample

In this section, we move from considering the risks inherent in membership profile management practices and financial management of the four deep dive candidates to consider the risks raised by the funeral insurance schemes of the informal funeral service providers in our survey sample.

9.2.1. Financial viability scenarios

In order to determine, firstly, the contribution of insurance revenue to the viability of the funeral service business (or put differently, of the ability of funeral service providers to adequately provide for risk) and, secondly, whether the funeral insurance schemes would remain viable if they were separated from the funeral service businesses (as required by law), we separated the funeral service businesses and the funeral insurance schemes (both revenue and costs) of the survey sample. This enabled us to calculate financial viability of, respectively, the funeral service business and the funeral insurance scheme.

Given the differences across the survey in data quality and in nature of funeral services provider, we rely on assumptions on the actual cost to deliver a funeral and the percentage of the cost of the funeral that would be paid out in cash were the client to be given a cash option (choice between funeral service and cash).

In order to draw conclusions that would hold up against errors in our assumptions, we construct two scenarios at opposite ends of the spectrum of assumptions (positive and negative) to derive a range of implications on the financial viability of the funeral service providers in our sample that currently provide informal insurance. The basic assumptions of the two scenarios are described in Table 13 below, while a more detailed discussion on the assumptions and calculations of the results of the two scenarios is contained in Appendix C.

Scenario 1: Status quo (best case for funeral service provider)	Scenario 2: Formalisation of the insurance component of the business (worst case for funeral service provider)
<ul style="list-style-type: none"> • Insurance business and funeral service business combined (as is currently the case with funeral service providers) • Funeral insurance scheme reimburses the funeral service side of business for all insurance funerals delivered at cost, i.e. no mark-up on funerals claimed for under the funeral insurance scheme. However, it is assumed that the premium set for the funeral insurance includes a mark-up. • Funeral services provider has no other sources of income apart from funerals delivered through insurance mechanism • Captive client base: all clients who claim on insurance product choose to have their funeral provided by the funeral services provider who sold them the insurance rather than by another provider • Given the above, all profit made in the business will be due to the pricing of insurance to include an implied mark-up on the cost of the funerals, leading to a stated cash value or price (higher than the actual cost of the funeral) • Funerals correctly priced to reflect input costs • In absence of cost data, cost of funeral assumed to be fixed percentage of stated cash value of an insurance funeral: we vary the assumed percentage 	<ul style="list-style-type: none"> • Revenue from insurance business and funeral service business separated (separate management) requiring each to be viable • Loss of captive client base: clients are free to choose between funeral service and cash pay-out and can therefore purchase the funeral from another funeral service provider • All claims for funerals paid out by the funeral insurance scheme are paid at the stated cash value of a funeral

Table 13: Summary of the assumptions of the two financial viability scenarios

Source: Authors

Under the above assumptions, Scenario 1 will allow us to conclude on whether funeral service providers in our sample that sell informal insurance are able to accurately price for risk and are viable under current operating conditions, while Scenario 2 will allow us to also consider the viability of the funeral insurance scheme if it were to be separated from the funeral service business as would be required if it were to formalise.

Results of Scenario 1

This scenario is referred to as a status quo scenario because informal funeral service providers in the main currently do not separate insurance and funeral businesses and also generally do not offer insurance clients the option to take a cash rather than an in-kind payment.

As mentioned in Table 13, we varied the assumptions on the mark-up on the cost of a funeral to derive results for Scenario 1. The results range from 21.7% of funeral service providers (10 out of 46 informal insurance providers who we were able to do this calculation for) being theoretically non-

viable under a 30% mark-up assumption to 10.9% (5 of 46) being insolvent under a 100% mark-up assumption²⁷. Regardless of the specific cost assumption, the majority of theoretically loss-making providers under each sub scenario seem to be small or medium-sized (in terms of number of insurance clients) as well as relatively young (five years old or younger).

Even at the extreme optimistic assumption, 10% of businesses in our sample are not financially viable given current pricing structure and number of insured clients. This means that even under the current (informal) operating conditions, 10% of businesses in our sample are not financially viable. The 100% mark-up assumption can be considered optimistic, especially in the case of the particular group that seems to be at risk of being non-viable (young and small businesses, or essentially start-ups – see below), as these businesses would be unlikely to have the luxury of such high mark-ups while establishing themselves in a competitive market. Therefore, the actual group that would be at risk of bankruptcy is likely to be higher than 10%.

Most of likely loss-making businesses are small and young. Irrespective of the final percentage of funeral service providers that are found to be loss-making under the status quo scenario, the majority of businesses that are loss-making (non-viable) under each set of assumptions are both small and young. This indicates that the biggest risk lies with this particular group of funeral service providers. This links to our concept of a “start-up lottery” where it might be necessary for small, young start-up funeral service providers to take on more risk than they are able to carry in the early years of their existence in order to fund business expansion. Ultimately this leaves clients exposed to the risk of bankruptcy of the funeral insurance scheme if multiple claims arise at the same time or, simply, if the number of claims is more than anticipated.

Results of Scenario 2

Under this worst-case scenario – separation of funeral insurance schemes and funeral service businesses and all insurance clients elect a cash pay-out rather than a funeral service - *the funeral insurance schemes of 28.3% of funeral service providers (13 of the 46 funeral service providers for which we could calculate the combined ratio²⁸) would have a combined ratio in excess of 100%* implying that the schemes would be insolvent under current pricing structures.

Out of the 13 that are insolvent under this scenario, 12 (92.3%) are small and medium-sized businesses and 8 (61.5%) are five years old or younger, again supporting our conclusion that it is smaller younger businesses that are putting their client base at risk in order to fund business start-up and expansion.

Almost a third of insurance funds loss-making if required pay out claims at stated cash price. Scenario 2 indicates that 28.6% of insurance funds would fail a worst case “stress test” like this one where all claimants choose a cash pay-out under the current cash package pricing structure. Evidence from the deep dives also indicates that given the current management practices applied to the pool of insured lives, it is possible that the insurance risk pools of funeral service providers’ insurance schemes will deteriorate over time (risks in the pool will increase over time) and it is therefore likely that even more will fail over time. Scenario 2 also does not consider any regulatory compliance costs that would add to the cost burden if funeral service providers are indeed required to formalise their insurance funds.

²⁷ We also considered a 50% mark-up scenario which resulted in 15.2% (7 out of 46) of informal providers being theoretically insolvent.

