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# Credit life insurance in South Africa: the customer's perspective

**By Nina Shand with Janice Angove for FinMark Trust**

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## List of Abbreviations and Acronyms

| | |
|---|---|
| ABIL | African Bank Investments Limited |
| AEC | Adverse Effect on Competition |
| AEDO | Authenticate Early Debit Order |
| ASIC | Australian Securities and Investment Commission |
| ASISA | Association of Saving and Investment South Africa |
| CBA | Credit Bureau Act |
| CCI | Consumer Credit Insurance |
| CPA | Credit Protection Act |
| FAIS | Financial Advisory and Intermediary Services Act |
| FSB | Financial Services Board |
| JDG | JD Group |
| LTIA | Long Term Insurance Act |
| MFRC | Microfinance Regulatory Council |
| NCA | National Credit Act, 2005 |
| NCR | National Credit Regulator |
| NLR | National Loans Register |
| OFT | Office of Fair Trading |
| PPI | Payment Protection Insurance |
| SAIA | South African Insurance Association |
| SAM | Solvency Assessment and Management Act |
| StanGen | Standard General Insurance Company Limited |
| STIA | Short Term Insurance Act |

# 1. Introduction[1]

Credit life insurance is one of the most widely available insurance products to low-income consumers world-wide and is often a low-income consumer's first encounter with insurance. Therefore the question of whether consumers are getting a fair deal when they purchase it is central to the inclusive insurance debate. This paper analyses the question through the lens of the low-income consumer in South Africa.

The research in this paper follows an independent panel of enquiry, known as the Nienaber panel, to "identify and eradicate undesirable practices prevalent in the consumer credit insurance market impacting negatively on consumers"[2]. The panel report, released in 2008, found that while consumer credit insurance (CCI) fulfilled a definite insurance need, it is in the first instance designed to serve the interests of the credit provider and that there were deficiencies in the system that could be exploited by unscrupulous providers. It found that CCI has a bad name – and not only in SA – and that this perception may relate to various factors, including a lack of proper disclosure. However, the panel cautioned that CCI comes in a variety of forms and is issued by a variety of insurers, making generalisation difficult.

In 2011, government formed a Consumer Credit Insurance Task Team, jointly led by National Treasury and the Financial Services Board, to investigate the state of the consumer credit insurance industry in South Africa. The current study complements the work of the Task Team in that it offers a demand-side perspective on how consumers experience the purchase of credit life insurance, particularly in the low income space, as per FinMark Trust's focus (using LSM 1-7[3] as a proxy indicator for the low-income market).

Note that this study focuses specifically on credit life insurance – insurance taken out by a consumer to cover a debt they have incurred in the event of death, disability or retrenchment, often at the insistence of the credit provider as a form of collateral security. The Task Team, as did the Nienaber panel, focuses on consumer credit insurance, a broader term referring to both credit life insurance and asset protection insurance on goods bought on credit.

The main methodology for the study is a mystery shopping exercise focused on a broad range of furniture retail and microfinance outlets operating in the LSM 1-7 space.[4] In addition, in-depth interviews were conducted with low income consumers who had entered into a credit agreement or taken out a micro-loan. The questions focussed on the whole process of purchasing credit life insurance, beginning with the application for credit, in an attempt to see at what point in the process and in what manner credit life is being sold. In

[1] At the time of publication the exchange rate between the South African Rand and the United States Dollar and Great British Pound was ZAR 10.36/USD and ZAR17.02/GBP respectively. USD and GBP equivalents shown throughout this document were converted at this rate.

[2] A Report by the Panel of Enquiry on Consumer Credit Insurance in South Africa, p1.

[3] "LSM (Living Standards Measure) refers to the most widely used marketing research tool in Southern Africa, cutting across race, gender and other traditional marketing segments to focus instead on how one lives, taking into account one's general living standards and access to amenities. It divides the population into 10 LSM groups, 10 (highest) to 1 (lowest). Lower-income products would generally be targeted at categories 2 through 6 (as those in category 1 would have no disposable income), although 7 is also relevant in the context of promoting financial inclusion.

[4] Credit life insurance sold through these outlets was the focus of this study because these were the most likely to target the lower-income segment. Exploring the retail clothing sector could be considered for a follow-up study.

effect, the purpose was to establish the way in which sales staff on the ground is complying with legislation and how this is impacting on the consumer experience of credit life insurance.

The rest of this paper is structured as follows:

- Section 2 provides an overview of credit life insurance models and the value proposition thereof.
- Section 3 outlines the regulatory environment for credit life insurance in South Africa,
- Section 4 provides an overview of the South African credit life insurance market.
- Section 5 outlines the findings of the study as emerged from the mystery shopping exercise and consumer interviews. In addition, data analysis is conducted to highlight trends in claims and expense ratios.
- The report concludes with emerging issues in Section 6.

# 2. What is credit life insurance?

## 2.1. Features

According to the National Credit Act (NCA): "'credit life insurance' includes cover payable in the event of a consumer's death, disability, terminal illness, unemployment, or other insurable risk that is likely to impair the consumer's ability to earn an income or meet the obligations under a credit agreement."[5] A credit provider is entitled to require a consumer to maintain credit life insurance during the time of the agreement so that the loan will be paid should something happen to the customer. The pay-out decreases in correlation to the repayment making it a decreasing sum assured product. It is designed to protect and provide a measure of security for both the insured and the credit provider. It also provides an additional source of income for the lender from the insurance sale.

Depending on how the product is structured, it can consist purely of a life insurance component or be structured as a "hybrid" product with life and general insurance components.

The life insurance component is typically structured as follows:

- Policies will pay a lump sum equal to the value of the outstanding debt in terms of a credit agreement in the event of the death of the assured life or their permanent disability.
- Policies also typically offer a benefit covering either a proportion of the outstanding debt, or a benefit that covers a proportion of your monthly instalment (up to 100%) for a specified period of time (sometimes as little as three months). Pay-outs are made in the event of the insured becoming temporarily disabled, retrenchment occurring, is placed

[5] http://www.ncr.org.za/pdfs/NATIONAL_CREDIT_ACT.pdf p19

on short time that leads to a 20% reduction or more on the monthly basic income, or for compulsory unpaid leave.

- Credit life insurance can also include dread disease cover where the consumer is covered for an amount equal to the death benefit if they are diagnosed with a dread disease such as renal failure, paraplegia, heart attacks or loss of speech, amongst others.

Typical terms and conditions that apply include:

- Retrenchment benefits are not paid if a person is self-employed or is retrenched within 30 days of the commencement of the insurance cover (in some cases, waiting periods are up to 3 months).
- In cases where the cover is towards monthly credit instalments, such instalments are paid to the credit provider for a maximum of 12 months (although some insurers pay the full amount owing by the assured).
- Credit life insurance is often not underwritten at the point of sale. In other words, the insurer does not ask any health specific questions at the application stage.
- Pre-existing conditions are limited to 24 months preceding the policy inception and these conditions are only excluded for 12 months post policy inception (as per the ASISA Guidelines)[6].
- Some insurers specify that their liability does not extend beyond a person's 65$^{th}$ birthday.

Sometimes credit life insurance is combined with asset protection cover which typically provides cover for accidental damage or destruction of goods, fire or theft from the premises, as well as riot cover. In terms of the NCA, credit providers may insist on both credit life insurance as well as product protection insurance. Product protection insurance claims must be submitted within 30 days if the asset is stolen or destroyed or damaged. The insured is then paid out for the loss and is relieved of the liability of continuing paying for an asset which they no longer have access to.[7]

## 2.2. Models

Credit life insurance can be provided in one of four ways:

| Model | Description |
|---|---|
| **Credit life insurance offered by the credit provider** | This is the most common arrangement. The insurer is the principal and the credit provider/retailer is the agent. The credit life insurance is sold by intermediaries for commission in conjunction with the credit transaction with the intermediary often being the credit provider. This is the model most of the furniture retailers use with regards to selling credit life insurance. In the past, furniture retailers would enter into agreements with conventional insurance companies whereby the retailers would market and administer insurance |

[6] Association for Saving and Investment (ASISA) Credit Life Insurance Guidelines effective 01-03-2011
[7] Panel of Enquiry into credit life insurance

| | |
|---|---|
| | products on behalf of the insurer concerned in return for a commission. Following a trend towards integration of the value chain, the major retailers now own their own insurance subsidiaries which provide the insurance products they need to secure their credit sales, such as credit life insurance and product insurance They also often offer additional insurance such as funeral cover which is not related to the credit sale but is a voluntary add-on. |
| **Cell captives** | Cell captives are a South African innovation[8]. Under a cell captive arrangement, an entity such as a credit provider buys a cell in a cell captive insurer (a specially licenced long-term or short-term insurer) in the form of a class of shares. This allows the cell owner to on-sell insurance to its client base without setting up an insurance company of its own or becoming a commissioned intermediary. Instead of paying premiums to an insurer, the cell captive can keep the underwriting profits and build capital in their cells. In effect, the cell owner thus "rents" or "buys" part of the cell captive insurer's licence, with the full insurance compliance burden resting on the cell captive insurer. |
| **Credit provider as policyholder** | Under this model, the credit provider's whole book is insured by one insurer, with the credit provider, rather than individual borrowers, as policyholder.[9] Thus no insurance is sold to borrowers. Instead, the credit provider pays the premium to the insurer and is the beneficiary of any claims payments. |
| **Self-insurance** | This covers credit for which there is no insurance offered and the credit provider carries the risk of default internally, implicitly pricing for it in the interest rate. |

**Table 1. Overview of credit life insurance models**

## 2.3. Value proposition

Credit life insurance protects both the credit provider and the consumer:

- It protects the credit provider against default on repayments relating to the risks covered. In addition, it provides credit providers with the opportunity to earn additional fee income (commission and administration fees), allows it to avoid the need to attempt claim payment from a deceased borrower's estate, which could lead to negative public relations, and allows the lender to offer a broader set of financial products.[10] These benefits have precipitated the expansion of credit life insurance and the establishment of closer links between credit providers and insurers offering this type of insurance.

[8] Cell captives now constitute more than R10 billion of the country's insurance market in terms of premiums written, accounting for one sixth of all short-term insurance written. Guardrisk has an estimated 56% of the cell captive market share and have a cell captive arrangement (for example) with Thuthukani Financial Services and the Elite Group.
http://www.financialmail.co.za/opinion/columnists/2013/07/11/cell-captive-insurance-was-invented-in-sa
http://www.cover.co.za/news/guardrisk-welcomes-publication-of-discussion-paper-on-cell-captive-insurance
[9] Capitec Bank is an example of this model. Channel Life covers Capitec's entire book (for loans 6 months or longer) for defaults due to death and retrenchment. There is no cover against default due to disability and government workers are not covered for retrenchment. They also have catastrophe cover for the full balance of their outstanding book.
[10] J. Wipf, E. Kelly, and M. J. McCord, 2011

- It protects dependents of the consumer by removing the obligation to repay the loan after the death of the policyholder; and protects the consumer against having to maintain credit repayments in the event of disability or retrenchment.

Credit life insurance can play a significant role in supporting access to finance. The decreased risk to providers due to the mandatory nature of credit life insurance facilitates the extension of credit.[11] Unsecured lending can be used to obtain credit and finance the acquisition of assets and expenditure of consumers. It can thus be a stepping stone to economic development across a broad base.

Furthermore, credit life insurance is often the first insurance encounter for low-income consumers. If correctly structured and explained to the client, it can educate the client about insurance and offer real value to him or her.[12] Thus it has the potential to introduce clients to the concept of insurance in such a way that they become voluntary clients of other types of insurance in future. It can also be argued that consumer credit insurance allows low income people access to short-term insurance, as people in the LSM 2-7 market would struggle to get a traditional insurer to provide standalone cover for, for example, their TV.

The value of credit life insurance to clients is enhanced when it covers more than just the outstanding balance of the loan. Insurers providing credit life cover to the low-income market have explored a number of measures to enhance value, including[13] :

- Providing cover for risks beyond death benefits, for example disability and retrenchment.
- Providing cover for the family of the policyholder, for example family funeral insurance riders on credit life insurance.
- Providing additional cover in the form of property insurance for the business equipment of the borrower.
- Providing a higher sum assured so that the dependants of the borrower receive a financial benefit beyond the repayment of the outstanding balance of the loan.

On the downside, these additional benefits increase the complexity of the product and the cost of credit life insurance[14].

Credit life insurance thus unlocks a diverse range of opportunities that could improve the standard of living by allowing access to products or services that cannot be acquired with cash. However, it can also impact negatively on consumers when it leads to high levels of indebtedness. Abuse in the provision of credit can occur because there is an imbalance of power between consumers and credit providers and consumer education levels are

[11] Research on the increase of unsecured loans in South Africa's credit market. Final Report to the NCR by Compliance & Risk Resources, 2012.
[12] Finmark Trust submission to Nienaber Panel
[13] J. Wipf, E. Kelly, and M. J. McCord, 2001
[14] One of the downfalls of the additional job loss cover often offered in South Africa, for example, is the additional complexity of the product in terms of claims conditions and exclusions. A number of rejected claims are due to policyholders failing to understand the claims conditions for job loss cover.

frequently low. Consumers are also often poorly informed about their rights and not in a position to enforce such rights through either negotiation or legal action. Furthermore, commission-driven agents, deceptive marketing practices and weak disclosure can easily cause consumers to enter into unaffordable credit contracts.[15]

Indeed, the value proposition of credit life insurance to providers may be more easily demonstrated than the benefits to policyholders. The question of whether credit life insurance in reality provides value for policyholders is an issue that has been raised in discussions on consumer protection both locally and internationally[16], and was core to the Nienaber Commission of Enquiry investigation. Questions relating to the value of credit life cover to policyholders typically relate to four main issues[17]:

- **Failure to focus on needs of policyholders:** benefits focus on covering the risks of credit providers.
- **High costs:** premiums are high relative to claims and fees paid to distribution and administration partners can be high.
- **Poor disclosure:** Lack of awareness of cover and high repudiation rates due to lack of understanding of cover.
- **Lack of choice:** compulsory nature of the cover and barriers to choice in practice.

This report addresses the value of credit life insurance to policyholders by investigating disclosure practices as well as practical barriers to choice from the perspective of the consumer.

# 3. The regulatory environment for credit life insurance in South Africa

## 3.1. Regulatory bodies

The National Treasury is responsible for financial policy in South Africa. The Financial Services Board (FSB) is a government-appointed, independent body established to oversee the non-banking aspects of the financial services industry. It is the supervisory authority of long and short term insurers as well as financial advisers and intermediaries. The NCR is responsible for the regulation of the credit industry, as well as carrying out education, research, policy development, registration, investigation of complaints, and enforcing the NCA.

