



Legal Expenses Insurance

Eighty20 Consulting

Prepared for FinMark Trust

July 2013

Acknowledgements

The project team thanks Jeremy Leach for his on-going support during the project. His interest in the product prompted this analysis, and his trusted network of contacts within the industry enabled the team to conduct productive interactions with leading players from the start. A special thank you also to Brian Martin, who acted as an expert resource to the project, providing invaluable input on the regulatory environment. The project benefitted significantly from Brian's passion for the product and in-depth knowledge of its workings. A number of providers shared confidential data with the project team. They fielded endless requests for data and constant questions of clarification from the project team without once losing patience or displaying irritation. We are very grateful.

The Eighty20 Project Team:

Illana Melzer

Jonathan Ayache

Maryann Bennett

July 2013

TABLE OF CONTENTS

1	INTRODUCTION	5
2	EXECUTIVE SUMMARY	7
2.1	<i>Customer feedback</i>	12
2.2	<i>Regulatory Review</i>	13
2.3	<i>Summary</i>	16
3	OVERVIEW OF THE LEGAL EXPENSES INSURANCE OFFERING	19
3.1	<i>Core product features</i>	23
3.2	<i>Key processes</i>	27
3.2.1	Marketing, sales and distribution	30
3.2.2	Claims and servicing	32
4	FOCUS GROUPS	39
4.1	<i>Legal insurance: Perceived value</i>	40
4.1.1	'Peace of mind'	40
4.1.2	Product satisfaction	41
4.2	<i>Legal insurance: Actual value</i>	42
4.2.1	How does the product work?	42
4.2.2	Familiarity with policy documents and understanding of the terminology typically used in those documents.....	44
4.2.3	Distribution.....	48
4.2.4	Quality assessment.....	50
4.2.5	Improving the offering.....	52
4.3	<i>Accreditation</i>.....	53
4.3.1	What is a proper company?.....	54
4.3.2	The role of the regulator and ombudsman.....	55
5	REGULATORY REVIEW	57
5.1	<i>Short-term insurance act</i>.....	57
5.1.1	Policy holder protection rules	57
5.1.2	Binder regulations.....	58
5.1.3	Outsourcing directive	60

5.1.4	General comment: Impact of the Short Term Insurance Act on the industry	61
5.2	<i>The Financial Advisory and Intermediary Services Act (FAIS)</i>	61
5.2.1	Fit and proper requirements	61
5.2.2	General code of conduct for authorised FSPs.....	62
5.2.3	Statutory OMBUD	63
5.3	<i>Proposed Micro Insurance Act</i>.....	64
5.4	<i>Treating Customers Fairly ("TCF")</i>.....	64
6	CONCLUSION	66
6.1	<i>Client issues</i>	66
6.2	<i>Provider issues</i>.....	67
6.3	<i>Regulatory issues</i>	69
6.4	<i>Legal profession</i>.....	72
7	APPENDICES.....	74
7.1	<i>Focus Group participant summary</i>.....	74
7.1.1	Cape Town: Legal insurance policyholders/ Lapsed legal insurance policyholders	74
7.1.2	Johannesburg: Legal insurance policyholders	75
7.1.3	Johannesburg: Never had a legal insurance policy	75
7.1.4	Pretoria: Legal insurance policyholders/ Lapsed insurance legal policyholders	76

1 Introduction

Legal expenses insurance covers policyholders against the potential costs associated with legal action. The offering typically comprises an insurance component covering large lump sum costs arising from litigation and an on-going service dimension that includes mediation and legal advice.

Legal expenses insurance is a sizeable class of business offered by a number of providers using various underwriting arrangements. The data available from FinScope 2012 sizes the current market for legal insurance at around 571 000¹ adults (main policyholders and beneficiaries²). Based on conversations with leading providers it seems that this figure is significantly understated and our analysis estimates the market at almost three million main policyholders and beneficiaries. Nevertheless, the data does indicate that legal insurance is one of the few classes of short term insurance business that is skewed towards the lower end of the market. According to FinScope, 62% of those who say they have legal insurance cover are in LSMs one to seven. In contrast, just 12% of those who have household contents insurance or homeowner's insurance are in LSMs one to seven.