²⁸ The combined ratio is the insurance pay-out value plus other costs incurred by the insurance fund (administration cost, overhead cost, etc.) expressed as a percentage of total insurance premiums collected during the year.

Funeral services business will also be under extreme financial pressure. The captive client base of funeral service providers would potentially be removed if providers were required to offer a cash pay-out option as an alternative to an in-kind funeral service pay-out on a funeral policy, since clients who take a cash pay-out would then be free to select any funeral service provider for the funeral service. This will put the funeral service provider business under substantial pressure. This effect will be worsened if the funeral insurance scheme and funeral service businesses are separated as the funeral service business will no longer be able to rely on cash flow from the funeral insurance scheme.

9.2.2. Financial data, reporting and management

In this section, we explore information on the financial data, financial reporting and overall financial management of the survey respondents. Together with our picture of the solvency of the funeral insurance schemes and funeral service businesses, this allows us to better understand the risks to clients.

Almost half of funeral service providers state they use an accountant. A relatively high proportion of the sample of informal funeral service providers state that they use an accountant for financial reporting (29 out of the 60 informal funeral service providers or 48.3%). This is in contrast to the higher 83.3% (10 of 12) of the formal funeral service providers that indicated that they use an accountant for financial reporting. Although lower than the formal funeral service providers, the number of funeral service providers that use an accountant is surprisingly high and this means that although these providers are unable or unwilling to comply with insurance legislation they are making an active attempt to manage their finances in a systematic way.

Majority informal funeral service providers own a computer and could therefore capture financial documents electronically. Only 15 (of 60 or 25%) of the respondents who are informal in terms of insurance provision indicated that they do not own a computer while all formal funeral services providers own a computer. Most of the informal (75%) and all the formal funeral service providers are at the very least able to keep electronic records of their finances.

Majority of informal funeral service providers do not offer clients the choice between cash and funeral service as required by law. 23 out of the 59 (38.9%) informal funeral service providers that answered this question indicated that they do offer a cash pay-out option, while only 6 of the 12 formal funeral service providers (50%) said that they offer a cash option. Non-compliance by formal funeral service providers with legislation regarding the requirement to offer a cash alternative is concerning. As can be viewed in Table 16 below, more of the medium and large (in terms of insurance client base) informal funeral service providers offer policyholders a choice between a monetary benefit and a funeral service as opposed the small and micro providers.

In analysing the monetary option granted by the aforementioned six formal funeral service providers, we found that three of the six do not explicitly state the amount while the other three indicate the percentage of the cash value of the funeral service that will be paid out, namely 66% (on average), 90%, and 100% minus an administration fee of R250. Again, it is concerning that these so-called formal funeral service providers are flouting legislation either by not stating the cash pay-out or by stating a pay-out which is less than the equivalent in-kind funeral service.

	Informal	Formal
Micro	35.3%	100.0%
Small	30.8%	33.3%
Medium	50.0%	33.3%
Large	66.7%	60.0%
Total	38.3%	50.0%
Total Number	23	6

Table 14: Right to monetary benefit

Source: Authors

Majority of informal funeral service providers do not separate insurance funds and general business revenue. As can be seen in Table 15 below, the majority of informal funeral service providers have only one business bank account (56.1% or 32 of 60) in contrast to the majority of formal funeral service providers that have two or more business bank accounts (58.3% or 7 out of 12). As discussed in Section 6 above, the FAIS Act requires all persons that intermediate insurance products to have at least two bank accounts: one for general business funds and one for the collection of insurance premiums, therefore both informal and worryingly formal funeral service providers are non-compliant in this regard.

Most informal funeral service providers and all formal funeral service providers that have more than one bank account indicated that they do so in order to separate the insurance premiums from general business revenue. It is not clear what incentivises the informal funeral services providers in this regard. One possible answer is that these entities may have been formal in the past or may have attempted to formalise in some way which may mean that they are aware of the regulatory requirement to separate these funds.

In all cases of non-compliance, the risk to clients is that the insurance funds are being used for general business purposes so that these may not be available to meet the providers' obligations when claims are made.

Number of Bank Accounts	Informal		Formal	
	Number	%	Number	%
1	32	56.1%	5	41.7%
2+	25	43.9%	7	58.3%
Total	57		12	

Table 15: Number of business bank accounts

Source: Authors

Majority of informal funeral service providers (almost 90%) could not become micro-insurers if we consider size of risk pool only. A risk pool needs to have at least 4,500 policyholders to be considered viable from a risk perspective²⁹. 58 out of the 65 respondents (89.2%) who answered the question

²⁹ A risk pool needs to have at least 4,500 policyholders to achieve 95% certainty that the actual number of deaths does not exceed the expected number of deaths by more than 7.5%. This is based on an assumption of 100 deaths per 1,000 policyholders/main members (the mortality rate of 10%). Although the risk tolerance margin can be set at different levels, here we have used a risk tolerance of no more than 7.5% of the expected number of deaths as this is the additional mortality margin prescribed by the South African Actuarial Society in the calculation of financial reserves (under the Financial Soundness Valuation Methodology).

on their number of insurance policyholders indicated that they have fewer than 4,500 policyholders. Only 7.5% (4 out of 53) informal funeral service providers indicated that they have 4,500 policyholders or more and only 25% (3 of 12 formal insurance providers) have 4,500 policyholders or more³⁰. The majority of informal funeral service providers (81.1% or 43 of 53) have only 1,000 policyholders or, alternatively, the sample (of informal funeral service providers) average is 1,274 policyholders. There are therefore a large proportion of informal funeral service providers that are at risk of having too few policyholders to ensure that the difference in risk experience between the actual number of deaths and the expected number of deaths is manageable. Furthermore, this indicates that the majority of informal funeral service providers would be unable to formalise their insurance businesses by becoming independent micro-insurers under the proposed regulations and may rather have to seek underwriting.

10. Conclusions

Outsourcing has implications for enforcement of health regulations. The outsourced nature of the business activities of funeral service providers has implications for compliance with health regulations. To ensure compliance with health regulations, it is suggested that it becomes a prerequisite to the issuing of a certificate under Section 4 of the Births and Deaths Registration Act that a funeral service provider has a Certificate of Competence or outsources to a funeral service provider that has a Certificate of Competence. From our discussions with one large metropolitan municipality, it appears as if no active attempts are made to identify funeral service providers that are none compliant with health regulations. Enforcement strategies need to ensure not only continuing compliance by those that have received Certificates of Competence, but also that those that have never complied are compelled to do so or are shut down.