## 3.2. Main regulatory provisions

The provision of credit life insurance is governed by the Short Term Insurance Act, 53 of 1998 (STIA), the Long Term Insurance Act, 52 of 1998 (LTIA) as well as the NCA. In addition,

[15] http://www.ncr.org.za/publications/Background_NCA_docs/Credit%20Law%20Review.pdf
[16] See Appendix A for a brief account of consumer protection concerns in both Australia and the United Kingdom in recent years.
[17] J. Wipf, E. Kelly, and M. J. McCord, 2011. Improving credit life microinsurance. ILO Microinsurance Innovation Facility. Geneva http://www.ilo.org/public/english/employment/mifacility/download/mp9cred.pdf

the Financial Advisory and Intermediary Services Act, 37 of 2002 (FAIS) regulates conduct within the South African financial services industry, including for the intermediation of credit life insurance. Insurers who belong to industry associations furthermore voluntarily submit to such associations' codes and guidelines. Further, there are various financial industry ombudsman from whom consumers can seek redress, namely an ombud for short-term insurance, an ombud for long-term insurance, a credit information ombud and the statutory FAIS ombud.

The main regulatory provisions for credit life insurance relevant to this study are briefly listed below. For those not familiar with the South African regulatory landscape, a more in depth overview of applicable regulatory provisions is provided in Appendix B[18].

**National Credit Act**

Section 106 of the NCA allows credit providers to require consumers to take out mandatory credit life insurance on their outstanding loan balance, but requires that the consumer be given the right to waive the policy offered by the credit provider in favour of a policy of his/her choice. Furthermore, it states that a credit provider may not demand that a consumer purchase insurance that is "unreasonable" or that "has an unreasonable cost to the consumer, having regard to the actual risk and liabilities involved in the credit agreement". However, because there is no cap on costs or explicit definition of "reasonable", what is "unreasonable" is a subjective matter and open to interpretation by insurers [19]

Additional conditions include[20]:

- The credit provider may only require insurance up to the value of the consumer's outstanding obligations.
- Insurance premiums may not be capitalised up-front.
- The credit provider needs to ensure that the customer understands the rights and obligations and the risks and costs associated with the credit agreement.
- Credit life needs to be listed separately on the credit quotation, as do other optional insurances.

The National Credit Regulator (NCR) recently sent out "Draft affordability guidelines and amendments to the credit providers' code to combat over-indebtedness" for written comment and input from the Credit Bureau Association (CBA). The guidelines are intended to establish calculation norms for credit providers to take reasonable steps in assessing prospective consumer's existing means, prospects and obligations. A table has been produced demonstrating an after tax percentage of household income to be made available for repayment of debt. The document also covers credit life insurance,

[18] Note that the Consumer Protection Act (CPA), aimed at establishing a uniform national benchmark for improved standards of consumer protection, applies to any goods or services nationally promoted or supplied. Insurance services covered by the Short- and Long-term Insurance Acts are excluded from the CPA's ambit, subject to these Acts being in line with the consumer protection measures stipulated in the CPA.

[19] http://www.moneyweb.co.za/moneyweb-financial/abils-excessive-insurance
[20] http://www.deloitte.com/assets/Dcom-SouthAfrica/Local%20Content/Articles/Insights%20into%20aspects%20of%20the%20National%20Credit%20Act.pdf

suggesting the premium be expressed as a Rand value for every R1,000 (US $96.53) cover purchased, as well as the total cost of cover for the duration of the credit agreement. The guidelines suggest that credit life insurance should provide minimum cover of outstanding balance settlement for permanent disability or death and six months instalment for retrenchment. R4 per R1 000 is envisaged as a "reasonable" all inclusive premium, and as a cap for premium rate. The credit cost multiple, that is, the ratio of total cost of credit to the principal debt advanced, should also be disclosed. [21]

**Insurance regulatory framework**

Credit life can be issued under either a short term or a long term insurance policy. In terms of the LTIA, credit life insurance is classified as a long-term policy by virtue of its paying out upon a life or disability event. Under the STIA, credit life fits into the Personal Lines category (any short-term policy for which the policyholder is a natural person) and could also cover a death or disability event. In addition, the miscellaneous category of short-term insurance would make provision for retrenchment cover. Section 44 of the LTIA and Section 43 of the STIA require a policyholder, in the event of mandatory credit cover, to have the option to cede an existing policy, or to choose an insurance provider. Apart from these provisions, which are also entrenched in the NCA, credit life Insurance is not discussed in any specific way in either the LTIA or the STIA.[22]

As an insurance product, credit life insurance is subject to all the requirements in the insurance regulatory framework, including requirements regarding intermediary remuneration and policyholder protection contained in insurance legislation and subordinate legislation, as well as the FAIS framework for intermediary services:

- *Remuneration regulation*. Remuneration to intermediaries in terms of the LTIA is broken down between intermediary who introduces the business but renders no administrative work in regard to the policy, and a separate cap for an intermediary who also does the administrative work post-contract such as claims handling and premium collection. A maximum of 7.5% commission is allowed as the "introductory" fee and a further 15% for the administrative work, the total maximum being 22.5%. In terms of the STIA, the maximum payable is 12.5% for motor policies and 20% for all other policies.
- *Policyholder Protection Rules*. The Policyholder Protection Rules issued under the LTIA and STIA, respectively, are designed to help policyholders make informed decisions with regard to insurance products. These rules also ensure that intermediaries and insurers conduct their business "honestly and fairly and with due care and diligence". The Rules ensure that the underwriting, selling and management of insurance policies is done in the interests of the policyholder and policy beneficiaries.
- *FAIS*. The FAIS framework provides requirements for the conduct of financial service intermediaries. A retailer can either sell credit life insurance as someone providing advice and therefore regulated under FAIS, or as someone merely providing factual information. To sell credit life insurance under FAIS currently requires a representative having to pass the Level 1 Regulatory Exam. The FSB is developing a new exam for

[21] https://www.compuscan.co.za/downloads/Letter%20to%20CBA.pdf
[22] Report by the Panel of Enquiry on Consumer Credit Insurance in South Africa, p61

simple, entry level products, such as credit life in recognition of the fact that many representatives of financial service providers will not be able to successfully complete the current exam. In the meantime, those representatives who render financial services to the lower and middle income market in respect of more basic financial products have been able to apply for an exemption[23].

**Industry guidelines**

In addition to the requirements entrenched in regulation, the credit insurance industry is self-regulated by the South African Insurance Association (SAIA), the short-term industry body, and the ASISA, the long-term industry body. SAIA members abide by the SAIA Code of Conduct applicable to all short-term insurers, while ASISA has developed specific Credit Life Insurance Guidelines which cover promoting awareness of credit life insurance cover as well as underwriting issues.

# 4. South African market for credit and credit life insurance

The section below provides a brief overview of the current credit life insurance market in South Africa including size, composition and uptake. A review of credit life insurance distributed by furniture retail and microfinance outlets follows. Details of the largest credit life insurance providers within the focus area of this study can be found in Appendix C.

## 4.1. Overview

### 4.1.1. Size and composition

There are currently around 5,450 credit providers in the country, holding over 36 million accounts. Banks continue to dominate the consumer credit market with a market share of 80% (R1.09 trillion or US $105.21 billion). Retailers' share of total credit granted in 2013 was 3.5% (R3.87 billion or US $373.55 million), non-bank financiers granted R6.40 billion (US $617.76 million) (5.8%), while "other credit providers" granted R11.61 billion (US $1.12 million) (10.6%). "Other credit providers" consist mainly of pension-backed lenders, developmental lenders, micro-lenders, agricultural lenders, insurers, non-bank mortgage lenders and securitised debt.[24]

The consumer credit insurance market turned over an estimated R16 billion (US $1.54 billion) in 2012. Around 70 insurance companies are active in the consumer credit insurance market, with 90% of premiums accruing to the 15 largest participants. The market is split between long-term insurers (76% of premiums) and short-term insurers (24% of premiums).

As shown in Box 1 below, overall credit uptake is on the increase in South Africa, particularly so for low-income groups. Similarly, uptake of insurance (including life insurance) has risen over the past year.

[24] http://www.ncr.org.za/publications/Consumer%20Credit%20Report/ccrm_2ndQ/CCMR%20Q2-Changes,%20F.pdf

**Box 1: Trends in uptake of credit and insurance**

According to FinScope 2013 data[25]:

- The number of people who are borrowing or using credit is on the rise: 14.2 million people have some form of credit, which is an increase of 1.1 million on 2012. This is largely driven by the uptake of credit in the R3 000 to R7 999 (US $290 to US $772) income bracket[26], which has increased from 1.4 m in 2012 to 3 million in 2013.
- The percentage of adults with credit products (formal and informal) has increased from 29% in 2012 to 36% in 2013, particularly due to an increase in non-bank formal credit products. This could also be in the form of store cards or store accounts.
- Borrowing from a formal institution has increased from 4.8 million to 7.1 million, driven substantially by growth in the R0 to R2 999 (US $0 to US $289) income bracket, which increased from 1.6m to 3 million. At the same time, informal borrowing has declined.
- 12.5 million people are showing signs of being in financial difficulty. These are mostly females, over 30, in LSM 5-8 and earning between R1 000 and R7 999 (US $97 to US $772). 4.7 million people are reportedly caught in a debt trap, of which all have formal credit. 41% of personal loans extended in South Africa between R1 000 and R8 000 (US $97 to US $772) are currently in arrears [27]. As much as 40% of the income of individuals earning between R3 500 and R 10 000 (US $338 to US $965) a month is being directed to cover loan repayments. [28]
- More people are entering the insurance market: in 2012, 6.2 million people had formal insurance, compared to 7.8 million in 2013. Life insurance has seen an increase of 1.4 million clients.

The current study focuses on credit life insurance to the low-income market, defined as LSM1-7, specifically as distributed through furniture retailer or microlending outlets. According to a 2011 NCR report[29] the combined book for furniture finance was R14.1 billion (US $1.36 billion), representing 2.8 million accounts. 67% of these loans were between R2 500 and R8 000 (US $241 to US $772), targeting individuals in the LSM 4-9 segments.

### 4.1.2. Products and providers

This section provides a brief overview of furniture retail and microfinance outlets operating in the LSM 1-7 space, as well as their product offerings.

**Providers**

*Furniture retailers*: The furniture retail market in South Africa is largely concentrated in four groups that together make up around 3,000 branches: the JD Group; the Lewis Group,

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[25] FinScope is a nationally representative survey of how people source their income and how manage their financial lives. See:www.finscope.co.za

[26] People in this income bracket fall within the LSM 1-7 focus of this study. In 2012 LSM 1 average monthly income was R1 363 and LSM 7 was R11 263. Source: saarf.co.za/**lsm**-descriptions/2012/**LSM**Descriptions2012.pptx

[27]http://www.ncr.org.za/press_release/research_reports/NCR_NCA%20IMPACT%20LITERATURE%20REVIEW_FINAL%20REPORT_260612.pdf

[28] http://www.moneyweb.co.za/moneyweb-special-investigations/credit-regulator-shocked-by-loan-abuse?sn=2009+Detail

[29] Feasibility, 2011. The cost of credit, access to credit and associated market practices. Report to the National Credit Regulator.

Ellerine Holdings (owned by African Bank Investment Limited) and OK Furniture (Shoprite Holdings). These furniture retailers all have a corresponding insurance company within their group which is responsible for providing consumer credit insurance to customers.

*Unsecured/personal loan providers*: There are 5,450 registered credit providers in the country with 41 642 branches, offering a variety of loans, loan terms, insurance offerings and even cellphone packages[30]. African Bank and Capitec Bank are the two largest providers of micro-loans in the country. FinBond, a mutual bank, has also captured a significant share of the market. A spectrum of 14 unsecured lenders was included in the study.

**Products and pricing**

*Retail furniture credit*: Retail furniture stores extend term loans specifically to fund the purchase of white goods such as household furniture and appliances. As noted by the 2011 NCR study, this was one of the few ways low income people could access credit in the past.[31] Now access to other forms of credit has improved, but there are clearly still people with limited credit alternatives who choose to finance their furniture and appliance needs with furniture loans.

**Box 2: Retail furniture credit pricing**

Interest rates on loans provided by furniture retail stores vary depending on the type of credit extension. Interest ranges from 5% per month for loans up to 6 months, to a formula linked to the repro rate for unsecured personal loans [(repro rate x 2.2) + 20%] and furniture retail term loans [(repro rate x 2.2) + 10%]. Pricing is also affected by initiation fees, monthly charges, extended warranties, delivery and installation charges, all of which can be included in the principal debt.

While credit life insurance and product protection insurance may not be added to the principle debt, if the instalments are added to the total cost of credit, the total amount repayable could be as high as 35%[32] of the cash value of the goods bought.

Furniture loans are in some cases treated as unsecured loans rather than loans secured by the value of the furniture or appliance purchased. This is partly because the goods purchased lose their value so quickly and are expensive to repossess in the event of default, and partly because the prevailing interest caps on unsecured loans is higher than that applicable to secured loans.

*Unsecured/personal loans*. Low income people also access personal loans to purchase white goods or for other expenditure such as food or electricity. This type of consumer credit extension can incorporate a wide variety of loan values and terms, including one month (so-called pay-day loans) and short term loans with terms less than 6 months and values typically less than R8 000 (US $772), but can go much higher over a much longer term.

The unsecured lending sector has been identified as a huge growth area, although it represents a very small percentage of South Africa's overall lending market. The NCA

[30] http://www.ncr.org.za/Annual%20Report/ebook/12-13/book_image/NCR_ANNUAL_REPORT_PRINT.pdf
[31] *Ibid*.
[32] http://www.moneyweb.co.za/moneyweb-financial/retail-customers-pay-more-for-the-insurance-than-i

distinguishes between two categories of credit agreements that are relevant to this study, short-term credit and unsecured credit:

- Short-term credit transactions do not exceed R8 000 (US $772) and are repayable within 6 months, with an interest rate of 5% per month or 60% per annum.
- Unsecured credit transactions have no limit to the amount loaned or the repayment period. The maximum interest allowable is [(repurchase rate x 2.2) + 20%]. Initiation and service fees are the same as with secured credit transactions.

The NCR is concerned that these consumers are not fully aware of how these loans are compiled, particularly with regard to the costs and role of credit life insurance and how it affects the overall cost of the unsecured credit facility. Fees and credit life charges can add dramatically to the costs of unsecured lending.[33] Credit insurance alone can add as much as 25% to the total cost of these loans. However, typically, most personal loan providers do not charge for credit life insurance if the term of the loan is under 6 months. As term and value of the loan increase, credit life insurance is more explicitly charged for.[34]

# 5. Does the credit life insurance market work for consumers?

Having sketched an overview of the market and its regulatory framework, the attention now turns to an assessment of the extent to which the credit life insurance market in South Africa serves consumer needs in practice. Three main fieldwork methods were used in the study:

- Consultations with industry role players, industry bodies and ombuds[35]
- A mystery shopping exercise with furniture retailers and microfinance outlets; and
- In-depth interviews with existing credit life insurance consumers.

In addition, we conducted an analysis of credit life insurance offered by insurance companies in the furniture retail and microfinance industries based on data from regulatory returns.

Below, the findings of the industry body, providers and ombud interviews (supply-side perspective), the mystery shopping and consumer interviews (demand-side perspective), and product and industry analysis (data perspective) are outlined respectively.

## 5.1. Supply-side perspective

### 5.1.1. Interviews with industry bodies and credit life insurance providers

The supply-side interviews were loosely structured, focusing on constraints in the market, consumer issues, regulatory issues and future outlook.