FinMark commissioned this study primarily because of the product's significant skew towards lower income segments of the market and the critical role it can play in enabling access to legal services. In addition, there is limited available research on the product and regulators and policymakers have not explored the impact of the current regulatory regime on consumer protection, product value and access. The primary objective of the research is therefore to better understand the legal insurance environment in South Africa, its position under current and pending regulatory regimes and the value of the product to consumers.

The project Terms of Reference highlights three key focus areas for research, namely:

- The structure of the industry and the level of competition. This includes:
 - Understanding the components of available legal insurance products
 - A review of the various models incorporating products sold by licensed insurers, use of cell captives, underwriting managers and membership-based unlicensed offerings
- The impact of existing and proposed insurance legislation on the design and distribution of the product
- The benefits of the service from a user's perspective

¹ The 95% confidence interval bands for the number of individuals with legal insurance are 468 452 and 719 810.

² The question in FinScope 2012 is: "Please tell me about your use of each of these insurance products or cover, using the options I am about to show you." The individual is considered covered if they answered either "Have it in my name" or "Covered by somebody else".

On the basis of this the project team was also required to develop a set of recommendations for FinMark relating to its engagement with this product class going forward.

In order to gather industry-related data the project team reviewed available products, interviewed a number of the larger providers and met with lawyers who work with legal expenses insurance providers. The team also conducted a thorough regulatory review exploring key pieces of legislation that govern the market conduct of short term insurance providers in South Africa.

With regard to client value, the project team ran a number of focus groups to explore the client experience with and expectations of the products. Team members also purchased legal expenses insurance products from a range of providers. In addition, the team gathered and analysed utilisation data provided by a number of providers.

2 Executive summary

Legal expenses insurance covers policyholders against the potential costs associated with legal action. There is no accurate data on the size of the current market for the product. According to Finscope 2012 there are in the region of 571 000 adults who either have a policy in their name or are covered by someone else. This appears to understate the true market size significantly; based on discussions with larger providers and returns submitted to the FSB by LegalWise and Clientele, it is estimated that there are roughly 1.4 million legal expenses insurance policyholders. Assuming a little over one dependent per policyholder the total current market is estimated at 3.0 million individuals.

According to FinScope 2012 the profile of Legal Insurance policyholders is skewed toward the lower LSMs. In fact, the proportion of product users in LSMs one through seven, at approximately 62%, is higher than any other insurance product save for funeral insurance at 78%.

The typical offering comprises access to legal services, including “advice” and mediation as well as an insurance component covering large lump sum costs arising from litigation. In general products cover civil, labour and criminal matters and some providers cover aspects of family law. Common exclusions include pre-existing matters, cases that are not deemed to have a reasonable prospect of success and cases where the costs are too high relative to the value of the settlement. It is standard for policies to cover a policyholder’s spouse and children and extended family can be included for an additional amount.

While available products are broadly aligned and similarly structured, providers have differentiated their offerings. Monthly premiums range between R35 and R230 with benefits typically at one thousand times the monthly premium. The amount covered is quoted on either an annual or per matter basis. Co-payments or excesses are uncommon and where they do apply, they are generally low. There are waiting periods for certain benefits, however legal advice is generally available immediately.

The dominant player in the industry is LegalWise. Other large providers include Clientele, Legal & Tax, Hollard, Lipco, Lexcorp and FNB’s Justice 1st. Various licensing arrangements and operating models exist. Some providers, including LegalWise, Clientele and Hollard are registered short term insurers. Lipco and Lexcorp are Underwriting Management Agents (“UMAs”) who act on behalf of

short term insurers. Legal & Tax is a cell captive while FNB Life markets Justice 1st as an intermediary of RMB Structured Insurance.