Fluctuating nature of informality. As illustrated by at least one of our deep dives and some of our insurance compliance verification against the FSB database, funeral service providers drift in and out of formality. For some providers we could find proof of FAIS compliance at early stages of the data capturing and verification, but this no longer held later in the study period as their registration had expired. Informality is therefore not a static state. This leads us to also conclude that informality, as identified with regards to insurance compliance, would be more comprehensively explored through a repeat survey over a few years.

Informality may be an initial state of business development. The relationship between value chain category, size of business (in terms of number of insurance clients) and age of business seems to indicate that there is a greater chance of formality as businesses evolve over time and up the value chain, so that it appears that informality may not be a choice but simply an initial state of business development. The intensely competitive environment and “start-up lottery” analogy described above also explain the reluctance in the early years to formalise.

Low level of awareness of regulation, low business skills and knowledge may also contribute to informality. Although many of the informal funeral service providers are generally aware of the FSB, they seem far less aware and able to explain what FAIS is, which may explain why they are not complying with the market conduct regulations. This is counter-intuitive as the implementation of FAIS could be viewed as the FSB’s main driver for engagement with funeral service providers. The need for industry education is explored in our policy note, and., this is supported by the fact that

³⁰ Only 4 formal funeral service providers have fewer than 1,000 policyholders. However, this would not be a problem as these providers obtain formal underwriting from an insurance company.

informal funeral service providers also tend to have lower levels of education than formal funeral service providers.

Sense of ownership, entitlement to insurance funds also a driver of non-compliance. Apart from potentially needing the revenue generated through the funeral insurance scheme to fund general business start-up costs, the explanations of some funeral service providers in our deep dive sample also made it clear that business owners have a sense of entitlement to the insurance funds. One provider stated that it does not understand why it would be necessary to pay over these funds to an insurance company to profit from them when they are the funds of the local community and should therefore remain in the local community. While reference to the local community may speak of a social development approach to business, it is not easy to know whether this argument may simply be masking a profiteering motive.

Significant barriers to formalising insurance business. The reasons for informality and barriers to formalisation are closely related concepts, but they do differ. While reasons for informality may be best answered by what is absent in a business (lack of knowledge or capital), the question of *barriers* to formality speaks to some of the actions that would have to be taken and attendant costs if informal funeral service providers were to formalise. Such barriers include:

- *FAIS compliance.* Funeral service providers will either have to register as FSPs or representatives of an insurance company and will have to have at least one key individual present in the organisation that will have to pass certain FAIS examinations and meet minimum qualification and experience requirements. If the provider were to register as an FSP in its own right, it would have to pay initial registration fees and annual levies have a compliance officer and submit at least a full set of financial documents on annual basis. Detail in this regard is provided in Section 6 and in the policy note.
- *Insurance underwriting compliance.* None of the funeral service providers would currently be legally able to underwrite their own policies as they would be unable to meet the onerous requirements on the Long-term Insurance Act (including registration as a public company). While less onerous, the proposed microinsurance framework will nonetheless also be burdensome for funeral service providers. In any event, given the above analysis on the size of the risk pools and the non-viability of many standalone funeral insurance schemes (which separation would be required in the event of formalisation), many funeral service providers that offer insurance will be unable to underwrite themselves and will have to seek underwriting. *Passing premiums on to insurance company.* Obtaining underwriting will require that they pass on premiums to the underwriters. This will have a large impact on these businesses as most are currently using premiums to fund day-to-day cash flow. They will however be entitled to a commission which is not subject to a cap and ranges between 10% and 20%. Given our calculations on the profitability of the funeral insurance schemes, these commission levels may leave many of the providers better off. However, the loss of cash flow generated from insurance premiums may mean that many of the smaller, younger funeral service providers will not be able to continue past the initial survival phase.
- *Client choice between cash and service.* Most of the informal funeral service providers do not provide their insurance clients with the choice between the cash value of the insurance policy and receipt of the insurance benefit in the form of a service. For providers that will have to give clients this choice if they formalise their insurance businesses, this will cause many to become insolvent (as explained in our deep dive and Scenario analysis above) or will significantly affect their ability to transform their funeral insurance schemes to micro-insurers (if their risk pool is of

a sufficient size). This may mean that as an interim step before formalising, funeral service providers should start to advertise the stated cash value of the insurance product and obtain actuarial assistance to have an accurate understanding of what a sustainable cash value per insurance policy could be. However, an added disadvantage of this is that funeral service providers will lose their captive client base which may mean that the funeral service business is also at risk. Further, the fact that margins on cash pay-outs are higher than the cost of the funeral will mean that funeral service providers will be unable to sustain this practice unless they are able to accurately price for this.

In all, the above paints a bleak picture for funeral service providers were they to formalise. Notwithstanding this, we believe that the risks to consumers of non-formalisation require that informal funeral service providers that sell insurance be brought within the regulatory net. We discuss below the evidence that leads us to this conclusion.

- *Use of funeral insurance funds as start-up capital and no separate management of insurance funds from business revenue constitute consumer abuse.* The evidence on the number of bank accounts and uses of the different bank accounts indicates that the majority of informal funeral service providers do not separate the insurance funds from their other business revenue and many, especially start-ups, use the former to fund their businesses. This means that funeral service providers may be unable to meet obligations to pay out funeral benefits.
- *Best practices not followed.* Funeral service providers do not adhere to insurance best practices in terms of grace periods when clients are unable to pay insurance premiums, do not offer clients the choice between cash or a funeral service, do not adhere to market conduct regulation such as notifying consumers in writing of the details of their policy and, in many cases, force clients to upgrade their funeral benefit at the time of pay-out.
- *Gender and poverty indicators indicate that users of funeral service provider insurance are relatively vulnerable.* The majority of the insurance clients of funeral service providers are females. Together with a number of other vulnerability indicators (predominantly African, low formal employment, high(er) unemployment and a large proportion of these clients being social grant recipients) this points towards the conclusion that the users of funeral service provider insurance products (also in comparison to the users of formal funeral insurance products) are a relatively vulnerable group. Being unable to rely on the funeral cover to which they may have contributed for many years will have dire financial consequences. Further, the fact that clients seem to show no preference in purchasing funeral insurance from either formal or informal funeral service providers indicates that they are unaware of the risks inherent in purchasing cover from informal providers.
- *Lack of management of risk pool points to prudential risk.* Lack of health or at the least age underwriting, lack of management of age distribution in the risk pools, over or under-pricing, failure to collect data of clients or poor data management, lack of requirements regarding insurable interest and lives covered, number of insured lives per policy exceeding requirements, lack of imposition of waiting periods to counter adverse selection, failure to generally manage the risk pool and often deliberate risk-taking particularly in the start-up years all point to poor insurance risk practices which places client at extreme risk.
- *Lack of financial management.* Inadequate governance structure and often rudimentary book-keeping mean that many informal funeral service providers do not know their financial status and are not managing their financial risks. This in turn puts consumers at risk.