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[33] *Ibid*, p89

[34] http://www.moneyweb.co.za/moneyweb-special-investigations/law-society-blasts-credit-regulator?sn=2009+Detail

[35] Consultations with industry role players included interviews with the following:

1. Industry bodies: SAIA, ASISA,
2. Long-term insurance Ombud, Credit Ombud
3. Suppliers in the industry: Lewis Stores, JD Group, African Bank, Capitec Bank, Thuthukani Financial Services
4. Regulators: NCR, FSB and National Treasury

The main argument in favour of credit life insurance arising from these interviews was that credit life is essential to the long-term sustainability of the credit industry in that it:

- enables credit provision as it mitigates the risk attached to it and this is a key and integral element of the credit industry;
- enables access to credit for lower income groups that might have previously been excluded on the basis of their risk.; and
- gives peace of mind to the consumer in that their dependents are relieved of the financial strain of paying the deceased member's debt.

Credit life insurance providers would like to further expand their insurance and financial service offerings into townships and rural areas. Industry acknowledges regulators' concern regarding low claims ratios for credit life insurance, but is equally concerned that any new regulation will impact negatively on their ability to supply insurance and other financial services to these previously under-served areas. Claims are low, they argue, not because of abuses in the system, but because of low consumer awareness.

Additional regulatory issues raised during supply-side interviews include the concern that any potential regulatory caps on premium rates would negatively impact on the industry and the fact that distribution requirements and caps on charges have remained unadjusted since 2007.

Market related observations include the generally negative consumer perceptions around credit life insurance. Suppliers believe consumers to underestimate the value offered by credit life insurance. The value of having a retailer carry infrastructure costs in the distribution of credit life insurance (effectively allowing for a cheaper offering) was also highlighted, while the emergence of consolidation loans and its effect on a consumer's ability to afford additional products was raised.

For further details on issues raised by credit life insurance providers, refer to Appendix E.

### 5.1.2. Interviews with ombuds

The nature of complaints to ombuds provides insights into issues in the credit and credit life insurance markets.

The long-term insurance ombud only hears complaints about the long-term insurance industry, which constitutes 76% of credit life insurance. Of the 4 000 – 5 000 cases they hear each year, just over 500 (11%) are credit life related. Of these, the majority of complaints are for claims not being paid (434 out of 513 in 2012). This was usually because of a pre-existing exclusion clause, retrenchment definition or proof issue. Another main complaints area was poor communications, documentation, info not supplied or poor service (48/513 in 2012). **Error! Reference source not found.** below contains the data on complaints received by the long term insurance ombud in 2012.

| Complaint | Life | Disability | Other | Total |
|---|---|---|---|---|
| Poor communications/ documentation or info not supplied/ poor service | 44 | 7 | 7 | **58** |
| Claims declined (policy terms or conditions not recognized or met). | 133 | 162 | 139 | **434** |
| Claims declined (non- disclosure). | 8 | 4 | 0 | **12** |
| Dissatisfaction with policy performance and maturity values | 1 | 1 | 0 | **2** |
| Dissatisfaction with surrender or paid-up values | 0 | 0 | 0 | **0** |
| Mis-selling | 0 | 0 | 0 | **0** |
| Lapsing | 2 | 1 | 1 | **4** |
| Miscellaneous | 3 | 0 | 0 | **3** |
| **TOTAL** | **191** | **175** | **146** | **513** |

**Table 2: Credit life insurance complaints categorised by nature of complaint (2012)**[36]

Issues that were highlighted by the two ombuds relate to: (i) consumer understanding (particularly related to retrenchment cover and confusing language used to write policies); (ii) difficulty in substituting credit life policies; and (iii) the fact that the debt review process might impact on consumer behaviour in terms of credit life insurance. For more information on concerns raised by the ombuds, please refer to Appendix E.

## 5.2. Demand-side perspective

### 5.2.1. Methodology

Following the supply-side interviews, questionnaires were designed bearing the main issues raised in mind, to try and understand the purchase and ownership of credit life insurance policies from the perspective of the consumer. Information was gathered in three ways:

- Mystery shopping at furniture retailers
- Mystery shopping at microfinance outlets
- In-depth consumer interviews

Mystery shopping can be defined as: "The use of individuals trained to experience and measure any customer service process, by acting as potential customers and in some way reporting back on their experience in a detailed and objective way."[37] It is a long-established research technique and is used extensively in many industry sectors to measure the quality of service provided and the way products are sold to consumers.

In total, 34 furniture retail store and 27 microfinance outlet mystery shops were completed and 47 consumer interviews were conducted. All the questionnaires/interview guides[38] covered the following areas, in line with various relevant regulations governing furniture retailers and microloan institutions as set out in the NCA[39]:

[36] Ombud for long-term insurance
[37] http://www.esomar.org/uploads/public/knowledge-and-standards/codes-and-guidelines/ESOMAR_Codes-and-Guidelines_MysteryShopping.pdf
[38] Copies of the questionnaires can be found in Annexures 2, 3 and 4.
[39] See Appendices B, C and D

- *Credit check and affordability assessment*: Were fieldworkers asked to present the necessary documentation for an affordability assessment to be conducted, thereby ensuring that the consumer is able to meet their obligations?
- *Credit offer*: Was the fieldworker offered more credit than they applied for? In what form was that credit offered, top-up cash loan or more credit? Was a quotation provided listing all the fees and charges?
- *Life insurance component*: Was the fieldworker informed about a life insurance component to the credit contract? How was it explained? What details were given? Was it compulsory or was an alternative offered? Were any details of the credit life insurance contract provided, such as who the underwriter was, if there were any exclusions, any medical underwriting?
- *Add-ons, riders, clubs*: Was the fieldworker offered funeral insurance or asset protection insurance? Were they offered any club membership?
- *Policy document*: Was a copy of the credit life insurance policy offered? What was covered in? What language was it available in?
- *Claims and complaints*: Were fieldworkers told how complaints and claims would be handled?
- *Commission*: Were fieldworkers told of any commission or fees that would be paid to an intermediary?
- *General observation and record of mystery shopping attempt*: What advertising for credit did you see? What did it say? What happened when you said you wanted to shop around for credit life insurance before accepting the credit offer?

The consumer interviews also included questions regarding the interviewee's credit history, their knowledge of the credit insurance they had and whether they thought credit life insurance offered value for money.

More detail on the methodology followed for each of the three methods is contained in Appendix D. Note that the analysis is based on a limited sample of qualitative responses and can therefore not be generalised. Rather, the findings should be seen as indicative.

In addition to the core mystery shopping exercise and consumer interviews, further analysis stemmed from:

- Quotations from furniture retail outlets, microfinance outlets, banks and insurance companies
- Advertising in the printed media and via the internet

### 5.2.2. Key findings

#### 5.2.2.1. Credit offering

Though the primary purpose of the mystery shopping exercise was to establish practices in the credit life industry, the exercise also covered a basic understanding of the credit offering initially, so as to position the credit life insurance findings. Key findings with regard to the credit offering include:

**Easy access to credit**

The findings suggest that access to credit has increased in the last five years, as has ease of obtaining credit. In the majority of consumer interviews (42 out of 47) consumers indicated that it was easy to obtain credit and 30 out of 47 consumers indicated they already had credit with more than one provider.

In addition, half of the furniture retail mystery shoppers were offered more credit than they required. This was offered in the form of a top-up loan or more expensive items in the store. One third of mystery shopping trips to microfinance outlets solicited offers of more credit that what was being applied for. Fieldworkers recollected:

> *"Sales staff try to convince you to buy a bigger item than you came in for when they realise you can get more credit than you applied for. 'Why do you want this, when you can have something bigger and better?'"*
>
> *"Would you like something else? You do qualify."*
>
> *"When I was at the store, the salesperson tried to persuade me to take more than one item that I had wanted and also tried to persuade me to join their funeral scheme".*
>
> *"You have to be emotionally prepared not to buy the products"*
>
> *"... I forgot my bank statement... so this lady helps me... I should bring her the bank statement the next day and also bring along three people that I work with who want to purchase something and we must come directly to her... she phoned the next day and I said I was busy at work and couldn't make it... so she said she would come and fetch the bank statement and other documents of the three people I was going to bring her. She sounded so desperate.... she then asked if I had R250 (US $24) cash for the deposit and the delivery and I told her no. She told me then I must select another item that gives R2 000 (US $193) cash back so I can get that R2 000 (US $193) and use it for the deposit."*
>
> *"Credit providers want to give you money rather than information!"*

Consumers are also phoned by credit providers and micro-lenders when their credit is nearly paid back and made unsolicited offers of further credit. More than 70% of consumers said they had been phoned and offered more credit towards the end of their repayment period:

> *"Yes, if there is about, for example, two payments left. They would call and offer credit purchase with no deposit upfront."*

*"...used to phone me when my loan was almost paid up and told me I can get more money. I can just come and sign".*

*"... I paid my loan finish... contacted me to ask me if I wanted another loan as I automatically qualify"*

**Inconsistency regarding affordability assessments**

To address issues of reckless lending and promote responsible credit granting, affordability assessments should be conducted by credit providers. The onus is on the credit provider to ensure that consumers are able to afford the credit and will not become over-indebted. In terms of Section 81(2) of the NCA a credit provider may not enter into a credit agreement with a consumer without first taking reasonable steps to assess the consumer's debt re-payment history, existing financial means, prospects and obligations, their understanding of the risks and costs of the proposed credit, and their rights and obligations under a proposed credit agreement. However, detailed financial information was not required by 30% of the furniture retailers in the mystery shopping, and only about 50% of microfinance outlets asked for any financial expenditure information. In the consumer interviews, 36% said they were not asked to provide this information.

The following table summarises the required documentation encountered across the three categories of fieldwork:

| | **Bank statement** | | **Proof of income** | | **Financial expenditure** | |
|---|---|---|---|---|---|---|
| | **Yes** | **No** | **Yes** | **No** | **Yes** | **No** |
| Furniture retailer | 26 | 9 | 33 | 2 | 25 | 10 |
| Microfinance outlet | 23 | 4 | 24 | 3 | 14 | 13 |
| Consumer | 43 | 4 | 44 | 3 | 30 | 17 |
| Total | 92/109 or 85% | | 101/109 or 92% | | 69/109 or 63% | |

**Table 3: Credit check and affordability assessment**

In total, a bank statement was required in 85% of instances and more than 90% of consumers had to provide proof of income as a prerequisite to accessing credit. Information regarding financial expenditure was required in less than two thirds of instances.

**Lack of transparency on total cost of credit, including credit life component**

Effective competition requires that consumers are able to make comparisons between credit offers. However, it was found to be complex to compare bundles of goods, credit and insurance. Quotations are also not easily obtainable – only half the mystery shoppers were able to get quotations from their trips to furniture retailers. Many of these quotations were incomplete, some just pointing out what the monthly instalment would be:

- 70% of fieldworkers received quotations from furniture retailers (25 quotations in total), but most were incomplete, and some just pointed out what the monthly instalment would be. Only half of these quotations included a monthly service fee.

- A total of 15 quotations were obtained from microfinance outlets. The more traditional and established suppliers such as the larger banks provided adequate quotations listing the total interest payable, fees and charges, instalment, number of instalments, annual interest rate and credit life insurance premium. But the smaller outlets just give the number of instalments and amount per instalment.
- 38 out of 47 of the interviewed consumers said they were given quotations. It is unclear how detailed all of these were. However, some consumers were able to produce their certificate of insurance and cost of credit schedules which were all laid out as specified in the NCA[40].

The full cost of credit, inclusive of initiation fees, administrative fees and credit life cost is also not being fully disclosed. All the fieldworkers complained that they were asked to first apply for credit before a quote would be forthcoming:

> *"Unfortunately I didn't get a breakdown of the premium. Their system is such that you have to actually apply for credit before they give you the quote."*

> *"She said I must sign first as I should qualify for what I was requesting. So I must sign a few documents before she explains the full procedure to me. I tell her no, as I want to know how much I will be paying. I cannot sign up for something that isn't clear to me. She kept trying to persuade me to sign the documents. She told me that all micro lenders have the same procedure – you sign the documentation, then get the explanation. Then I will receive the money within 2 days.... she wanted me to sign and then afterwards bring up a whole lot of extra costs that would be involved and I wouldn't be able to say I cannot proceed with the lending, because I would have already signed for it."*

> When asked "*How much time was spent explaining the quote to you*?" one fieldworker remarked: "*Not long because they wanted me to sign before they can spare me their time*".

In another instance, a fieldworker said she had asked for a quote and told the store she was doing some comparative shopping. The sales person told her there was no better offer to be had and that she must sign first with them before she could get any information. She was told it was store policy to only give information to customers.

Part of the problem is that the credit life insurance component of the quotation for some suppliers is variable depending on an individual's credit score. For example, the rate of the credit life insurance can be dependent on how credit worthy a customer is. This is based on a formula with as many as eight variables.[41] Hence, the credit check is done before the quotation is produced. The stores have to pay the credit bureau for each credit check they conduct. Thus they may be reluctant to produce a quotation without an assurance that it will lead to a purchase.

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[40] www.deloitte.com/assets/Dcom-SouthAfrica/Local%20Content/Articles/Insights%20into%20aspects%20of%20the%20National%20Credit%20Act.pdf, p7

[41] This emerged in the interviews with suppliers.

There were also instances of the price displayed on the items not being the actual total cost:

> *"On the display of the fridge it shows R320 (US $31) x 36 months and when I asked why it (the quotation) is R527.67 (US $51), they told me there is goods and credit life insurance included. The guy asked me if R527.67 (US $51) is ok a month. I said yes, but would like to shop around and I want more details. He then refused to give (me the quotation) saying he will explain or tell me more then I decide to take it".*

Getting a quote was also experienced as onerous: one of the fieldworkers applied for credit in order to obtain a quote from one retailer and then the following week went to another. The sales staff at the second retailer said she had to go back to the first retailer and cancel the offer of credit there before they could help her. Another fieldworker reported:

> *"They did not want to tell me anything unless I was approved."*

**Difficulty to compare quotes; effective total cost of credit far exceeds value of loan/credit item**

Below are two product comparison tables listing the details of three quotations obtained from furniture retailers and three quotations obtained from microfinance outlets, respectively. Please see Annexure F for snapshots of the actual quotations, which illustrate the difficulty in comparing the information contained in them:

| Financial details of quotations | Retailer A | Retailer B | Retailer C |
|---|---|---|---|
| Total value of goods | 2 599.99 | 2 648.99 | 2 017.51 |
| Less deposit | | 265 | |
| Delivery charge | 600 | 250 | 350.83 |
| Extended warranty | 798 | 429 | 526.27 |
| Sub-total | 3 997.99 | 3 318.00 | 2 894.61 |
| Initiation fee | 512.76 | 135 | 282.62 |
| VAT | | | 444.81 |
| Total credit advanced (principal debt) | 4 510.75 | 3 197.99 | 3 622.04 |
| Interest | 21%[42] | 684.58 (19%[43]) | 844.86 (21%[44]) |
| Total deferred amount | | 3 882.57 | 4 466.90 |
| Insurance – Credit life | 1644.53 | 834.24 | 1125.00 |
| Insurance - Product | | 357.60 | 554.02 |
| Club fee | | | 526.80 |
| Service fee | 840 | Zero | 892.80 |
| Total amount repayable | 8 196.48 | 5 074.41 | 7 565.52 |
| Add back deposit | | 5 339.41 | |
| Account balance to be paid: | | | |
| 23 monthly instalments | R341.52 | R211.43 | R316.00 |
| Final payment | R341.52 | R211.52 | R297.52 |

**Table 4: Comparison between 3 major furniture retailers (see Appendix F for originals)**

[42] No amount provided on this specific quote, only a percentage.