There are a number of unregistered products available. In some cases these are offered as membership based schemes that offer access to legal services in return for a monthly membership fee.

The table below summarises key parameters for a number of available products;

Table 1. Legal insurance product overview (*Formal providers in blue, membership based offerings in red*)

Product	Underwriter	Entry level offering			Premium offering		
		Monthly premium	Cover	Other matters covered	Monthly premium	Cover	Other matters covered
Lexcorp	Santam	R35	R55 000 per annum	Family	R85	R100 000 per annum	Family
Scorpion Legal (Entry Level)	Legal Expense	R39	R45 000 per annum	Only civil or only labour	No Premium offering		
Edgars / Jet legal plans	Hollard	R39	R50 000 per matter		R59	R100 000 per matter	
Legal Best	New National	R45	R45 000 per annum	Family	R95	R95 000 per annum	Family
Lipco	Absa Short Term Insurance	R53	R60 000 per annum	Family	R155	R200 000 per annum	Family
Lawyers Voice ³	New National, Gryphon Underwriting Managers	R55	R30 000 per annum	Family, Property, Estate, Consumer, Vehicle, Housing, Debt	R120	R100 000 per annum	Family, Property, Estate, Consumer, Vehicle, Housing, Debt
FNB Justice1st	RMB Structured Insurance	R60	R60 000 per matter	Administrative	R190	R200 000 per matter	Administrative
Lesaka	Constantia Insurance Company	R60	R50 000 per annum	Family	No premium product		
Scorpion Legal	Legal Expense	R63	R55 000 per annum	Administrative	R96	R110 000 per annum	Administrative
Legal Defender	Constantia Insurance Company	R65	R200 000 per annum	Family	Only one product offered		
LegalWise	Legal Expense	R67	R67 000 per matter		R150	R150 000 per matter	
Multisure	Guardrisk	R68	R70 000 per annum	Family	Only one product offered		

³ In 2013 the FSB investigated Lawyers Voice and determined that it contravened section 7(1) of the Short-term Insurance Act. The FSB fined the company R600 000. New National became the Underwriter from 1 May 2013

Product	Underwriter	Entry level offering			Premium offering		
		Monthly premium	Cover	Other matters covered	Monthly premium	Cover	Other matters covered
LegalNexus	Constantia Insurance Company	R79	R80 000 per annum	Family	R105	R120 000 per annum	Family
Legal Edge / Guard	Centriq (cell captive)	R80	R40 000 per matter	Unclear from website	R130	R90 000 per matter	Unclear from website
Legal & Tax	Centriq (cell captive)	R90	R105 000 per matter	Family, Vehicle	R175	R175 000 per matter	Family, Property, Vehicle
Legalex	Guardrisk	R90	R45 000 per annum	Family	R110	R85 000 per annum	Family
My Lawyer	Not Underwritten – FSB investigating	R99	R175 000 per matter	Family (contested divorce included), Vehicle	Only one product offered		
Hollard	Hollard	R120	R120 000 per matter		R200	R200 000 per matter	
Clientele	Clientele	R130	R130 000 per annum		R230	R320 000 per annum	
Legal IQ		No information available					

Source: Provider marketing material and websites as at April 2013 (My Lawyer as at August 2013)

The primary channels used to market products are call-centres (inbound and outbound), sales representatives and worksite marketing. Affinity-based marketing is also common (i.e. Hollard underwrites legal expenses insurance products offered by Edgars and Jet) and some providers use multi-level network marketing (for example Clientele and Multisure).

Typically legal insurers employ 'legally qualified' staff who provide legal *advice* and assistance as well as mediation services through call-centres and in some cases walk-in servicing centres. Litigation services are outsourced as legal expense insurers cannot employ practicing attorneys to conduct litigation in-house, as it is in contravention of existing legislation governing the legal profession as administered by the Law Society of South Africa.