The above implies that any government policy aimed at formalising the provision of insurance by funeral services providers needs to carefully balance the protection of vulnerable consumers with the policy goal of business development or not unnecessarily harming primarily black-owned micro, small and medium enterprises (SMMEs) in the funeral service provider industry. Should informal providers be forced to formalise through an effective enforcement strategy, many of them will most likely be unable to survive on their funeral service income only and, unless they find alternative financing mechanisms, will face bankruptcy in the absence of alternative financing mechanisms. Imposing a blanket requirement for formalisation may therefore lead to a much smaller and potentially much less competitive industry. It may furthermore be that, while informal funeral service providers are providing services at a price and in a manner that is not altogether consumer friendly, they are nevertheless honouring claims by providing a funeral service, meaning that it will not be desirable for them to close down. There is thus a need to balance consumer protection considerations against the likely consequences of enforcement.

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Appendix A: Socio-economic profiles of sampling areas

Our sampling towns are situated in four municipalities in four different provinces of South Africa (see numbers 1-4 in **Error! Reference source not found.**). We provide a basic description of the socio-economic profile of each of the municipalities under which the sampling towns fall below:

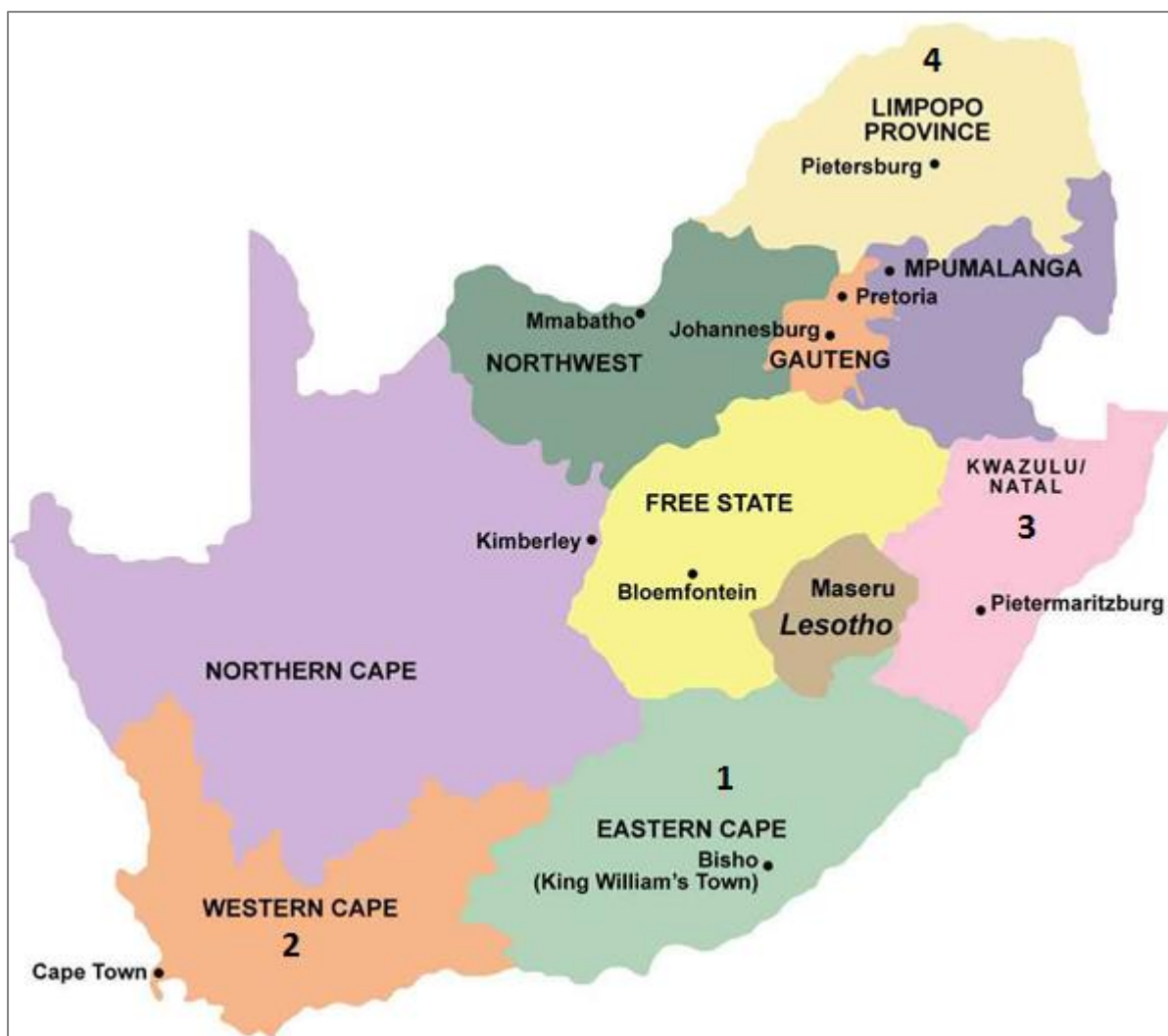


Figure 12: Map of South Africa

Source: <http://towns.bookingsouthafrica.com/images/map.jpg>

- **Amathole District Municipality (Eastern Cape Province as indicated by 1 in Error! Reference source not found.):** The District is 21,595 km². It extends from the Indian Ocean in the south to the Amathole Mountains in the north. The District is composed of seven municipalities, namely Amahlati, Great Kei, Mbashe, Mnquma, Nkonkobe, Ngqushwa and Nxuba. The most popular language in the region is isiXhosa which is spoken by 97.2% of the population. The region has large income disparities. These disparities are attributable to significant economic activity in some regions namely, East London, Bhisho, Butterworth and King Williams Town, and minimal economic activity in the former homelands of Ciskei and Transkei. The government is the leading employer in the region accounting for 32% of the employment.