[43] Note that the calculation method here is not clear. If we calculate 684.58/3197.99, it amounts to 21%. Yet the quote states 19%.

[44] Once again the method of calculation is not clear. 844.86/3622.04 renders 23%, yet the actual quote states 21%.

If the costs of credit life insurance, interest, initiation fees, extended warranties, maintenance contract costs and monthly service charges are added up, a consumer could expect to pay more than R5,000 (US $483) on goods worth R2,500 (US $241). This is an effective cost of credit of nearly 200%. Consumers can definitely benefit from shopping around. In the example above, the initiation fee for Retailer B is far less than Retailer A, and the credit life insurance for the same retailer is half that of Retailer A. Retailer B also does not appear to charge a monthly service fee. Hence the consumer could expect to pay double the cost of the item in fees and charges, 50% less than the other two retailers are charging.

It is worth noting that the extended warranty is currently being capitalised before interest is added, meaning that interest is paid on the extended guarantee throughout the term of the loan.

Below, quotes obtained from unsecured lending outlets are compared:

| Financial details of quotations | Credit provider 1 | Credit provider 2 | Credit provider 3 |
|---|---|---|---|
| Total value of credit<br>Initiation fee | R2 000<br>R 285 | R2 000<br>R285 | R2 000<br>R285 |
| Sub-total | R2 285 | R2 285 | R2 285 |
| Interest/ Finance charges | 31% | R300.77 | 31% |
| Insurance – Credit life per month<br>Service fee | R36.06<br>R57.00 | R33.42<br>R57.00 | R11.11<br>R57.00 |
| Total amount repayable | R3 872.76 | R2 947.40 | R3 233.97 |
| Monthly instalment | R322.73 (12) | R737 (4) | R359.33 (9) |

**Table 5: Comparison between 3 microloan providers for loans to the value of R2 000**

The quotations obtained from microfinance outlets were less competitive as they all charge the same rate of interest, the same for monthly service fees and the same initiation fees. It is interesting to note that all these microfinance outlets are charging the maximum allowable for interest and charges, although one of the providers is a large bank, another is a small microfinance provider and the third is one of the largest unsecured lenders in the country. The difference in the total amount repayable is the loan term and the credit life insurance charge which for Provider 3 is a third what the other two providers are charging. A shorter loan term can substantially reduce the costs of a loan, a fact often not understood by consumers.

#### 5.2.2.2. Insurance offering

The mystery shopping and consumer interviews rendered three main insights regarding the insurance offering:

- there is limited choice as to insurance provider for credit life in practice;
- credit life insurance is more expensive than open market options; and
- disclosure is limited

**Choice on paper vs. choice in practice**

Despite the regulatory requirement that it should be known to consumers that they can choose an insurance provider of their choice, the mystery shopping exercise consistently found choice to be limited in practice. A number of issues emerge:

*Inconsistent disclosure*. In 21 of the 35 mystery shops conducted shoppers were told of the credit life component. However, only 5 out of 35 were told they would be allowed to substitute it for their own policy. Consumers interviewed were also asked to recall if they had been told about credit life when they took out credit. 26 out of 47 said they were told about it and 24 out of 47 said they were given details. 19 out of 47 recalled being told that they could choose not to use the credit life proposed by the retailer and only 9 out of 47 recalled being advised that the proposed credit life could be substituted with a product from another provider. The following quotes illustrate:

> "*I signed for the quotation and only saw the credit life insurance in the taxi on the way home – they never bothered to mention it."*
>
> *"Three of the people I interviewed told me that they were forced to take a certain insurance that was part of that particular store/company they had done their purchase in. One guy had all the rules and regulations read to him over the phone of which he could not hear the person clearly, but since he was desperate he agreed to everything and confirmed his ID as a signature".*

In terms of the total sample, Table 6 indicates that 54% were told about a credit life component and given details of that insurance. 57% said they were informed that the insurance was compulsory and only 15% were told they could use an alternative policy:

| | **Told about Insurance** | | | **Details of insurance given** | | | **Optional or compulsory** | | | **Can be substituted** | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Yes** | **No** | **Bl**[45] | **Yes** | **No** | **Bl** | **Yes** | **No** | **Bl** | **Yes** | **No** | **Bl** |
| Furniture retailer | 21 | 14 | | 22 | 19 | 3 | 13 | 20 | 2 | 5 | 19 | 11 |
| Microfinance outlet | 12 | 15 | | 13 | 11 | 3 | 6 | 18 | 3 | 2 | 17 | 8 |
| Consumer | 26 | 20 | 1 | 24 | 17 | 6 | 19 | 24 | 4 | 9 | 29 | 9 |
| Total % "yes | 54% | | | 54% | | | 35% | | | 15% | | |

**Table 6: Credit life specific questions**

*Limited consumer incentive for shopping around*. Mystery shopping revealed that some consumers regard credit life insurance as just another finance charge offering no real value to them. Because the amount for the credit life insurance appears small as a monthly sum on the credit account, customers are unlikely to bother seeking other insurance. Consumers furthermore tend to use the credit provider's options as doing so speeds up the pay-out process. One of the consumers interviewed remarked:

> "*I was focussing to have money only. Anything else did not matter to me".*

[45] BL refers to "blank" on the questionnaire, meaning that the fieldworker did not fill in this section of the questionnaire or interview sheet.

*Limited alternative options*. It is not possible to buy credit life insurance from one distributor to cover your credit account with another retailer. In theory, one could use a stand-alone credit life insurance policy or a life insurance policy as alternatives. But there is only one provider offering stand-alone credit insurance and it is not aimed at the low-income consumer. Stand-alone cover tends to be expensive as there is no access to customers who are being sold the insurance at point-of-sale.

*Practical challenges to shopping around.* The research furthermore found that the actual process of shopping around for credit life insurance is not easy as there is a lack of standardisation of forms and quotes. This is evident in the quotation comparison provided in Table 4 and Table 5 above. Furthermore, multiple enquiries at credit bureaus would have a negative impact on a person's credit scoring. Consumers were asked if they thought choosing a different insurance provider would jeopardise their credit application:

> "*She said it might affect my chances of getting the credit approved*."
>
> *"Yes, it would take longer to approve and my chances would be slimmer."*
>
> *"Yes... I believe the store works with who they are comfortable with."*
>
> *"I do not know because I did not have an option to choose, because it was a benefit for me to choose their insurance provider".*

*Product features further limit substituting alternatives.* Even if they had an existing life insurance policy and wanted to substitute it, mystery shoppers and consumers interviewed would be met by the requirement of needing retrenchment cover, which most life insurance policies do not have. In the case of furniture retail credit, the alternative could also be a separate household content insurance policy, but most providers are unwilling to insure the contents of a shack in a township. Mystery shoppers indicated that even if they were told they could substitute their own policy for the retailer's, they did not feel that this could easily be done in reality.

*Active discouragement of choice.* As the quotations above indicate, choice is often discouraged by sales staff in practice. In only 5 out of 35 mystery shops were shoppers offered any alternative to the credit life insurance policy offered in-store. Furthermore, mystery shoppers were actively discouraged from substituting a life insurance policy for the credit life insurance on offer in-store and often felt intimidated by sales staff:

> *"No other insurance was accepted. My insurance would not offer what hers does".*
>
> *"If you bring your own credit life insurance it is going to take months for us to approve your credit".*
>
> *"She put me in a corner... I was shocked!"*
>
> *"As a consumer you get "pressurised" by sales staff and end up getting ripped off. What a horrible experience!"*

Mystery shoppers were asked to record what they were told when they said they wanted to shop around for CCI before accepting their credit offer:

*"The salesperson told me that I wouldn't find any better offer than theirs".*

*"I was told that the life insurances are all the same in every furniture store, and I will be offered the same amount and the same policy".*

*"She said that this might affect my chances of getting credit approval*".

*"If you want it, take it now, but if you want to shop around and get your own, it's gonna take you a whole lot longer".*

*"I was told that trying to get credit life insurance elsewhere would negatively influence my loan chances – it might even stop the process".*

*"They were frustrated and said I wasted their time and tried to persuade me to take the credit or the loan that was offered."*

*"I was told to come back when I am ready to buy, then she will give more details about the insurance".*

*"They begged me to take the product".*

*"They also said that I must buy the product if they give me the credit. I cannot apply for credit and not take it."*

*"The consultant was frustrated and said I had wasted her time".*

*Bundling and add-ons challenge price comparisons.* Other types of cover are often bundled with credit life. Add-ons encountered during the mystery shopping exercise include: product/asset insurance; product insurance for cash customers; life insurance for credit customers whose life partner's income is taken into consideration during the credit affordability test; and club membership. These add-ons can add considerably to the cost of credit. A third of the furniture retailer shoppers were also offered product insurance and 14 out of 35 were offered funeral insurance. Extended warranties were actively sold to half the mystery shoppers:

*"They (sales staff) know more about extended warranties than they do about credit life".*

The microfinance outlets offered 10 out of 27 of the mystery shoppers funeral insurance and more than half of consumers interviewed said they had been offered either funeral or product insurance. One fieldworker said that all the microfinance outlet tried to do was push her to take out a funeral policy: *"that seemed to be their main selling point"*. In the consumer interviews, 25 out of 47 said they had been offered add-ons. A bundled product offering is more difficult to compare and makes for lack of transparency in pricing of the credit life insurance component.

**Credit life insurance more expensive than "open market" options**

The mystery shopping exercise and consumer interviews rendered the following insights regarding the cost of credit life insurance:

*Cost of credit life insurance not clear.* On the whole, consumers did not know the cost of their credit life insurance or how it was calculated. Only 30% of consumers interviewed said they knew the cost, and no-one knew how it was calculated.

*"I am not sure and I have no idea how it is calculated."*

*A substantial part of the credit expense*. The analysis of quotes received in Table 4 and Table 5 showed that the cost of credit life accounts for up to 50% of the initial value of the credit[46]. However, as long as they can afford the monthly total, the consumers interviewed did not appear to be concerned by the cost of the credit life insurance:

*"I have no idea but I'm fine with the instalment."*

*"Insurance is part of the package*".

*Multiple policies imply higher costs for consumers***.** The phenomenon of having multiple policies, each with a different credit provider, means a consumer can easily end up paying far more than if the total sum of their credit were covered in a broader life insurance policy. Arranging cover on the basis of a number of small decreasing term insurance policies, each attached to a particular loan, is not the cheapest option for the consumer. Moreover, the cover expires at the end of each separate insurance term as opposed to a broader life insurance policy which continues to provide cover.

*Mixed consumer views of value for money*. Customers interviewed gave mixed replies to the question: Does credit life insurance offer value for money?

*"... I do not see the use of it. It is just a waste of money, because these things they mention do not just happen..."*

*"No I don't see its importance because they don't fulfil their promises. It's just a waste of money."*

*"No, you pay more for a long period of time".*

*"I do not think so because it is an additional amount that does not return when I have finished paying my loan".*

*"Yes, it is essentially to protect me from paying when my financial situation changes."*

*"Yes, anything can happen. I wouldn't want my family paying for my debts after I have passed."*

*"Yes, because if something happens, you loan is fully paid".*

**Limited disclosure**

In addition to limited disclosure with regard to the credit life choice and options as outlined above, the research findings suggest that disclosure in practice is limited on four fronts:

- *Policy documents and details*. The research found that details of the credit life insurance policy are not being properly disclosed to consumers. Many are not even receiving a copy of the policy once the credit agreement has been concluded. When asked if they received a copy of the insurance policy document, only 27 of the 47 consumers

[46] According to one quote obtained, a typical credit transaction for R2 500 would attract R893.42 in interest and R1 218.96 in consumer credit insurance, as well as several other fees, bringing the total repayable amount to R6, 295.68. The credit life insurance therefore amounts to around 20% of the total repayable amount, or almost 50% of the cash price of the goods bought.

interviewed said they had. Only 7 out of 35 of the furniture retail and 4 out of 27 of the microfinance mystery shoppers said they were shown or given a copy of the policy.

- *Commission and fees*. Disclosure of commission and fees is still largely neglected. Results from all three components of consumer research indicated the absence of disclosure – only 15% of the total sample was told about commission or fees being paid to an intermediary.
- *Complaints and claims procedures.* The mystery shopping and consumer interview findings suggest that complaints and claims mechanisms are not properly disclosed. Half the furniture retail and micro finance mystery shoppers reported being told about a complaints mechanism or how to go about making a claim; less than half of consumers interviewed reported being told about a complaints mechanism and only 15 out of 47 remembered being told how to put in a claim.
- *Cooling-off period.* Just one fifth (7 out of 35) of furniture retail mystery shoppers, a seventh of microfinance mystery shoppers and a quarter of consumers interviewed reported being told of a "cooling-off" period.

One fieldworker described the disclosure experience as: "*If you don't ask, we won't tell...*"

*Blank forms.* 7 out of 47 consumers reported being asked to sign a blank or partially completed form, in direct contravention of the NCA.

## 5.3. Data perspective

In addition to the mystery shopping and consumer interviews, this study also considered whether credit life insurance did in fact offer any value to low income consumers. The value proposition is that this type of insurance protects both the credit provider and the consumer. By considering the premium levels, claims and expense ratios of insurers operating in this space, we sought to understand whether insurers were offering consumers reasonable premiums relative to the benefits they offered. Seven insurers were chosen based on their relationships to the four major furniture retailers and microfinance outlets. This was not an exhaustive list as many other insurers also provide credit life insurance in this low income space, albeit on a much smaller level. The information used was based on their statutory returns, as well as financial and qualitative information provided to the FSB under Information Request 3/2011.[47]

### 5.3.1. Cost of credit life insurance

The mystery shopping findings outlined in Section 5.2 suggest that credit life insurance is more expensive than open market insurance offerings. There have been two proposals in South Africa to ensure reasonable premiums relative to benefits for credit life cover:

[47] Limitations and disclaimer: This analysis is only as reliable as the data and information upon which it is based. While reasonable steps have been taken to ensure the validity of the data and information, the authors can accept no liability for errors in the investigation arising from incorrect data or information. This report must be read as a whole and considered in its entirety for the most accurate understanding and interpretation.

- Zimele products standards for credit life products determined by ASISA[48]. These standards, developed under the Financial Sector Charter, are aimed specifically at the low-income market.
- Draft Revised Affordability Assessment Guidelines and Amendments to Credit Providers' Code to Combat Over-indebtedness issued by the NCR in September 2013[49]

The table below shows current premium rates among the insurers analysed relative to the proposed maximum rates.

| | **Proposed reasonable maximum premium rates[50]** | **Monthly premiums for Initial Cover of R3 500** |
|---|---|---|
| Draft Revised Guidelines and Amendments to Credit Providers' Code | R4 per R1000 of initial cover (risk event not specified) | R14.00 |
| Zimele Products | R5 + R3.5 per R1 000 of initial cover (death)<br>R5 + R4.25 per R1 000 of initial cover (death and physical impairment)[51] | R17.25 (death)<br>R19.88 (death and physical impairment) |
| Products in the market[52] | N/A | R22.00 (death)<br>R26.00 (death and disability)<br>R33.50 (death, disability and loss of employment)<br>R53.86 (Material & riot, death, disability, retrenchment)<br>R31.07 (Comprehensive)[53] |

**Table 7: Current premium rates relative to proposed maximum rates.**

The table indicates that actual premiums charged on a sample of products are significantly above the Zimele product standards and the draft revised NCR guidelines.