If litigation is required, these matters are commonly referred to panel attorneys who are contracted by the legal expense insurer and provide services based on negotiated rates linked to government gazetted tariffs. These fees are significantly lower than fees charged by a typical attorney. Attorneys provide regular updates to the legal expense insurer on the progress of legal cases.

In some cases providers allow clients to select their own attorneys, who are remunerated at the same rate as contracted attorneys. In such cases the client is personally responsible for payment of any shortfalls.

Claims ratios⁴ in the legal insurance industry are significantly lower than the average claims ratio for the short-term industry as a whole. According to the latest available returns submitted to the FSB, LegalWise's claims ratio is 10%, while Clientele's is 9%. The average for the short-term industry over the same period was 63%. The low claims ratio is primarily a reflection of the reporting conventions in the industry; legal expense insurers only include costs associated with litigation when calculating claims ratios while the costs of other legal services provided by in-house legally qualified staff, including advice and mediation, are not included. Based on discussions with providers if these expenses were included a more comprehensive claims ratio including costs associated with providing access to all legal services would be between 45% and 55% of premiums.

With regard to utilisation between 0.9% and 2% of policyholders⁵ claim on their policies each year (that is, they make use of the litigation benefit). However, insurers estimate that around 20% of policyholders make use of legal services provided by in-house legally qualified staff, including

⁴ The claims ratio is calculated as net insurance benefits and claims as a percentage of net premium income based on figures from the income statement submitted to the FSB.

⁵ This is for the 2009 join cohort.

telephonic advice, drafting legal documents and mediation in any given year. One major provider has monthly queries equivalent to around one fifth of its client base although the data cannot clarify whether these are unique clients.

On average 12% of claims are rejected each year. The most common reason for rejection is non-payment of premiums, accounting for 51% of rejections. The next most common reason claims are rejected, accounting for around one fifth of all repudiated claims, is that the case is deemed to have no reasonable prospects for success. Policyholders can appeal to an internal committee if they believe their case has merit, and can take the matter to the Short Term Insurance Ombud if the appeal is unsuccessful.

2.1 Customer feedback

Three focus group discussions were held with existing policyholders to gather qualitative demand side data on the perceived value derived by policyholders from their legal insurance policies. In addition, one focus group discussion was conducted with a group who did not have a legal expenses insurance product, with the aim of assessing their views of the usefulness of the product. The income profile of participants was slightly above the typical product user; over 80% of participants had a household income in excess of R10 000 per month.

In general, feedback from policyholders was positive. They described benefits in terms of peace of mind, and highlighted the sense of safety or protection they feel as policyholders. The primary motivation for purchasing the product was the high cost of legal services and the fear of not being able to access legal assistance should a legal issue arise.

Those who had made use of their legal insurance product, including advice, mediation and litigation services, were satisfied with the quality of legal services they had received and the outcome of the legal matters they had referred to their legal expenses insurer. Even policyholders who had not utilised any benefits were satisfied with the product; they were confident that they would need to make use of the policy at some stage and that when they did, the value of services rendered would more than compensate what they had paid in premiums.

In some cases, perceptions regarding the level of security provided by the product were not aligned with the actual benefits stipulated by product providers in policy contracts. Across the groups participants indicated that they seldom read the terms and conditions of their legal insurance

policies and were often unaware of specific exclusions. Focus group participants did not understand the financial and legal terminology used in policy documents. Given that the income profile of the focus group participants was relatively high, it would be reasonable to assume that if anything, actual levels of understanding in the target market for the product are lower than those of focus group participants.

As is often the case with specialist services, clients were unable to assess the quality of legal advice or services provided either by in-house legally qualified staff, or outsourced attorneys. Clients did not ask in-house staff what qualifications or experience they had but believed they were knowledgeable and suitably qualified. With regard to attorneys, policyholders relied primarily on aesthetic proxies, such as the appearance of an attorney's office, to assess quality.