- **City of Cape Town Metropolitan Municipality (Western Cape Province as indicated by 2 in Error! Reference source not found.):** The City of Cape Town is situated on the southern peninsula of the Western Cape province. It is home to the South African Parliament and is the legislative capital of South Africa. The City is one of six Metropolitan Municipalities in South Africa. The City covers a region of 2,445 km². The City has fifteen suburbs of which we focussed on four in our study: Khayelitsha, Nyanga, Langa and Gugulethu. Cape Town is regarded as the economic hub of the Western Cape Province, contributing 10.9% to the South African Gross Domestic Product (“GDP”) (Source IHS Global Insight regional eXplorer, Data Version, 463, 31 December 2009). The main economic sectors are Finance & Business Services, Manufacturing & Wholesale and Retail Trade.
- **eThekweni Metropolitan Municipality (KwaZulu-Natal Province as shown by 3 in Error! Reference source not found.):** This is the largest municipality in KwaZulu-Natal and, like the City of Cape Town, a metropolitan municipality. eThekweni is a cosmopolitan region, with 36% of the region classified as rural and 29% classified as peri-urban (Source: eThekweni Municipality website). The areas in the municipality where we conducted our research are Durban, Umlazi, and KwaMashu. The languages spoken in this municipality are mainly English and isiZulu. The municipality has a large diversified economy with its coastal location promoting the facilitation for a large export related industry. Its warm all-year climate and natural resources allow for an influx of tourists. The eThekweni Municipality accounted for 10.4% of the South African GDP in 2009. 30.7% of the population live in poverty. In 2009, the municipality recorded an unemployment rate of 20.6%. (Source: HIS Global Insight Regional Explorer, Data version: 463, 31 December 2009).
- **Vhembe District Municipality (Limpopo Province as shown by 4 in Error! Reference source not found.):** This municipality forms part of the Limpopo province. This district is situated in the northern part of South Africa and lies on the borders of three SADC countries, namely Botswana, Zimbabwe and Mozambique. The current socio-economic challenges faced by Zimbabwe impact the district as many Zimbabweans cross the border seeking services that cannot be found in their own countries. Bordering on three countries has its advantages as it facilitates for easier trade in comparison to other regions in South Africa. Similar to Amathole District Municipality, the most jobs in the region are provided by government accounting for 39% of the region’s employment. The main drivers for economic growth are Community Services and Agriculture and Households. The District is divided into 4 municipalities, namely Thulamela, Makhado, Musina, and Mutale Municipalities. We visited the Thulamela Municipality. A large number of funeral service providers are located in Thohoyandou, the bureaucratic centre of Thulamela Local Municipality and Vhembe District Municipality. Thohoyandou is the former capital of the Venda Homelan

		Sources of Information	Amathole District Municipality	City of Cape Town Metropolitan Municipality	eThekweni Metropolitan Municipality	Vhembe District Municipality
Area (km ²)		Executive Mayors	21, 595	2 445	2 297	25, 597
Population (No.) (2010)		Metro/ District Council population estimates & Stats SA community Survey 2007	1 746 952	3,409,077	3 499 254	1 336 493
Urbanisation Classification:	Urban: Urbanisation index of 75% - 100% Semi-Urban: Urbanisation index of 50 - 74% Rural: Urbanisation index of 25% - 49% Deep Rural: Urbanisation index of 0 - 24%		Rural	Urban	Urban	Deep Rural
Density (people/km ²)		Metro/ District Council population estimates	80.9	1, 394.3	1,527.4	52.2
Racial Makeup (2007)	Black African	Stats SA community Survey 2007	97.80%	34.90%	71.10%	98.90%
	Coloured		1.30%	44.00%	2.30%	0.10%
	Indian/Asian		0.10%	1.80%	18.70%	N/A
	White		N/A	19.3	7.90%	1.10%
Languages (2 Most Common)		Stats SA Census Survey 2001	1. Xhosa (97.2%) 2. Afrikaans (1.5%)	1. Afrikaans (41.4%) 2. Xhosa (28.8%) 3. English (28%)	1. Zulu (63%) 2. English (30%)	1. Venda (68.4%) 2. Tsonga (26.3%)
% GDP (South Africa)		Global Insight's Regional eXplorer		10.9%	10.4%	
Economic Sectors:	Agriculture, Fishing, Forestry	Global Insight's Regional eXplorer	2%	2%	1.5%	22%
	Mining & Quarrying		0%	0%	0.2%	1%

	Sources of Information	Amathole District Municipality	City of Cape Town Metropolitan Municipality	eThekweni Metropolitan Municipality	Vhembe District Municipality
	Manufacturing	18%	18%	22.8%	3%
	Construction, Civil Engineering	1%	2%	3.4%	4%
	Electricity, Water, Gas	13%	4%	2.6%	1%
	Wholesale & Retail Trade	0%	14%	15.2%	8%
	Transport, Storage, Communication	6%	9%	12.8%	2%
	Financial & Business Services	26%	36%	22.3%	4%
	Community Services, Government	32%	13%	19.2%	39%
	Other	N/A	2%	N/A	15%
Unemployment Rate	Stats SA community Survey 2007	43%	25%	33%	40%