Although setting maximum premium rates should limit the premiums paid for credit life insurance, South Africa does not have a practice of regulating premiums and this approach introduces its own challenges. A maximum premium rate will not take the risk and the costs of the individual insurer into account. It is also possible that insurers will set premiums at the maximum premium level regardless of the cost of the business as per the experience for initiation fees, where credit providers have gravitated to using the maximum allowed initiation fees.

48 http://www.asisa.org.za/index.php/en/zimele-product-standards
49 https://www.compuscan.co.za/downloads/Letter%20to%20CBA.pdf.
50 All inclusive premiums
51 The fixed amount of R5 compensates the insurer for a minimum level of fixed costs for initiating the policy.
52 Authors own research
53 Estimate from random selection of premium quotes from four insurers

### 5.3.2. Claims and expense ratios

One of the ways in which the value of credit life cover to policyholders can be assessed is in terms of the claims paid relative to net premiums (known as the **claims ratio** or loss ratio). A higher ratio means the amount paid back in benefits to policyholders is higher. As premium is constituted of claims, expenses and profit, a lower claims ratio may be indicative of inflated expenses which, in the case of credit life insurance, could relate to high fees paid to credit providers for managing the credit life business or expensive policy initiation, administration and claims processes. It is therefore also relevant to track the **total expense ratio**, defined as commission plus administration expenses as a proportion of net premiums. A more efficient product provides more value to the customer if cost efficiencies are passed onto policyholders in the form of lower premiums. A lower **insurance profit ratio**, defined as net premiums less claims and total expenses as a proportion of net premium, will also increase the value to clients[54].

Regular monitoring of claims, expenses and insurance profits is important for assessing value of insurance to customers. The following table compares two proposals on reasonable expectations for claims and expense ratios for microinsurance, internationally, to the experience of South African consumer credit insurers in general, as well as the sub-set of low-income targeted credit life insurers specifically considered in this study:

| | Claims ratio | Expense ratio | Insurance Profit |
|---|---|---|---|
| Credit Microinsurance Research, ILO Microinsurance Innovation facility[55] | Greater than 60% | Less than 25% | Less than 10% |
| Consumer Credit Insurance Model Regulation (NAIC) (1992)[56] | 60% or such lower loss ratio as may be necessary to provide an adequate margin for insurer administrative expenses, premium taxes, creditor compensation, etc. | N/A | N/A |
| South African experience: total credit life market (2012)[57] | 23% | 28% | 49% |
| South African experience: micro-credit insurance[58] (2012) | Average 23%<br>Min: 12%<br>(1% for a new player)<br>Max: 65%<br>Majority less than 25% | Average: 20%<br>Min: 3% (largest player)<br>Max: 76% | Average: 55%<br>Min: 3%<br>Max 76% |

**Table 8: Claims and expense experience for credit life business for South African insurers**

[54] Wipf et al, 2011
[55] Wipf et al, 2011
[56] The National Association of Insurance Commissioners (NAIC) is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from across most of the continent.
[57] True South, 2013
[58] Author's calculations based on statutory returns of 7 insurers providing micro-credit life cover

It is important to bear in mind that the analysis of the South African experience is only based on two years of data. It is important to monitor the experience of insurers over time to reduce the effects of unusual experience on the results. Despite the limited amount of data, the results of the analysis give some high level insights into the claims and expenses of insurers:

- At 23%, the average claims ratio for credit life insurance across all insurers is significantly below the 60% ratio suggested by Wipf et al (2011) for micro-credit insurance. A more detailed analysis of the total credit insurance market showed that 7 insurers with a net premium income of at least R5 million had a claims ratio of less than 5%[59]. Among the 7 insurers providing micro-credit life business, only the credit life business for one credit provider has a claims ratio of more than 60% - and this is the only credit provider in the sample where the whole book is underwritten, with the credit provider as policyholder, and no individual credit life insurance is sold to customers.

- The average expense ratio for all consumer credit insurers is 28% compared to the 25% benchmark suggested as acceptable for micro-credit insurance. For insurers providing micro-credit life this figure drops to 20%, but there is a wide range of expense ratios, with a number of insurers having ratios greater than 50%.

- The low claims ratios translate into high insurance profit ratios for the insurers at an average of 55% in the micro-credit life space and 49% across all consumer credit insurers[60].

When assessing the reasonability of claims ratios one needs to bear in mind that premiums need to be set at a sufficient level to cover claims, commission, and administration expenses and allow for profit to the insurer. Although a reasonable claims ratio of 60% has been recommended by Wipf et al (2011), a lower claims ratio might be required in this market to avoid the business being loss making and to allow for a reasonable return to shareholders. There is likely to be no underwriting for credit life insurance in the low-income market. Thus there may be margins in the premiums to provide some protection to the insurer against the risk of anti-selection.

The question of reasonability of expense ratios, commission, fees to distribution and administrative service providers and other expenses is more problematic to address, partly due to data only being available for two years, which makes establishing benchmarks difficult, but also because regulatory returns currently do not require insurers to disclose fees paid to administrators in statements on credit life. However, they can be considered relative to the maximum commission regulations and regulations on the principles for determining fees for outsourced services[61] in this regard.

In terms of looking at what is reasonable, the responsibilities and services provided by the administrator can be considered. It would be expected that the more responsibilities

[59] True South, 2013.
[60] Note, however, that vertical integration in the CCI market makes it difficult to interpret profit ratios, as profit may be taken at various points in the value chain.
[61] Part of the binder and outsourcing agreement requirements; Outsourcing directive (Directive 159A(i) 2012.

undertaken by the administrator[62], the higher the fees to the administrator and, conversely, the lower the insurer's internal management fees.

It may be challenging to look at credit life insurance administration fees because one of the issues with the credit life arrangement is that the administrators, loan providers and insurers are often part of the same group of companies, which opens the question of whether the fees for services are set at market or competitive rates.

# 6. Conclusion

The purpose of this study was to gauge trends in the consumer credit insurance market from the customers' perspective, so as to better understand the value offered, disclosure practices and whether consumers in practice are able to exercise their freedom of choice regarding insurance providers. To do so, a mystery shopping exercise was conducted, as well as interviews with credit life customers. The demand-side findings were complemented by insights from supplier, industry body and ombud interviews, as well as an analysis of reported data. Note that, as the mystery shopping and interviews were based on a limited sample, these findings cannot necessarily be generalised and are subject to confirmation through further research.

The findings suggest a number of insights into the working of the market:

*Questionable consumer value.* The fact that credit life insurance seems to be more expensive than life policies available on the open market, combined with low claims ratios and high expense ratios (bearing in mind that the absence of underwriting would require higher expenses) are indicative of low consumer value. Credit life insurance in the first instance serves the interests of the credit provider.

*Inability to exercise freedom of choice in practice.* Quotes received indicate that customers would benefit from searching for the cheapest credit option, including the credit life component, as there are price differentials between suppliers. However, few if any do shop around. On the whole, customers do not have suitable alternative policies to cede and tend to use the credit provider's options as doing so speeds up the credit process. In addition to customers' inertia, there are a number of supply-side barriers to shopping around for the cheapest offering: comparison quotes are difficult to obtain and standardised forms clearly reflecting the credit life component are lacking. There is limited availability of suitable alternatives in the market covering small life insurance amounts or individual assets. Ceding an existing life policy is further challenged by the inclusion of elements such as retrenchment cover in many credit life policies.

*Insufficient disclosure.* For the consumer, an easily obtainable, readable, simple quotation is the first step to exercising their right to freedom of choice. Without it, they cannot shop around, cannot compare credit life insurance offerings, cost of credit, commission being paid and the like. However, mystery shoppers found it difficult to obtain quotations. When

[62] For example policy initiation and document verification, collecting premiums, giving proof of payment of premiums, sending reminder for premium payment, dealing with queries and claim processes, regular reporting and data reconciliation etc.

obtained, quotations are difficult to interpret, with a number of additional fees and components included. While the issue of disclosure is adequately dealt with by regulatory provisions and though the supply-side interviews indicate that suppliers emphasise disclosure in line with regulatory requirements, the mystery shopping and consumer interviews suggest that on the ground disclosure practices may deviate from company policy. Instances were reported where sales staff intimidate shoppers and actively discourage them from shopping around.

Furthermore, under FAIS, official company policy is often to train sales staff to merely give the facts about the insurance, no advice. Customers are then referred to a FAIS accredited staff member or call centre for any advice needed. However, there was no mention in the fieldwork of call centres or referrals for advice. On the contrary, the mystery shoppers and consumers interviewed experienced the sales staff as advising them to take the product offering rather than shop around, or to take more credit than they asked for.

# 7. Appendix A: International examples

Credit life insurance regulation and misconduct have been in the spotlight in Australia and the United Kingdom in recent years. Both countries have experienced conduct that has been regarded as inappropriate and led to consumer protection concerns. This experience has some resonance and relevance for credit life insurance in South Africa

## 7.1. Australia

Consumer Credit Insurance, called CCI, has come under the spotlight in Australia in recent years, where more than 850 000 CCI policies are sold to customers each year. In 2011 the Australian Securities and Investments Commission (ASIC) found problems with selling practices and below-average success in claims. ASIC found that some Australian consumers had ended up with CCI without realising it, while others had been pressurised into buying it or had bought it without understanding how it worked. ASIC also found that CCI was unusually profitable for the insurer because an unusually high proportion of claims were denied (13% compared with 2% for general insurance) and only 34% of premiums were paid for claims. ASIC continued its research in 2012 with a second-stage review of CCI, looking at claims and complaints handling procedures and the high number of denied claims and cancellations of policies. In Australia, unlike South Africa, CCI is optional.

As in South Africa, CCI appears attractive because for a small amount of money each month, the customer gets a certain amount of life cover or monthly debt payment upon job loss or disability. But according to an investment manager with IMF Australia, James Middleweek, this type of insurance offers appalling value and stand-alone life insurance would be 30 to 100 times cheaper.[63] According to data collected by the Financial Ombudsman Service, only one in 38 customers claimed on their CCI policy in 2010-11, and 10 per cent of those claims were rejected. By way of comparison, one in 16 home contents and building insurance policyholders made a claim, and only 3 per cent were rejected.[64]

The 2011 ASIC review of CCI found that:

- Consumers were being sold CCI products without their consent or knowledge;
- Pressure tactics and harassment were being used to induce consumers to purchase CCI products;
- Misleading representations were being made during the sale of CCI;
- There were serious deficiencies in the scripts being used for the sale of CCI;
- Consumers were found to not be eligible to claim on all components of the CCI policy they have purchased; and
- Consumers did not understanding the cost or the duration of the CCI policy.

There were serious disclosure omissions such as only providing Product Disclosure Statements to customers after they acquired CCI. Some complaints were from consumers

[63] http://www.smh.com.au/money/planning/credit-insurance-risks-uncovered-20121127-2a4vm.html
[64] http://www.smh.com.au/money/planning/credit-insurance-risks-uncovered-20121127-2a4vm.html#ixzz2eh0iKUHv

who had not authorised the purchase and some from those who requested for CCI to be cancelled without effect. The review produced the following recommendations:[65]

| Nr. | Recommendation | Description of recommendation |
|---|---|---|
| 1. | Formal sales scripts | When CCI is sold over the telephone, distributors should have formal scripts in place for their sales staff. |
| 2. | Evidence of consent | Distributors should obtain adequate evidence that a consumer has consented to purchase CCI. |
| 3. | Disclosure of interest payments | If a CCI premium is fully funded by the underlying loan, consumers should be informed verbally, and in the loan contract, that they will pay interest on their CCI premium. |
| 4. | Separate quotes | When CCI is sold with a credit product, staff should quote repayments for the underlying loan separately to the CCI premium. |
| 5. | Disclosure of premium structure | Consumers should be informed how their premiums will be structured, such as:(a) whether premiums are to be funded by the underlying loan or paid separately by the consumer; (b) how premiums are calculated (e.g. whether premiums are based on the credit actually used by the consumer or the overall limit of the underlying loan); and (c) whether premiums are payable up-front, or in monthly or annual instalments. |
| 6. | Duration of CCI policies | Where the duration of a CCI policy is not linked to the duration of the underlying credit product it is sold with, consumers should be informed (including as set out in formal scripts) about the duration of the policy (and when it will expire in relation to the duration of the underlying credit product). |
| 7. | Timing of provision of Product Disclosure Statement (PDS) | Distributors should ensure they provide PDSs to consumers at the appropriate time (in most circumstances, before the consumer acquires the CCI policy). |
| 8. | Ongoing information | Consumers should be provided with ongoing information about their CCI policy, including a contact number to call if they have any queries or need to make a claim. |
| 9. | Training programs | Distributors should review their training programs to ensure that they are provided to staff on an ongoing basis and that they adequately address each of the issues raised in the report. |
| 10. | Monitoring systems | Distributors should have documented monitoring systems in place that comprise a range of systems to detect non-compliant sales of CCI. These systems may include, for example: (a) regular reviews of sales, complaints and cancellations reports (including appropriate follow-up with sales staff and/or consumers where issues are identified); (b) mystery shopping exercises; and (c)sales verification calls. |

**Table 9: Product disclosure recommendations from ASIC review of Australian CCI market**

[65] http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep256-issued-19-October-2011.pdf/$file/rep256-issued-19-October-2011.pdf

ASIC commissioned a further study: *Consumer credit insurance policies: consumers' claims experiences*[66], which was released in 2013. The review found that there was significant room for improvement on consumers' claims experiences for CCI, including cases where consumers received a payment or benefit under their policy. The review was mainly for credit-card customers. The report found that process of claiming on a CCI policy could be stressful and costly for consumers who are already experiencing significant events in their life like the loss of a job or illness. While consumers whose claims were accepted were generally pleased to receive a benefit payment that assisted them, they were not always happy with their experience, because their benefit payment was less than they had expected, or payments were not made in a timeframe consistent with credit card repayment due dates.

Consumers whose claims were denied generally felt that they were worse off for making a claim, given the time, money and effort they spent to complete forms and evidence their claim. Also, these consumers were often upset that they had been sold a policy without being made aware at the time that important exclusions and conditions on their policy could or did apply to them. ASIC Deputy Chairman Peter Kell said, 'It is evident from the research that the more informed a consumer was at the time of purchase, the more likely they were to have a successful and positive claim experience.' ASIC is currently conducting an industry surveillance focusing on the handling of CCI claims, complaints and cancellations as a next step in the process.

## 7.2. United Kingdom

Credit life insurance is called Payment Protection Insurance (PPI) in the UK. It has received considerable attention since 2005 when a consumer body, Citizens Advice, submitted a super-complaint to the Office of Fair Trading (OFT). The report they produced, "Protection racket: CAB[67] evidence on the cost and effectiveness of Payment Protection Insurance" raised three main areas of concern:

- consumers pay excessive prices for PPI;
- the protection consumers buy is partial with evidence of high pressure and unfair sales tactics; and
- the administration of PPI claims could be slow and unfair.