The focus group discussions also explored awareness of regulatory oversight. One participant mentioned the importance of registration, FAIS and the FSB. Overwhelmingly however, the key indicators used to assess the legitimacy of an insurance company were advertising, company reputation and the opinions of close associates.

2.2 Regulatory Review

The legal expenses insurance industry is currently governed by two key pieces of legislation; the Short-term Insurance Act and the Financial Advisory and Intermediary Services Act ("FAIS"). In addition, the proposed Micro Insurance Act and Treating Customers Fairly initiative are likely to impact on the industry.

While existing legislation offers some protection to policyholders, the review highlighted that in many cases the specific features of the product are not well catered for under the current framework. For instance, in line with the Policyholder Protection Rules, policyholders must be made aware of their right to approach the Ombud in the event of a dispute. However, they are not necessarily informed of their right to approach the Law Society or Bar Council if they believe their attorney or advocate has not acted in their best interests or has acted unethically. In addition, because legal expenses insurance providers are not members of the Law Society of South Africa, policyholders would have little recourse if the quality of legal services provided by legal expenses insurers was poor.

The so-called Binder Regulations promulgated under the Short Term Insurance Act govern the relationship between the insurer and the underwriting management agent ("UMA") who performs one or more of the binder functions on behalf of an insurer. A drawback of the binder regulations in the case of low premium products such as legal expenses insurance lies in the difficulty and cost of distribution. Because UMAs act on behalf of short term insurers, they cannot act as intermediaries. Providers must therefore rely on brokers to sell the product. However given the low potential commissions or fees generated by the product, brokers have little incentive to do so.

The binder regulations also appear to have created considerable confusion. Despite disclosure on policy documents, policyholders are unlikely to be aware that they are not insured by the UMA with whom they interact but with the insurance license holder, and would in all likelihood be surprised to find that the insurer can place the book of business with another UMA, or can bring the binder activities in-house.

Given that the focus of this study is on market conduct and the consumer, prudential regulations were not explored in detail. However providers highlighted that requirements of the Short Term Insurance Act in this regard are onerous and arguably overly cautious given the mechanisms that are embedded into contracts to limit the liability of the insurer. They highlighted that loss ratios are generally lower, the risk spread is far wider and the individual claim exposure more limited than is the case with short term insurance more generally. Providers also highlighted that the requirements for registration are onerous, and that the costs involved in establishing and complying with regulations are high.

During discussions, providers commented that they expect this is likely to be exacerbated by Solvency Assessment and Management (SAM) framework. Regulations are thought to create significant entry barriers leading to the limited number of specialised legal expenses insurers in the South African market, and the relatively high proportion of providers who operate as UMAs, intermediaries or cell captives. It is also a factor leading to the emergence of unregulated operators.

While regulators acknowledge that governance and risk management requirements under Pillar 2 of SAM will be more rigorous than the current requirements, they highlight that the impact of Pillar 1 of SAM may differ. Given that the capital requirements under SAM will be more risk based, , to the extent that Legal Expenses Insurance is a low risk product, there is a possibility that it may have lighter capital requirements under SAM.

The FAIS Act has had a significant impact on providers, who have responded to the legislation in various ways. Some have obtained a temporary exemption⁶ while other providers have adopted no-advice sales processes. According to providers, costs to comply with FAIS are high. This has a material impact on the costs of distribution and by extension, on the premiums associated with the product. Because FAIS requirements are not aligned with the needs of the product this additional layer of cost comes with limited commensurate benefit to consumers.

The requirement for representation to be in plain and simple language in line with the General Code of Conduct is of specific importance in the legal expenses insurance industry. In addition to poorly understood terminology common to insurance contracts in general, these policies have the added complexity of legal terminology. Consumers are therefore at even more risk of not understanding exactly what they are purchasing and what they are covered for.

Two proposed pieces of legislation may also impact on the legal expenses insurance industry; the Micro Insurance Act and the Treating Customers Fairly initiative.