Table 16: Socio-economic indicators of municipalities of sampling towns

Appendix B: Summary data on surveyed funeral service providers

Nr	Province	Formality w.r.t. insurance	Value Chain	Business Start Date	Nr Insurance Clients	Nr of Insurance Claims per year	Average premium	Cash Option	% Funerals Insured	Nr Funerals per year	Most Popular Cash Funeral Price	Nr of Staff	Own Refrigeration	Nr of Business Bank Accounts	Use Accountant
1	EC	Informal	full service	1999	500	-	R120	No	<25%	156	23 000	12	Yes	1	Yes
2	EC	Informal	full service	1996	300	24	/	No	<25%	156	8 000	7	Yes	1	Yes
3	EC	Informal	full service	2011	57	12	R150	No	<25%	/	7 500	2	Yes	1	No
4	EC	Informal	full service	2008	106	28	/	No	<25%	156	4 500	4	Yes	2	Yes
5	EC	Informal	full service	1998	3 000	/	R85	No	<50%	156	5 000	30	Yes	1	Yes
6	EC	Informal	full service	2002	400	20	R125	Yes	<25%	156	7 500	20	Yes	1	Yes
7	EC	Informal	full service	2008	500	12	/	Yes	<25%	156	7 000	10	Yes	2	Yes
8	EC	Informal	full service	2007	500	60	R80	Yes	<75%	208	12 000	30	Yes	2	Yes
9	EC	Informal	full service	1998	300	10	R108	No	<25%	104	12 500	3	Yes	1	Yes
10	EC	Informal	full service	2002	1 200	56	R100	Yes	<50%	156	8 000	25	Yes	2	Yes
11	EC	Informal	full service	2003	5 000	8	R70	Yes	<25%	208	15 000	6	Yes	1	Yes
12	EC	Informal	transport	2009	/	4	R63	Yes	<25%	156	12 000	10	No	1	Yes
13	EC	Informal	outsource everything	2006	300	8	/	No	<50%	52	6 500	3	No	1	No
14	EC	Informal	outsource everything	2008	200	14	R100	No	<25%	208	4 000	2	No	1	Yes
15	EC	Informal	outsource everything	2007	60	16	R100	No	<25%	156	3 500	1	No	1	Yes
16	EC	Informal	outsource everything	2009	80	24	R68	Yes	<25%	/	8 000	1	No	1	Yes
17	EC	Informal	outsource everything	2010	133	16	R60	Yes	<25%	104	6 000	1	No	NA	No
18	EC	Formal	full service	2005	2 000	32	R68	Yes	<25%	208	7 500	10	Yes	2	Yes
19	EC	Formal	full service	1981	6 000	120	R68	Yes	<75%	156	12 500	26	Yes	3	Yes
20	KZN	Informal	full service	2002	3 000	254	R113	No	>75%	52	6 000	11	Yes	2	No
21	KZN	Informal	full service	1980	443	60	R100	No	>75%	52	6 000	2	Yes	2	No

Nr	Province	Formality w.r.t. insurance	Value Chain	Business Start Date	Nr Insurance Clients	Nr of Insurance Claims per year	Average premium	Cash Option	% Funerals Insured	Nr Funerals per year	Most Popular Cash Funeral Price	Nr of Staff	Own Refrigeration	Nr of Business Bank Accounts	Use Accountant
22	KZN	Informal	full service	2009	100	48	R59	Yes	<25%	52	2 000	4	Yes	1	No
23	KZN	Informal	full service	2004	4 000	200	R88	No	<75%	52	It Varies	25	Yes	1	Yes
24	KZN	Informal	full service	1998	800	220	R73	No	>75%	156	4 500	5	Yes	1	No
25	KZN	Informal	full service	2006	200	140	R80	Yes	<75%	208	3 500	4	Yes	1	No
26	KZN	Informal	full service	1984	5 000	/	R35	No	>75%	156	5 000	10	Yes	2	Yes
27	KZN	Informal	full service	2007	400	/	R140	No	>75%	156	5 000	5	Yes	1	No
28	KZN	Informal	transport	2006	800	/	R118	No	<75%	52	5 000	1	No	2	Yes
29	KZN	Informal	outsource everything	2000	/	12	R120	No	<25%	52	7 000	1	No	1	No
30	KZN	Informal	outsource everything	2010	48	-	R 60	No	/	156	/	2	No	1	No
31	KZN	Informal	transport	2005	500	-	R110	No	<25%	156	14 000	6	No	2	No
32	KZN	Informal	transport	2007	300	/	/	No	>75%	52	5 000	-	No	2	Yes
33	KZN	Informal	transport	2000	150	2	/	No	<75%	156	2 750	3	No	1	No
34	KZN	Informal	transport	1998	45	/	/	No	>75%	/	5 500	10	No	1	No
35	KZN	Informal	transport	2006	200	/	/	No	<75%	156	5 000	1	No	2	Yes
36	KZN	Informal	outsource everything	2011	100	12	R70	No	<75%	156	6 000	2	No	1	No
37	KZN	Formal	full service	2000	1 500	262	R125	No	<75%	156	5 000	6	Yes	1	Yes
38	KZN	Formal	full service	2001	3 000	/	R150	No	>75%	52	5 000	10	Yes	1	Yes
39	KZN	Formal	transport	2006	300	/	R110	No	>75%	52	5 167	4	No	2	No
40	Limpopo	Informal	full service	2006	400	60	R120	No	>75%	104	5 500	6	Yes	1	No
41	Limpopo	Informal	full service	1999	/	120	/	No	/	156	10 000	80	Yes	2	Yes
42	Limpopo	Informal	full service	2003	4 000	288	R125	Yes	>75%	104	9 500	40	Yes	1	No
43	Limpopo	Informal	full service	2008	400	40	R97	No	/	156	10 000	10	Yes	2	Yes
44	Limpopo	Informal	full service	2008	/	48	R60	Yes	>75%	156	15 000	10	Yes	3	Yes
45	Limpopo	Informal	full service	2002	22 544	182	/	Yes	>75%	156	19 667	113	Yes	4	Yes

Nr	Province	Formality w.r.t. insurance	Value Chain	Business Start Date	Nr Insurance Clients	Nr of Insurance Claims per year	Average premium	Cash Option	% Funerals Insured	Nr Funerals per year	Most Popular Cash Funeral Price	Nr of Staff	Own Refrigeration	Nr of Business Bank Accounts	Use Accountant
46	Limpopo	Informal	full service	2009	/	10	R87	Yes	>75%	156	5 000	10	Yes	2	No
47	Limpopo	Informal	full service	2009	300	36	R73	No	>75%	104	7 000	24	Yes	2	Yes
48	Limpopo	Informal	full service	2010	100	12	/	No	>75%	156	It Varies	8	Yes	NA	No
49	Limpopo	Informal	full service	2008	300	12	R75	No	>75%	156	12 000	15	Yes	2	No
50	Limpopo	Informal	transport	2007	102	20	R65	/	>75%	104	5 000	8	No	2	Yes
51	Limpopo	Informal	transport	2011	/	24	R50	No	/	/	5 000	4	No	1	No
52	Limpopo	Informal	transport	2003	2 000	100	R100	Yes	/	104	5 000	10	No	1	Yes
53	Limpopo	Informal	transport	2009	197	26	R50	Yes	<75%	156	12 500	4	No	1	No
54	Limpopo	Informal	transport	2008	200	8	R70	No	/	156	6 500	6	No	1	No
55	Limpopo	Informal	outsource everything	2010	26	18	R60	No	/	208	12 500	4	No	1	No
56	Limpopo	Informal	outsource everything	2008	/	12	R80	No	/	156	4 500	1	No	1	No
57	Limpopo	Formal	full service	2005	5 000	288	/	No	>75%	156	20 000	37	Yes	1	Yes
58	Limpopo	Formal	full service	1999	20 000	4 800	R123	Yes	>75%	208	It Varies	700	Yes	4	Yes
59	Limpopo	Formal	full service	2006	4 000	70	R63	No	/	156	16 500	26	Yes	2	Yes
60	WC	Informal	full service	1994	6 300	240	/	Yes	>75%	52	5 200	11	Yes	2	Yes
61	WC	Informal	transport	2002	550	48	R105	No	<25%	52	18 000	5	No	2	No
62	WC	Informal	transport	1995	270	10	R103	Yes	<25%	104	18 000	4	No	2	No
63	WC	Informal	transport	2004	500	14	R 75	Yes	<25%	104	2 500	8	No	1	Yes
64	WC	Informal	transport	2004	60	6	/	Yes	>75%	52	6 500	8	No	2	No
65	WC	Informal	transport	2009	101	4	R53	Yes	>75%	52	14 000	1	No	2	No
66	WC	Informal	transport	2003	300	20	/	Yes	>75%	156	5 700	2	No	2	Yes
67	WC	Informal	transport	1999	105	-	R90	Yes	<50%	52	5 937	2	No	1	No
68	WC	Informal	outsource everything	2002	20	10	/	No	>75%	-	15 000	4	No	1	No
69	WC	Formal	full service	1998	3 500	/	R140	Yes	>75%	52	4 000	22	Yes	4	Yes