The OFT carried out its own market study in 2006; the trade association issued consumer guidelines and the FSA concluded its own investigation to improve sales standards in the PPI market in 2007.

The Competition Commission led a report in 2009: "Market investigation into PPI". The Commission found that distributors and intermediaries faced little competition for the sale of PPI when sold in combination with the credit it insures. It also found that there were market features which led to an adverse effect on competition (AEC) in these markets and in turn resulted in consumers facing higher prices and less choice than they would if there was

[66] http://www.asic.gov.au/asic/asic.nsf/byheadline/13-195MR+Claiming+on+consumer+credit+insurance+%E2%80%93+a+mixed+bag?openDocument
[67] Citizen's Advice Bureau (CAB)

effective competition between PPI providers. As a result of this lack of competition, the commission found that it was highly profitable for distributors to sell PPI and found there were serious deficiencies in the competitive process for selling PPI policies.

It therefore proposed a prohibition on distributors and intermediaries from selling PPI to their credit customers within seven days of a credit sale, unless the customer had proactively returned to the seller at least 24 hours after the credit sale; a prohibition on selling single-premium PPI policies (where the premium is paid in one upfront payment, generally by adding the premium to the credit borrowed); a requirement on retail PPI distributors to offer retail PPI separately when they also offer retail PPI bundled with merchandise cover; and several requirements to provide specified information in marketing materials, at the points of sale of credit and PPI, and each year after the PPI policy has entered into force.

In 2011, the banks sought a judicial review and the High Court ruled against the Banks. The Court ruled that Banks had to review all sales of PPI regardless of whether or not a consumer complained. Banks have set aside over £9 billion (R153.18 billion) to pay compensation to customers who were mis-sold PPI.[68]

[68] http://www.theguardian.com/money/2013/sep/25/ppi-complaint-handling-serious-problem-fca

# 8. Appendix B: Overview of legislation relevant to credit life insurance in South Africa.

Below is a more detailed discussion of the main provisions discussed in Section 3:

## 8.1. National Credit Act, 34 of 2005

Section 106 of the NCA allows credit providers to require consumers to take out mandatory credit life insurance on the outstanding loan balance, but requires that the consumer be given the right to waive the policy offered by the credit provider in favour of a policy of his/her choice. Furthermore, it states that a credit provider may not demand that a consumer purchase insurance that is “unreasonable” or that “has an unreasonable cost to the consumer, having regard to the actual risk and liabilities involved in the credit agreement”. However, because there is no cap on costs or explicit definition of “reasonable”, what is “unreasonable” is a subjective matter and open to interpretation by insurers [69]

Additional conditions include[70]:

- The credit provider may only require insurance up to the value of the consumer’s outstanding obligations.
- Insurance premiums may not be capitalised up-front.
- The credit provider needs to ensure that the customer understands the rights and obligations and the risks and costs associated with the credit agreement.
- Credit life needs to be listed separately on the credit quotation, as do other optional insurances.

### 8.1.1. NCA provisions

*Interest and fee caps*. Whether a credit agreement is an instalment agreement, mortgage agreement, secured loan or an unsecured personal loan, the NCA limits what a credit provider can charge a consumer for buying on credit by providing for maximum interest rates chargeable and allowing only certain charges. Credit providers may further include fees and charges which are relevant under that specific credit agreement:

- *Interest rate*: The NCA has set the maximum percentage of interest that a consumer may be charged using the formula ((repro rate x 2.2) + 20%), which currently works out to 22.1%. For unsecured lending the cap is 32.1%.

- *Service fee*: Credit providers can charge consumers up to R50/US $5 (R57/US $6 including VAT) monthly for servicing, administering or maintaining a credit agreement under the NCA.

[69] http://www.moneyweb.co.za/moneyweb-financial/abils-excessive-insurance
[70] http://www.deloitte.com/assets/Dcom-SouthAfrica/Local%20Content/Articles/Insights%20into%20aspects%20of%20the%20National%20Credit%20Act.pdf

- *Initiation fee*: These are once-off fees credit providers charge consumers for entering into a credit agreement. This is currently a fee of R150 (US $14) plus 10% of the agreement in excess of R1 000 (US $97), but limited to R1 140 (US $110.04) including VAT.

*Credit life provisions.* Credit providers may require consumers to take out credit life insurance. It should be known to consumers that they can choose an insurance provider of their choice, they don't have to use the credit provider's one. The Act states that it is illegal for a credit provider to offer or demand that a consumer purchase insurance that is "unreasonable" but because there is no cap on costs, "unreasonable" this is highly subjective. Furthermore, insurance premiums may not be capitalised upfront and the credit provider needs to ensure that the customer understands the rights and obligations and the risks and costs associated with the credit agreement.

Additional features of the NCA of relevance for this study include:

*Quotations.* In terms of the Act, a credit provider cannot enter into a credit agreement unless they have given the consumer a quotation in the prescribed format, identifying all the costs involved, the risks associated with the loan, and the consumer's rights and obligations. Credit life needs to be listed separately on this quotation, as do other optional insurances. The quotation is valid for a minimum of 5 business days. The quotation refers to the cost of credit, not the value of the goods for which the credit is sought

*Reckless credit and affordability assessments*. The NCA aims to increase access to credit to as many consumers as possible, while simultaneously preventing over-indebtedness. The provisions that prohibit reckless credit granting form part of the measures that were introduced by the NCA with the aim of resolving the problem of over-indebtedness and preventing reckless credit lending. In terms of Section 81(2) of the NCA a credit provider may not enter into a credit agreement with a consumer without first taking reasonable steps to assess the consumer's debt re-payment history, existing financial means, prospects and obligations, their understanding of the risks and costs of the proposed credit, and their rights and obligations under a proposed credit agreement. The credit agreement will be reckless in terms of the NCA if the credit provider fails to conduct this assessment, irrespective of the outcome of the assessment.[71]

The pre-agreement statement should provide the consumer with sufficient information to ensure they understand the obligations under the agreement. The agreement should include the following:

- Credit advanced or value of goods
- Instalment including interest, fees and credit life insurance
- Deposit deducted

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[71] www.saflii.org/za/journals/PER/2011/11.rtf

- Number of instalments
- Total of all instalments, including interest, fees, credit insurance, excluding optional insurance
- Initiation fee, which will be added to the credit advanced
- Annual interest rate
- Monthly service fee, included in instalment
- Credit life insurance, included in instalment

An affordability assessment should be conducted to ensure that the credit provider is satisfied that the consumer has the ability to meet their obligations. Credit providers are expected to use specific content as a basis for assessment. This includes personal details, all income, monthly expenses, list of all debts, as well as living expenses. A client applying for a micro loan must also provide certain documentation which is used to perform an affordability assessment.

*Credit Bureaux*. The NCA requires credit grantors to report information into a national credit register or a credit bureau. This information is used by credit grantors to determine whether a customer is credit worthy, to trace a customer, to verify employment information and to prevent fraud. Credit grantors can use credit bureau information to check a customer's credit record before it markets products to them. A credit bureau keeps record of all credit applications, credit agreements, payment history and patterns and other consumer credit related information concerning credit, financial and personal history. All this information is used to determine a person's credit record. Individuals have the right to request a credit bureau report once every 12 months free of charge. If a consumer is in arrears, the credit grantor has to give 20 working days' notice prior to submitting any adverse information to a registered credit bureau. Judgements are listed automatically by the credit bureau from information received from the courts.

As part of the credit assessment and to protect consumers against over indebtedness, their repayment ability is calculated according to their income and expenditure during each credit application. A consumer's debt re-payment history under credit agreements that they currently have or have had in the past is assessed. This is obtained from credit reports from the bureaux. With regard to micro-loans, Micro Finance Organisations have access to the National Loans Register (NLR). The NLR is used to view all current debt that a client might have and also the payment profile of a client. When a loan is granted the Microfinance Institution (MFI) uses an Authenticated Early Debit Order (AEDO) to debit the client's account when the payments are due. All transactions are recorded on Loan Administration Programs which provide clients with all the necessary legal NCR documentation.

## 8.2. Insurance legislation

Credit life can be issued under a short term or a long term insurance policy. In terms of the LTIA, credit life insurance is classified as a long-term policy by virtue of its paying out upon a life or disability event. Under the STIA, credit life fits into the Personal Lines category (any short-term policy for which the policyholder is a natural person) and could also cover a death or disability event. In addition, the miscellaneous category of short-term insurance would make provision for retrenchment cover. Section 44 of the LTIA and Section 43 of the STIA require a policyholder, in the event of mandatory credit cover, to have the option to cede an existing policy, or to choose an insurance provider. Apart from these provisions, which are entrenched in the NCA, credit life Insurance is not discussed in any specific way in either the LTIA or the STIA.[72]

As an insurance product, credit life insurance is subject to all the requirements in the insurance regulatory framework, including requirements regarding intermediary remuneration and policyholder protection contained in insurance legislation, as well as the FAIS framework for intermediary services. Remuneration to intermediaries in terms of the LTIA is broken down between an intermediary who introduces the business but renders no administrative work in regard to the policy, and a separate cap for an intermediary who also does the administrative work post-contract such as claims handling and premium collection. A maximum of 7.5% commission is allowed as the "introductory" fee and a further 15% for the administrative work, the total maximum being 22.5%. In terms of the STIA, the maximum payable is 12.5% for motor policies and 20% for all other policies.

The Policyholder Protection Rules are designed to help policyholders make informed decisions with regard to insurance products. These rules also ensure that intermediaries and insurers conduct their business "honestly and fairly and with due care and diligence". The Rules ensure that the underwriting, selling and management of insurance policies is done "in accordance with sound insurance principles and in the interests of the policyholder and policy beneficiaries".[73]

A retailer can either sell credit life insurance as someone providing advice and therefore regulated under FAIS, or as someone merely providing factual information. To sell credit life insurance under FAIS currently requires a representative having to pass the Level 1 Regulatory Exam. The FSB is developing a new exam for simple, entry level products, such as credit life in recognition of the fact that many representatives of financial service providers will not be able to successfully complete the current exam. In the meantime, those representatives who render financial services to the lower and middle income market in respect of more basic financial products have been able to apply for an exemption[74].

## 8.3. Industry guidelines

In addition to the requirements entrenched in regulation, the credit insurance industry is self-regulated by the SAIA, the short-term industry body, and the ASISA, the long-term industry body. SAIA members abide by the SAIA Code of Conduct applicable to all short-term insurers, while ASISA has developed specific Credit Life Insurance Guidelines which cover promoting awareness of credit life insurance cover as well as underwriting issues. The Guidelines take note that credit life insurance can be underwritten at either point of sale or at the claims stage. In the case of furniture retailers and micro-lenders, underwriting is more likely to occur at the claims stage. By not underwriting at the point of sale, a quick and accessible product is rendered to the consumer, who needs only provide a health

[72] A Report by the Panel of Enquiry on Consumer Credit Insurance in South Africa, p61
[73] http://www.finmark.org.za/wp-content/uploads/pubs/SACase-Study-ConsProt31-10-11.pdf, p12
[74] https://www.fsb.co.za/Departments/fais/regulatory/Documents/Circular_to_industry_Bespoke_Exam_exemption.pdf

declaration. The insurer then determines whether there is a valid claim in terms of the policyholder's health at the claims stage.[75]

## 8.4. Planned legislation

*SAM*. In addition to the current regulatory framework, two pipeline regulatory developments are relevant to credit life insurance. Under the proposed Solvency Assessment and Management (SAM) Act, the new proposed solvency regime for South African insurers and reinsurers to take effect from January 2016, consumer credit will be a separate class of insurance under non-life insurance. In addition to the core credit life insurance component, the following rider benefits will be allowed: "payment of outstanding balance to credit provider on retrenchment; premium waivers on death or disability".[76]

*Microinsurance*. In July 2011, National Treasury published a policy document that sets out a proposed microinsurance regulatory framework. It aims to promote better access to affordable insurance products, helping consumers match the products they need with the products they buy, and strengthening consumer protection. Amongst others, it proposes dedicated prudential requirements, distinct treatment under FAIS, as well as the creation of a composite class of microinsurance policies. The microinsurance framework will apply to some credit insurance models as it will form the new regulatory model for long-term risk and short-term asset insurance in the lower-income market.

[75] www.**asisa**.org.za/**asisa**docs/credit-**life**-**insurance**-**guidelines**

[76] Solvency Assessment and Management: Pillar I - Sub Committee Technical Provisions Task Group, Discussion Document 29 (v 5), Authorisation classes of business under SAM, FSB

# 9. Appendix C: Overview of main credit providers in the credit life space

## 9.1. Furniture retailers

**Ellerines: African Bank Investments/StanGen**

African Bank Investments Limited (ABIL) acquired Ellerine Holdings Limited in 2008. African Bank is the credit provider for the Ellerines Holding group's retail stores and is also the largest provider of unsecured loans in the country. There are more than 1 154[77] furniture stores in the Ellerines Holdings group, including the brands Dial-a-bed, Beares, Ellerines, Town Talk, Furniture City, Savells, Fairdeal, Lubners, Mattress Factory, Geen & Richards, Wetherlys, Osiers and Roodefurn. There are also 643[78] branch kiosks of African Bank within the Ellerines stores.

Ellerine Holdings Limited is engaged in the business of retailing furniture and appliances for cash or credit to the markets spanning LSM's 4-8. While other furniture retailers retain ownership of goods until they are paid for in full, Ellerines' credit transactions are effectively unsecured by the goods that are sold. The credit for sales is provided by African Bank, who also provides unsecured personal loans through its own branches. Using Ellerines outlets in its distribution of financial services means African Bank has low infrastructure costs. Ellerines has seen a reduction of 13% in merchandise sales across all its brands during the 2012/2013 financial year while cash sales were down 12% and credit merchandise sales down 13%[79].

Credit life insurance is mandatory for all credit transactions undertaken by Ellerines and for loans provided by African Bank with a 12 month or longer term. The Standard General Insurance Company Limited (StanGen) is a subsidiary of ABIL and is registered as a life insurance company. It provides credit life insurance products to customers of African Bank as well as credit customers of Ellerines Holdings. African Bank pays StanGen a commission in respect of sales of credit life insurance policies. ABIL holds that they do not want an overreliance on insurance for its income[80].The credit life policy offers full pay-out cover on retrenchment, temporary and full disability. A contractual reduction in earnings is also deemed a retrenchment. They regard this as a high risk micro insurance product. There is a short waiting period of 1 month and no underwriting.

African Bank does not have separate agents selling insurance as this is not sustainable. The same agent that does the credit transaction also does the insurance transaction. The Bank holds that it has a special arrangement with the FSB that says they are sufficiently informed to sell credit life but not to provide an advice component.