The objectives of the proposed Micro Insurance Act are to extend access and enhance inclusion, to formalise informal provision, to encourage competition while protecting consumers through prudential and business conduct regulation and to improve enforcement and consumer education specifically in the low-income population. Current published proposals indicate lower capital adequacy requirements (a minimum capital adequacy requirement of R3 million with a build up over three years) as well as greater flexibility with regard to fit and proper requirements for financial services providers. Assuming proposed benefit caps can be aligned with the structure of legal expenses insurance contracts, the more flexible regulations and lower capital requirements may incentivise some providers who currently operate as UMAs, intermediaries or cell captives to restructure as micro insurers. It may also encourage entry into the industry of new players, and the formalisation of membership-based offerings. However the proposed Act will have no impact on premium products which exceed micro insurance caps.

The TCF initiative outlines a number of customer outcomes that should apply throughout all stages of interaction with the client. It includes a requirement that products perform as firms have led customers to expect, and that associated service is both of an acceptable standard and what they

⁶ Certain providers have received temporary exemptions for their intermediaries from having to write the current RE2 examinations. This exemption is in place until such time as the regulator develops a more relevant examination. Intermediaries are still required to have a matric certificate and must have completed certain NQF levels.

have been led to expect. Given that legal expenses insurance is a service-intensive offering this requirement is potentially significant. However, TCF is principles based rather than rules based and there is significant scope for interpretation. In addition it is not clear what sanction can be applied where companies violate these principles. Nevertheless as they stand, some processes that are common across the industry appear to be at odds with these principles. For instance, during mystery shopping exercises some providers could not make available policy documents without first capturing banking details and getting authorisation to process debit orders. In addition, shoppers were required to cancel policies in writing despite the fact that policies were purchased telephonically. Perhaps most importantly, given the inherent conflicts of interest, some processes adopted by providers in adjudicating whether a case has prospects of success may be at odds with the TCF principles.

2.3 *Summary*

The review highlighted a number of key areas for further engagement. These are summarised below from the perspective of four key stakeholders; Clients, Providers, Regulators and the Legal Profession.

Clients

- Clients who participated in focus group discussions feel vulnerable with respect to the law, and place a high value the protection that they perceive is offered by the product. However, the market is characterised by low levels of financial literacy and low levels of legal literacy. Clients do not read policy documents and are often unaware of exclusions that apply. This increases the vulnerability of clients who often do not fully understand the products they have purchased
- In general, clients are unable to assess quality of legal services they receive either from in-house legally qualified staff, or from panel attorneys used by legal expenses insurers
- There is limited knowledge of rights and avenues for recourse within the financial services realm as well as within the legal profession

Providers

- There is no industry body which represents the interests of legal expenses insurers and which can make submissions on its behalf to regulators
- Terminology used in policy documentation is complex – sometimes unnecessarily so
- Some current practices are not aligned with TCF. Most importantly, insurers have clear vested interests when assessing reasonable prospects for success

- There is no industry standard with regard to the definition of claims expenses
- There is no industry standard with regard to the minimum qualifications of employed legally qualified individuals

Regulators

- The current regulatory environment is not well suited to the specific characteristics of the product
- The Binder Regulations have made it difficult to distribute the product within the UMA model and raise questions whether they are appropriate for micro insurance particularly as brokers play a lesser role in this segment with the focus on low advice or no-advice sales.
- With regard to FAIS, the accreditation process is not aligned with the product. It thus imposes additional costs on providers without according protection to policyholders
- Reserving requirements are overly onerous given the nature of the product (e.g. SAM)
- High costs of compliance increase barriers to entry and have led to a number of providers offering unregulated, member-based products
- The proposed Micro Insurance Act may reduce barriers to entry and reduce compliance costs for qualifying products. However, it will not address key regulatory weaknesses that impact on the development of premium products that could be marketed to higher income segments
- TCF may enhance consumer protection. However, the initiative is principles-based rather than rules-based and there is scope for interpretation
- Current reporting requirements do not adequately capture true utilisation levels. In addition data gathered by regulators is not compiled into any useful industry measures