Nr	Province	Formality w.r.t. insurance	Value Chain	Business Start Date	Nr Insurance Clients	Nr of Insurance Claims per year	Average premium	Cash Option	% Funerals Insured	Nr Funerals per year	Most Popular Cash Funeral Price	Nr of Staff	Own Refrigeration	Nr of Business Bank Accounts	Use Accountant
70	WC	Formal	transport	2007	350	2	/	Yes	<25%	52	13 000	5	No	1	Yes
71	WC	Formal	outsource everything	2010	100	-	/	Yes	<25%	156	20 000	6	No	2	Yes
72	WC	Formal	transport	2000	300	8	R77	No	>75%	156	5 800	1	No	1	No



Appendix C: Financial viability scenario assumptions

- **Scenario 1 (Status quo):** In this scenario, we combine the funeral insurance scheme and funeral service businesses into one entity (as is currently the case for most funeral service providers, therefore the reference to the “Status quo” scenario). If we assume a) all clients opt for an in-kind rather than a cash benefit, b) the insurance scheme pays the funeral service provider exactly enough to cover its costs for the funeral, c) funeral service packages are correctly priced to reflect input costs of the funeral and d) the funeral service provider has no sources of income other than payments received from the insurance scheme, then the funeral service business will break even and the combined business viability is dependent on the surplus or loss made by the insurance scheme.

This can be considered the best case scenario for the combined business (from the owner’s short-term profit perspective and also in comparison to the second scenario) and, in particular, the funeral service provider business. This is because we assume that all clients who claim on their insurance choose to “buy” their funeral service from the funeral service provider that runs the funeral insurance scheme, rather than take a cash pay-out and purchase the funeral from another funeral service provider. The client lock-in effect from the insurance, together with our other assumptions, create a “best case scenario” because any realistic changes in the assumptions will only result in deteriorating viability (losses) for the funeral insurance scheme (or combined business) as is the case in Scenario 2.

- **Scenario 2 (Formalisation of insurance provision component of the business):** Similar to what would occur during a formalisation process, under this scenario we assume that the funeral insurance scheme income and revenue from funeral services have been separated. We further assume that all claims are paid out to the insurance clients in cash at the full monetary value (cash price) of the funeral insurance packages. This can be viewed as the worst case scenario for the viability of the funeral insurance scheme as all claims are paid out at the maximum monetary value that the insurance scheme could be required to pay out, but it is also the worst case scenario for the funeral service provider as there is no guarantee that clients will choose to buy their funeral service from the same funeral service provider with whom they were insured. Under this scenario, the funeral service provider therefore loses the client lock-in effect provided by insurance assumed in Scenario 1.

Solvency Scenario 1: Status quo

As explained above, under Scenario 1 it is assumed that the insurance scheme pays the funeral service provider the actual cost³¹ of providing funerals. The viability of the funeral insurance scheme is calculated using the combined ratio. The combined ratio is the insurance pay-out value plus other costs incurred by the insurance scheme (administration costs, overhead costs, etc.) expressed as a percentage of total insurance premiums collected during the year. All costs are included in this measure, meaning that a funeral service providers’ insurance scheme that has a combined ratio of less than 100% generated some surplus on the insurance scheme and that these schemes (and therefore the combined business as well) are essentially solvent. Conversely, funeral service providers with a combined ratio (on their insurance schemes) greater than 100% are in effect insolvent.

³¹ To derive this we used the total of variable and overhead expenses incurred and divided it by the total number of funerals (cash and insurance). This reflects the all-in cost of delivering a funeral service.



As stated above, we assume that the actual cost of providing a funeral is equal to the stated insurance package value. However it is possible that funeral service providers, when devising a funeral insurance package, are not pricing accurately as they do not have an accurate understanding of the financial information underlying their costs (see Figure 13 for a summary of the various assumptions and flow of funds between the insurance scheme and funeral service business). The stated insurance package pay-out may, therefore, not always equal the cost to provide the funeral service.

If we now assume that *the stated insurance package value equals the total cost of delivery of a funeral services plus a 30% mark-up*, we can calculate the cost of delivering funeral services based on the stated cash price of a funeral service (cash price of the most popular funeral package as collected through our survey). This can be used, in turn, to calculate the combined ratio (as described above). Under this construct, insurance schemes with a combined ratio higher than 100% would be considered non-viable as their costs exceed their revenue.