Product insurance is offered as an optional extra and can be included in the credit agreement. However, this product is provided by Relyant insurance. Relyant Insurance

[77] http://www.securities.com/Public/company-profile/ZA/ELLERINE_HOLDINGS_LIMITED_en_2038278.html
[78] http://south-africa.deposits.org/providers/african-bank.html
[79] http://africanbank.investoreports.com/media-2013/capitec-and-abil-same-market-distinct-methods/
[80] http://africanbank.investoreports.com/africanbank_ar_2011/downloads/africanbank_ar_2011.pdf

Company Limited is another subsidiary of ABIL and is registered as a short term insurance company, and is primarily engaged in the sale of these optional insurance products on goods purchased by customers on credit from retail stores in the Ellerines group.

Relyant Life Assurance Company Limited is yet another subsidiary of ABIL and is registered as a life insurance company. It also provides funeral insurance products and insurance of credit life products to customers of African Bank Limited and retail stores in the Ellerines group[81].

**JD Group: JD G Financial Services**

The JD Group has 8 different furniture store brands including Barnetts, Bradlows, Electric Express, Joshua Doore, Morkels, Price and Pride and Russells. The group has 988 stores across all furniture store brands. JD Group Financial Services provides consumer finance to the Group's chain stores as well as insurance products. Their insurance business is divided between three subsidiaries: JDG Micro Life Ltd (JDGML), a long-term insurer; JDG Micro Insurance (JDGMI), a short-term insurer and JDG Trading Insurance Department which acts as an independent intermediary for both insurance companies. Both JDGML and JDGMI offer credit insurance products to the credit retail market.

The JD Group pays commission to JDG Insurance for insurance policies sold – the staff does not earn commission on insurance sales. There are dedicated kiosks in each of the group's furniture and cash retail stores with specialised financial service consultants. According to the Group, these consultants receive on-going training to enhance their understanding of the regulatory obligations of the CPA and compliance issues[82].

Personal loans are currently available for up to R25 000 (US $2,413) over 24 months and the focus is on granting responsible credit to qualifying customers. The average term on their furniture book is 27 months and their average loan is R6 500 (US $627). There are deposit requirements for customers who are considered high risk. In order to get pre-approval for a loan on-line or via SMS, a customer must provide their name, surname, ID number and state their monthly income.

The company currently offers product insurance and credit life insurance linked to credit deals. Their credit insurance offering consists of three products: a) Basic b) Comprehensive and c) Comprehensive Plus (which includes a funeral plan). In addition, they offer a stand-alone funeral plan and have recently introduced a personal loan product and life partner cover, which is a life insurance offering to credit customers whose life partner's income is taken into consideration during the credit affordability test. They are also introducing a pilot goods insurance policy that can be offered to customers paying cash.

Club membership is offered as an ancillary product offering to all customers who purchase with credit – a fee is charged for benefits such as funeral insurance and disability cover, discounts, cash and product prizes.

[81] (http://africanbank.investoreports.com/africanbank_ar_2012/financials/directors-report/)
[82] JDG Annual Report 2012

The target market for the JD Group is LSM 4-7. An estimated 98% of customers elected to take-up credit life insurance with JDGMI[83]. A call centre is operated for customers who need financial advice. This ensures that the Group meets the requirements of the FAIS Act.

The Group's annual report states that they responded to the trend for people wanting to rather pay in cash by employing more aggressive credit sales marketing campaigns. Credit sales accounted for 65% of turnover in 2012 (R2 976 million or US $287.26 million) and cash sales for 35% (R1 587 million or US $153.19 million).

Financial services for the group generated a return of 26% on capital employed in 2012.

**Lewis Group: Monarch Insurance**

The Lewis Group has 619 stores across 3 brands: Lewis Stores (who has 560 of the 619 stores), Best Home & Electric and My Home. The Lewis Group operate their own credit facilities, while Monarch Insurance, a short-term insurance company within the Lewis Group offers credit life insurance. Monarch Insurance is a wholly-owned subsidiary of the Lewis Group and a registered short-term insurer which underwrites customer protection insurance benefits. Monarch employs no staff. All its distribution and administrative functions are outsourced to two companies. The first being Lewis Stores itself, who does all the administrative work in regard to the policies issued by Monarch. The other is a separate company, Transqua Administrative Services (Pty) Ltd, to which all aspects of "advice" for purposes of the FAIS Act are outsourced.

Customers are obliged to take out credit life insurance to receive credit from the Lewis Group and Monarch offers a basic package to cover settlement of a customer's outstanding debt in the event of death or permanent disability. Monarch also offers optional add on insurance products including retrenchment cover and cover for replacement of goods as a result of any form of accidental loss, such as fire, theft or natural disaster. Customers who purchase Monarch Insurance qualify for free membership to the Lewis Club, which gives them access to benefits like prizes, giveaways, vouchers and a magazine.

When entering a new credit agreement, customers are all interviewed by the store manager and the cost of the credit as well as the terms and conditions are all explained, as well as the cost, terms and conditions of the credit insurance offering. Credit applicants can select any combination from 5 insurance options which includes goods cover, death cover, disability cover, retrenchment cover and riot protection; however, the customer must have at least death cover in order to obtain credit. After they have made a selection, the applicant is given a summary of the cover and they can phone a call centre if they need any advice. Each customer is also given a copy of the insurance policy. More than 95% of customers take out some part of the insurance product offering; and 75% take out all the parts. The offering is structured so that self-employed people and pensioners cannot take out the retrenchment part of the cover. For good paying, long standing customers, Lewis don't insist on insurance.

[83] Disclosed during interview with JD Group.

Monarch Insurance pays Lewis Group commission on the sale of all credit life insurance policies. 50% of their claims are for life and 40% for retrenchment (for which Monarch write-off the entire outstanding debt amount).

Within the Lewis Group, income from all sales for 2012 was R2 470.3 million (US $238.45 million), finance charges and initiation fees earned R1 082.3 million (US $104.47 million), insurance revenue earned R994.7 million (US $96 million) and ancillary services such as Club membership earned R640 million (US $61.78 million). Credit sales accounted for 71% of total sales.

Lewis Stores (not the Lewis Group) have a target market of traditional workers in the LSM 4 - 7 market earning around R4 000 to R5 000 (US $386 to US $483) a month. They have 700 000 customers, of which around 40-50% are government workers.

**OK Furniture: Shoprite Holdings/ Shoprite Insurance Company**

Shoprite Holdings owns the OK Furniture group, within which there are 314 furniture retail groups across three brands: OK Furniture (248 stores), OK Power Express (17 stores) and House and Home (49 stores). The target LSM for OK Furniture and Power Express is 5-7 and for House and Home is LSM 7-10. About 70% of the OK Furniture Group business is cash and only 30% credit. Their debtors book for the group is R1 260 million (R121.62 million) and they generated 247 018 new contracts in 2012. The chains targeting the lower to middle income (OK Furniture and OK Power Express) did the best in the last financial year compared to all other retailers in the 4 main retailer groups.

Rainbow finance, a trading division of Shoprite Holdings, is the credit provider for the OK Furniture group and Shoprite Holdings regards the granting of credit as an integral part of selling furniture.[84] Credit life insurance is mandatory when applying for credit and is offered by Shoprite's own short-term insurance company, the Shoprite Insurance Company. During 2012/2013 net premiums earned amounted to R333 million (US $32.14 million) compared to R295 million (US $28.47 million) the previous year. This amount includes extended guarantee fees over the life of the policy.

## 9.2. Unsecured/personal loan providers

Traditionally, South Africa's mainstream banks did not offer unsecured credit to low income earners. These individuals were forced to use other less regulated alternatives such as loan sharks to cater for their needs. However, an exemption to the Usury Act in 1992 allowed money lenders to loan out amounts of up to R6 000 (US $579) for a term up to 36 months. This was to help lower income individual's access cash loans. In 1999 the government increased the maximum allowed for money lenders to R10 000 (US $965)[85] but put a cap on the interest rate of 27%[86]. It also established the Microfinance Regulatory Council (MFRC) as a regulatory body for micro financiers who needed to be registered and accredited to be allowed to lend money. In 2007, the NCA came into effect to stem the growing problems of

[84] http://www.shopriteholdings.co.za/InvestorCentre/Documents/2013/10_Shoprite_Integrated2013_Financial_Report.pdf
[85] http://www.mfrc.co.za/
[86] http://www.ncr.org.za/the_act/12.%20usury_act_rates_table.pdf

micro financing and deal with consumer protection concerns. The NCA disclosure and other requirements were designed to improve consumer understanding of the credit agreement and encourage competition. It was also passed to stop reckless lending.

There are around 5 450 micro-lenders registered with the NCR and FSB. Any institution with more than 100 credit agreements or a credit book of more than R500 000 (US $48,262) must register with the NCR. Accredited micro-lenders can lend up to R10 000 (US $965) over 36 months. Two of the largest providers of micro loans in the country are African Bank and Capitec Bank, although unsecured lending has also been the biggest growth area for the big banks in recent years. The total value of personal loans extended grew by over 100% from 2008 to 2010, from R36 billion to R72 billion (US $3.47 billion to US $6.95 billion). The amount of people with personal loans rose from 4.66 million to 6.4 million over the same period. The NCA clearly has met part of its intended goal, to increase access to finance for a broader range of SA consumers. Individuals with an income of less than R10 000 (US $965) a month dominated the short-term transactions market.[87]

### 9.2.1. African Bank

Aside from offering furniture loans through the Ellerines Group, African Bank also offers unsecured personal loans to its customers. It is the largest unsecured lender in South Africa, accounting for about 40% of total unsecured loans. In the 2012/13 financial year, ABIL reported having 2.74 million active customers (3.1 million total) as well as 643 African Bank outlets and 1 154 retail stores (Ellerines). The Bank offers a maximum of R180 000 (US $17,375) over a period of 84 months. The average loan term was 49 months and the average loan amount R12 215 (US $1,179). To complement the loan product, the Bank offers credit cards with a revolving credit facility to lower risk customers. Loans and credit cards are fully insured with StanGen, a wholly-owned subsidiary of ABIL.

### 9.2.2. Capitec Bank

Capitec is a fully-fledged retail banking offering. It has experienced explosive growth since its establishment in 2001 and currently has 17% of the market share of total unsecured credit in the country and 4.2 million clients. While the other four main banks have similar sized loan books, this book is much smaller in the context of their overall lending.[88] The maximum loan amount Capitec Bank offers is R230 000 (US $22,201), over a maximum term of 84 months. The Bank targets the lower-middle income market and has attracted clients by providing simple and affordable products that appeal to the low income sector[89]. Capitec Bank offer their clients "free" credit life cover, offered at no additional fee to clients who take credit for longer than a six-month term. This is possible because they have insurance cover on their total outstanding book with Channel Life (a subsidiary of Sanlam) and they therefore do not charge policy premiums to the client[90].

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[87] http://www.ncr.org.za/Annual%20Report/ebook/12-13/book_image/NCR_ANNUAL_REPORT_PRINT.pdf page 28)
[88] www.capitecbank.co.za/downloads/Capitec_at_a_glance.pdf
[89] http://africanbank.investoreports.com/media-2013/capitec-and-abil-same-market-distinct-methods/
[90] http://www.citypress.co.za/business/credit-life-dont-be-ripped-off-20120616/

The cover includes death and retrenchment cover for loans from 6 months. Channel Life does not provide cover for loans between 1 and 6 months and this is provided for by Capitec in its reserves. When a person whose loan is less than three months old is retrenched, Capitec Bank will cover half of the outstanding amount of the loan. There is no cover offered for disability and government workers are not covered for retrenchment. They also have catastrophe cover for the full balance of their outstanding book.

### 9.2.3. Other micro lenders

While African Bank and Capitec are the biggest players in the micro-lending market, there are thousands of small micro-lenders in the country. These smaller credit and financial service providers provide varying loan sizes and loan terms as the sample below indicates. Finbond is the only one listed below that can be regarded as “short-term” [91]:

| | Capitec | African Bank | Wonga | JDG Trading | Finbond |
|---|---|---|---|---|---|
| Max loan size | R230 000 | R180 000 | R500 000 | R24 000 | R7 000 |
| Max loan term (months) | 84 | 84 | 120 | 24 | 6 |

**Table 10: Loan comparison for 5 providers**

Many of these credit-providers and micro-lenders have begun insisting on credit life insurance as the term of the loan and the amount of the loan has grown, needing some form of security against default. The smaller micro-lenders tend to have a cell captive agreement in place to provide credit life insurance with a larger insurance company such as Guardrisk or African Unity. Some providers even charge no interest, making their profits on the initiation and monthly service fees, such as African Bank on loans under R10 000 (US $965). So-called payday loans such as Wonga, Bayport and Halifax loans do not insist on credit life insurance.

| Name of microlender | Credit life policy | Insurance company | Amount per R1 000 cover | Loan term |
|---|---|---|---|---|
| Elite Group | Credit Protection Insurance | Guardrisk | R2.40 | 6 months |
| Bridge Loans | | African Unity | R35.80 | 6 months |
| Thuthukani | Guardrisk Protection Plan | Guardrisk | R20 | 6 month |
| JDG Trading | | JDG Trading | R22.30 | 6 months |
| African Life | Group Scheme | StanGen | 0 | 9 months |

**Table 11: Comparison of 5 credit life policies**

[91] http://www.bdlive.co.za/business/financial/2013/09/19/smaller-loans-shorter-repayment-periods-are-key-to-success-says-finbond

# 10. Appendix D: Mystery shopping and consumer interview methodology

The key to successful mystery shopping is to have simple, believable scenarios for the shoppers to follow. We have tried to make the scenario as realistic as possible so as to mimic natural consumer behaviour in the market concerned and so that it can be enacted convincingly by the fieldworkers. In the case of the furniture retail mystery shops, shoppers were asked to enquire about buying a fridge in the region of R2 500 (US $241) for their home. Fieldworkers visiting micro-lending outlets were to try and borrow R2 000 repayable over 6 months, as well as obtain a quotation to borrow R2 500 (US $241) over 24 months. We then ran a pilot to check that the scenarios made sense in the real world and to test whether the briefing notes and feedback questionnaire covered all the issues adequately. After the first furniture store visit, the first consumer interview and the first microfinance institution visit, we met with the fieldworkers, adjusted the forms accordingly and troubleshot some of the issues which emerged. After completing the pilot, we made the necessary changes and the main fieldwork began.

The mystery shopping exercise was aimed at understanding how the consumer experienced the credit purchase both from a furniture retailer and a microfinance outlet. It was also aimed at establishing how easy it was for the consumer to both 1) obtain and 2) compare quotes. Furthermore, we wanted to ascertain how the consumer experiences the credit sale, what information they received about the credit life component of the transaction and at what stage into the sale this came up.

We recruited thirteen fieldworkers in total from two Further Education and Training Colleges in the Western Cape – Northlink and False Bay. We used students to conduct the fieldwork who were in either the finance or marketing faculties as it was hoped they would benefit from the experience as well. These students also had to be credit worthy. The students were in the job placement part of their training, so they were all able to meet the criteria to apply for credit. This is the first stage of the mystery shopping exercise, as the furniture stores only go into detail with quotations, including elaborating on the credit life component, once a person has been deemed credit worthy.

The fieldworkers all received training at a day-long workshop to equip them to firstly understand the credit market and environment in South Africa, and secondly credit life insurance and how it fits into the credit market. We also gave them training on how to conduct in-depth interviews and how to handle the mystery shopping experience. It was explained to them that when they apply for credit this is registered with the credit bureau and it stays on their record for 2 years. However, it would not jeopardise their chances of getting credit in the future. They were each expected to conduct 4 furniture retail store visits, 5 consumer interviews and 4 microfinance contacts, one of which being a store visit, the rest either via the internet or on the telephone.

The fieldworkers all fitted into the LSM 3-7 segments and the stores/outlets targeted were based on those for whom the target audience was LSM 3-7. The fieldworkers had to allow five days between store visits as offers of credit are valid for 5 days. If they were to apply for credit at another store during this five day period, it would show up on their credit record and the second store would have no way of knowing if the consumer was going to take up the previous offer of credit or not. Furniture stores visited were Russells, OK Furniture, Furniture City, My Home, Electric Express, Best Home & Electric, Price & Pride, Beares, Ellerines and Lewis Stores. Microfinance/unsecured lending outlets contacted were Bayport Loans, Finbond, Capitec bank, Supreme Finance, Thuthukani, Old Mutual, Standard Bank, Pep Stores, Wonga.com, Nedbank and Halifax.

All in all, 47 consumer interviews were conducted and 34 furniture retail store and 27 microfinance outlet visits were made. Below, the methodology followed for each is explained in more detail.

**Furniture store visits**

We briefed the fieldworkers about what they could expect to find when they visited furniture stores, as well as what documentation they needed to take along to speed up the transactions. There are four documents that are requested by furniture retailers in order to conduct a credit check on prospective clients. These are: a SA bar-coded ID; proof of residence or a letter from person you are living with as well as proof of their residence; bank statements for the last three months and/or a salary slip or letter from your employer. We were concerned that some of the fieldworkers might not qualify for the full amount of credit they asked for. They were advised to try and find out why not and how much they did qualify for, then to rather ask for the smaller amount of credit and find something in the store that meets the amount of credit they were allowed. A second concern was that the retailer may not want to give them the quote after they have stated that they want to think about it. They were told to try and insist they needed it and to explain that without the quote, they wouldn't be able to discuss the matter with their mother/father/husband/wife. If they still didn't get the quote, they were advised to try and remember what was on it and write it down the minute they left the store.

The fieldworkers were also briefed that they would be asked to fill in a budget to see if they qualified for credit after their monthly expenses had been paid. They were advised to be realistic but not to load the quote or they wouldn't qualify for credit. We suggested making sure about R500 (US $48) of their income was available after expenses.

Fieldworkers were instructed to make a special mental note of what the salesperson said to them about the credit insurance part of the transaction as well as the product insurance or any other add-on such as funeral insurance. They were also asked to look around the store and see what advertising was relevant and to see whether there was a specific insurance agent or whether the furniture salesperson also handled the insurance?

**Microfinance visits/ telesales/internet**

The second part of the research was to visit or make contact with 5 microloan organisations. This could be done by phoning them, making contact via the internet or going to their offices.

Here fieldworkers were to try and borrow R2 000 (US $193) repayable over 6 months, as well as a quotation to borrow R2 500 (US $241) over 24 months. This was to enable us to compare the cost of retail store credit versus a micro-loan. They were briefed to not provide information for a credit check, as this might have interfered with the furniture retail mystery shopping but to rather say they didn't have the correct documentation with them. They were at all times asked to record what happened.

**Consumer interviews**

In-depth interviews are useful for situations in which you want to ask open-ended questions that elicit depth of information from relatively few people. They allow the interviewer to deeply explore the respondent's feelings and perspectives on a subject. This results in rich background information that can shape further questions relevant to the topic. Fieldworkers were instructed to, at the start of the interview, make introductions, explain the purpose of the study, and put the respondent at ease. Their main responsibility was to listen and observe as they guided the respondents through a conversation until all of the important issues on the interview guide are explored. They were reminded to write-down responses as accurately as possible. Fieldworkers were also reminded that some people are embarrassed that they have credit and may not want to talk to them. They were also asked to consider other cultural issues that might stand in the way of consumers wanting to talk to them.

Each fieldworker was asked to find 5 people to interview. They were told to first find out whether the interviewees had recently bought anything on credit or had taken out a loan that had credit insurance attached to it. Family and friends tend to be the best people to target.

# 11. Appendix E: Issues raised by credit life insurance providers

This appendix covers the issues raised in interviews with suppliers of credit life insurance as well as industry bodies and the two ombuds (covered in Section 5.1) in more detail.

## 11.1. Issues raised by providers and industry bodies

Issues raised by providers and industry bodies are grouped into common themes relating to regulation, the marketplace and credit bureau related issues:

### 11.1.1. Regulation

*Class of insurance***.** Credit life insurance is currently not stipulated as a separate class of insurance. Providers consulted are of the opinion that having credit life insurance as a separate class of insurance would make it easier to regulate and supervise. This will be rectified once the SAM project of the FSB is implemented.

*Market conduct and compliance*. Market conduct and compliance requirements are regarded as major constraints from industry's perspective. Many suppliers expressed dissatisfaction at the current regulations for selling life insurance, arguing that FAIS exams were too complicated and were unnecessary for furniture sales staff selling a simple, single product. This should be rectified when the single product exam is introduced.

*Caps on premium rates.* Those consulted feel that regulating the price of credit life insurance could destroy competition between suppliers as they would all gravitate towards the maximum allowable rates as they have done for other regulated fees such as initiation fees and monthly service fees. The interest rate is also an instrument suppliers use to mitigate risk and if a maximum is set, that instrument is no longer available.

*Caps on charges.* Dissatisfaction was expressed with the current level of caps for the interest rate for secured and unsecured credit provision, as well as for initiation charges and monthly service fees. Nominal caps (like initiation fees and service charges) have been unadjusted since 2007, while costs to suppliers have increased annually.

### 11.1.2. The marketplace

*Negative perceptions.* Credit life insurance has negative perceptions among consumers, regarded more as an extra finance charge than as a financial product with value. The benefits of this type of insurance tend to be under-estimated by consumers with low financial literacy and with little knowledge of these products.

***Retailers not insurers.*** Furniture retailers are primarily in the business of selling furniture on credit. They do not, therefore, regard themselves as "insurers". Some retailers provide "facts only" about their credit life policies and leave any advice to call centres, linked to their insurers.

*Value for money.* Some suppliers hold that they offer value-for-money insurance products to their customers as some of the infrastructure costs of providing and offering insurance are held by the retailer and are not passed on to the consumer. This allows them to provide a cheaper offering than an insurance provider operating in isolation from a retailer.

*Stand-alone product.* There is a definite market opportunity for a stand-alone credit life insurance product tailor-made for small sums of money such as below R15 000 (US $1,448).

*Consolidation loans.* Consolidation loans were perceived by furniture retailers and other smaller credit providers to be problematic as they are consuming a person's affordability and result in them paying credit life over a much longer period or on a larger amount than necessary.

### 11.1.3. Credit bureaux

*Over-indebtedness*. Large banks are only submitting their credit bureau information every 30 days. Smaller credit providers in the industry felt they should be compelled to submit every 48 hours in order to avoid over-indebtedness.

*Funeral policies*. A consumer's credit rating is also affected by the number of funeral policies they have. Suppliers indicated that many people have multiple funeral policies which affect their affordability assessment.

## 11.2. Issues raised by the two ombuds

*Consumer understanding*. Gauging from complaints received, the ombuds felt that credit life insurance policies are not explained properly to consumers and that they simply do not understand them. This is compounded by the fact that policies are sometimes written in confusing language.

*Substitution*. Ombud experience suggests that retailers make it difficult for consumers to substitute life insurance policies for the credit life insurance offered by the store or issued under a group scheme.

*Debt review*. This is a new area of concern. Counsellors might not be familiar or up to date with the details of credit life insurance and might recommend people to stop paying the insurance. Consumers have taken this advice, and then tried to claim.

## 12. Appendix F: Snapshots of quotations

# QUICK QUOTE

DATE:
ACCOUNT TYPE
NCR NUMBER:

**THE GOODS**

| STOCK CODE | DESCRIPTION OF GOODS | QUANTITY | UNIT PRICE | VALUE |
|---|---|---|---|---|
| 322703 | KIC KTF523WH 215L WHITE T/F FRIDGE *M* | 1.00 | 2,499.00 | 2,499.00 |
| 317949 | ELLIES FBWPP/FBWPPE SURGE PLUG *M* | 1.00 | 149.99 | 149.99 |

**COST OF CREDIT**

| | | |
|---|---|---|
| *** TOTAL GOODS VALUE** | R | **2,648.99** |
| LESS DEPOSIT | (R | 265.00 ) |
| LESS DISCOUNT | (R | .00 ) |
| **ADD ADDITIONAL CHARGES SUBJECT TO INTEREST** | | |
| * EXTENDED GUARANTEE | R | 429.00 |
| * FITTING CHARGES | R | .00 |
| * DELIVERY CHARGES | R | 250.00 |
| * TV LICENCE FEE | R | .00 |
| * SERVICE FEE | R | .00 |
| * INITIATION FEE | R | 135.00 |
| LESS INITIATION FEE (IF UP FRONT OPTION SELECTED) | (R | .00 ) |
| **TOTAL DEFERRED AMOUNT CARRIED FORWARD** | R | **3,197.99** |

| | | |
|---|---|---|
| **TOTAL DEFERRED AMOUNT BROUGHT FORWARD** | R | **3,197.99** |
| ADD INTEREST FOR 24 MONTHS AT 19.00 % PER ANNUM ON DEFERRED AMOUNT | R | 684.58 |
| **TOTAL DEFERRED AMOUNT** | R | **3,882.57** |
| **ADD ADDITIONAL CHARGES NOT SUBJECT TO INTEREST** | | |
| * CREDIT LIFE INSURANCE | R | 834.24 |
| * ALL RISK INSURANCE | R | 357.60 |
| **TOTAL COST OF CREDIT** | R | **5,074.41** |
| ADD BACK DEPOSIT | R | 265.00 |
| ADD INITIATION FEE (IF UP FRONT OPTION SELECTED) | R | .00 |
| **QUOTATION TOTAL** | R | **5,339.41** |

**ITEMS MARKED WITH (*) ARE INCLUSIVE OF VAT**

TOTAL COST OF CREDIT IS PAYABLE IN 23 MONTHLY INSTALLMENTS OF R 211.43 AND A FINAL PAYMENT OF R 211.52

THIS QUOTE IS VALID FOR 5 DAYS, OR IF THE QUOTE IS FOR A PRODUCT(S) ON PROMOTION,
THE QUOTE IS THEN VALID UNTIL THE END OF THE PROMOTION OR WHILE STOCKS LAST

**THE AFORESAID QUICK QUOTE IS GIVEN IN TERMS OF SECTION 92(7) OF THE NATIONAL CREDIT ACT AND DOES NOT CONSTITUTE A PRE- AGREEMENT DISCLOSURE AS ENVISAGED IN THE ACT**

## QUICK QUOTE

Branch Copy

| | |
|---|---|
| Branch: | Purchaser |
| Phone Number<br>Date | Phone Number<br>ID Number |

| Item Code | Description of Goods | Quantity | Unit Price | Total Price |
|---|---|---|---|---|
| 226258 | POLY SNUG 150 X 200 BLANKET | 1.00 | 2,500.00 | 2,500.00 |

| | | | |
|---|---|---|---|
| Account type | **SMALL CREDIT AGREEMENT** | | |
| Finance Period | 24 | | |
| **Selling RSP** | **2,500.00** | Interest Rate | 21.00 |
| Master Guard | .00 | Monthly Service Fee | 35.00 |
| Delivery Charges | 450.00 ✓ | Monthly charge of Customer Protection Insurance | 50.79 |
| Maintenance | .00 | Options | A – Material & Riot 17.46<br>B – Death 21.43<br>C – Disability 3.97<br>D – Loss of Employment 7.93 |
| TV Licence (None) | .00 | | |
| SubTotal | 2,950.00 | | |
| Initiation Fee | 393.30 | Total of all Instalments | 6,295.68 |
| **Principal Debt** | **3,343.30** | No. of Instalments | 24 |
| Deposit Required | .00 | **Monthly Instalment** | **262.32** |

**NOTE:**

**THIS QUOTE MERELY INDICATES TO YOU , A PROSPECTIVE CUSTOMER, A WILLINGNESS ON OUR PART TO CONSIDER AN APPLICATION TO ENTER INTO A CREDIT AGREEMENT UP TO THE SPECIFIED MAXIMUM VALUE AND IS NOT BINDING ON YOU THE PROSPECTIVE CUSTOMER OR THE COMPANY WITHOUT A FORMAL DEBT ASSESSMENT.**

# QUOTATION

Application Ref No:
Sales Person:
VAT Reg No:

Date:
User:
NCR Reg No:

**Consumer**
Residential Address:

Account Type: Term Loans

**The Credit Provider**
Trading As:
Reg No:
Physical Address:

Address where agreement Conclude

Contact Number:

**Goods**

| Description of Goods | Product Code | Quantity | Price(ZAR) | Discount(ZAR) | Excl. Price(ZAR) |
|---|---|---|---|---|---|
| EXTENDED GUARANTEE 24MONTHS ELECTRICAL | 000000000010002367 | 1 | 599.95 | 0.00 | 526.27 |
| HISENSE 220LT FRIDGE MET H220TM | 000000000010002756 | 1 | 2,499.95 | 200.00 | 2,017.51 |
| DELIVERY CHARGE | 000000000010010337 | 1 | 399.95 | 0.00 | 350.83 |
| | | | | Cash Price (excluding VAT) | 2,894.61 |

| Credit Agreement details (goods and other charges) | (ZAR) |
|---|---|
| Value of goods on Credit | 0.00 |
| Delivery Charges | 350.83 |
| Deposit (including Initiation Fee if paid upfront) | 0.00 |
| Total deferred amount excluding initiation fee | 2894.61 |
| Initiation Fee | 282.62 |
| VAT | 444.81 |
| Total goods and other charges to be financed (Principal Debt) | 3622.04 |
| Total amount to be financed | 3622.04 |
| Interest (Finance Charges) at an Annual Interest rate of 21.00 % | 844.86 |
| Total Credit Advanced | 4466.90 |

**Insurance (subject to Insurance policy terms and conditions)**

| | |
|---|---|
| Comprehensive Life Insurance charge of 46.88(ZAR) per month for 24 months-non interest bearing. | 1125.00 |
| Comprehensive Product Insurance charge of 23.08(ZAR) per month for 24 months-non interest bearing. | 554.02 |
| Total cost of Insurance | 1679.02 |

**Optional Additional Services and Other Charges**

| | |
|---|---|
| Optional Club Fee charge of 21.95(ZAR) per month for 24 months-non interest bearing. VAT inclusive | 526.80 |
| Initial discounted Service Fee* charge of 37.20(ZAR) per month for 24 months-non interest bearing. VAT inclusive | 892.80 |

*(This may be increased to the maximum Service Fee as per Regulation 44 of the National Credit Act 35 of 2005)

Total Amount Repayable 7565.52

**Repayment plan (Including optional items if selected)**

Total amount repayable including optional items to be paid in consecutive monthly payments commencing the 2013/10/01 with 23 payments of 316.00(ZAR) and one final payment 297.52(ZAR) on 2015/09/01

*(These dates are subject to change depending on the delivery date of the last item)

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