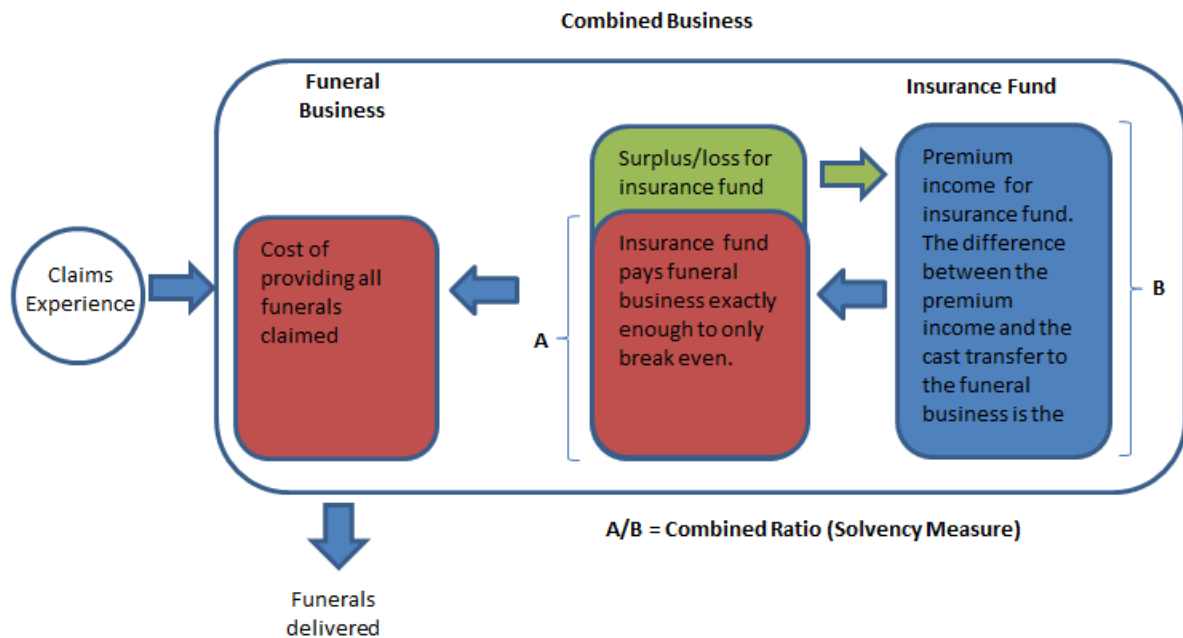


Figure 13: Solvency Scenario 1

As the cash price of funerals remains fixed (as provided by survey respondents), any increases in the “mark-up percentage” mentioned above would only result in the cost component of funeral packages to decrease. An increased mark-up assumption is therefore actually a decreased cost assumption³².

Solvency Scenario 2: Formalisation

This scenario considers the impact of separating the insurance business from the funeral services business as will be required if funeral service providers are required to formalise their insurance businesses. It assumes the extreme scenario where all clients opt for a cash pay-out rather than receiving the pay-out in the form of a benefit in-kind (a funeral service) (this option will be required

³² Under a 30% mark-up assumption, the cost as % of cash price would be 76.9%. This cost % decreases to 66.7% for a 50% mark-up assumption and to 50% for a 100% mark-up assumption.



if funeral service providers comply with insurance legislation). In such a case, the funeral services side of the business will only be able to rely on cash funerals for income.

This can be considered the worst case scenario for the funeral insurance scheme as we assume the maximum pay-out amount (100% funeral package value on all claims i.e. at a price that already includes some mark-up on the funeral services), but it is also the *worst case scenario for the funeral services* side of the business as funeral service providers would no longer be guaranteed of a captive client base (client lock-in effect). Further, even if the insurance clients do buy the funeral service from the funeral service provider with which they are insured, our analysis indicates that many of the funeral service providers require the cash flow associated with a funeral insurance scheme to remain viable businesses and separation of the two businesses would deprive them of this.

This implies that for those funeral service providers where the insurance scheme is calculated to be insolvent, the total business is at high risk of also being insolvent under this scenario. Even if the insurance scheme is only marginally solvent, the funeral services business may still be insolvent.

Using this scenario, we are then able to consider, first, the implications for the financial viability of the funeral insurance scheme in a scenario where the insurance business is formally separated from the funeral service business and, second, the funeral insurance business's ability to accurately price for risk when it determines its policy premiums.

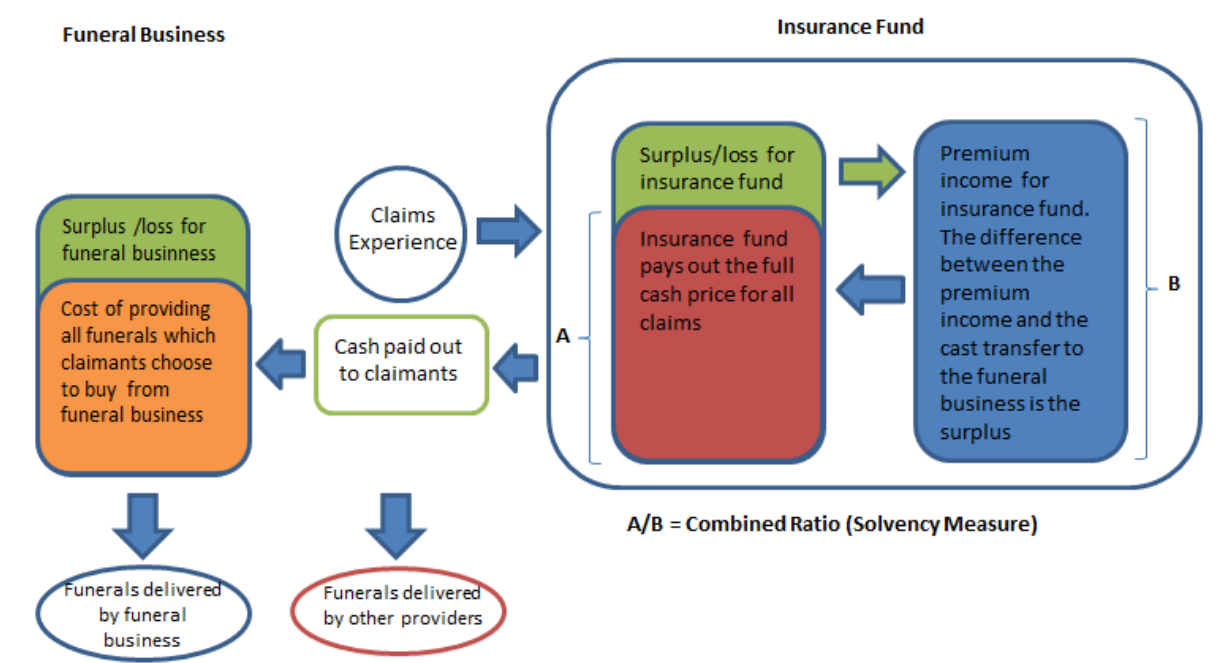


Figure 14: Solvency Scenario 2