Legal profession

- The legal expenses insurance industry operates independently of the legal profession. Legal expenses insurers can not own a legal firm as is common in Europe. They may not hire practicing attorneys to represent clients in court and more junior staff employed by insurers cannot be articulated due to the lack of court exposure. This increases costs and reduces the opportunity to support the training of new attorneys. In addition, there is no recourse to the profession for policyholders who receive poor legal services provided by insurers

- Access to legal aid is limited to those with very low incomes. There is a sizeable market comprising those who earn above the legal aid threshold but below the level at which they can afford to hire attorneys
- The profession has not engaged with the product and explored its potential to enhance access to the law for the market as a whole. It has also not assessed the impact of the product on demand for legal services offered by panel attorneys
- Panel attorneys who provide services for legal expenses insurers service two clients – insurers and the consumer. There is no recognition by the profession of the challenges this creates

How these issues are dealt with is largely a function of the ultimate vision for the product and the role it could play in enabling access to the law for citizens in South Africa. It can remain a niche product, attracting a small but not insignificant number of clients. Providers can continue to market and service the product despite a number of onerous regulatory requirements, without formalised engagement with the legal profession. Alternatively, the product could become the primary mechanism that enables access to the law for those who are not poor enough to qualify for Legal Aid, but not rich enough to be able to afford to hire an attorney at standard market rates. To create this reality, the industry needs to organise itself and represent its interests to regulators, to engage with the legal profession and to develop strategies to capacitate clients. It also needs to ensure its products, levels of disclosure, operating processes and standards of service are of high quality.

3 Overview of the legal expenses insurance offering

As noted in the introduction, legal expenses insurance or legal insurance covers policyholders against the potential costs associated with legal action. The offering typically comprises access to legal services, including advice and mediation as well as an insurance component covering large lump sum costs arising from litigation. In general products cover civil, labour and criminal matters and some providers cover aspects of family law. Legal insurance should not be confused with non-insurance legal advice and assistance products which do not offer any litigation insurance and which are commonly bundled with other risk products as 'value add'⁷.

LegalWise, the dominant player in the industry introduced legal expenses insurance to the South African market in 1984. Initially, LegalWise developed, distributed and serviced the product but did not bear any insurance risk as the product was underwritten by Hollard. LegalWise subsequently obtained its own short term insurance license in 2005. In 1996 LegalWise launched Scorpion Legal, an entry level product with more affordable premiums to meet the needs of lower income segments of the market. Several other providers have introduced variants of the product, including Clientele, Legal & Tax, Hollard, Lipco and Lexcorp.

The lack of accurate data makes it nearly impossible to accurately size the legal expenses insurance market. Data from FinScope 2012 indicates that there are in the region of 571 000⁸ adults⁹ who either have a policy in their name or are covered by someone else¹⁰, with a further 200 000 adults who say they used to have the product (see question in Box 1 below). This estimate is far lower than estimates based on available supply-side data.

The survey data on providers indicates some confusion in the market, with several respondents citing companies such as Old Mutual, Liberty and OUTSurance as their legal expenses insurance providers despite their not offering the product. This confusion may arise from the provision of legal advice as a value added benefit to policyholders. For instance, Old Mutual offers access to legal assistance as one of the "Care 4U" add-on benefits under its Greenlight personal cover policy and as part of its Family Support Services offered to Burial Society Support Plan clients. This amplifies

⁷ Old Mutual Care 4U offers its policyholders the add-on benefit of legal advice and services but not litigation cover. Santam offer litigation cover as an optional add-on to their extended personal legal liability cover, it cannot be purchased as a standalone product.

⁸ The 95% confidence interval bands for the number of individuals with legal insurance are 468 452 and 719 810. The question in FinScope 2012 is: "Please tell me about your use of each of these insurance products or cover, using the options I am about to show you." The individual is considered covered if they answered either "Have it in my name" or "Covered by somebody else".

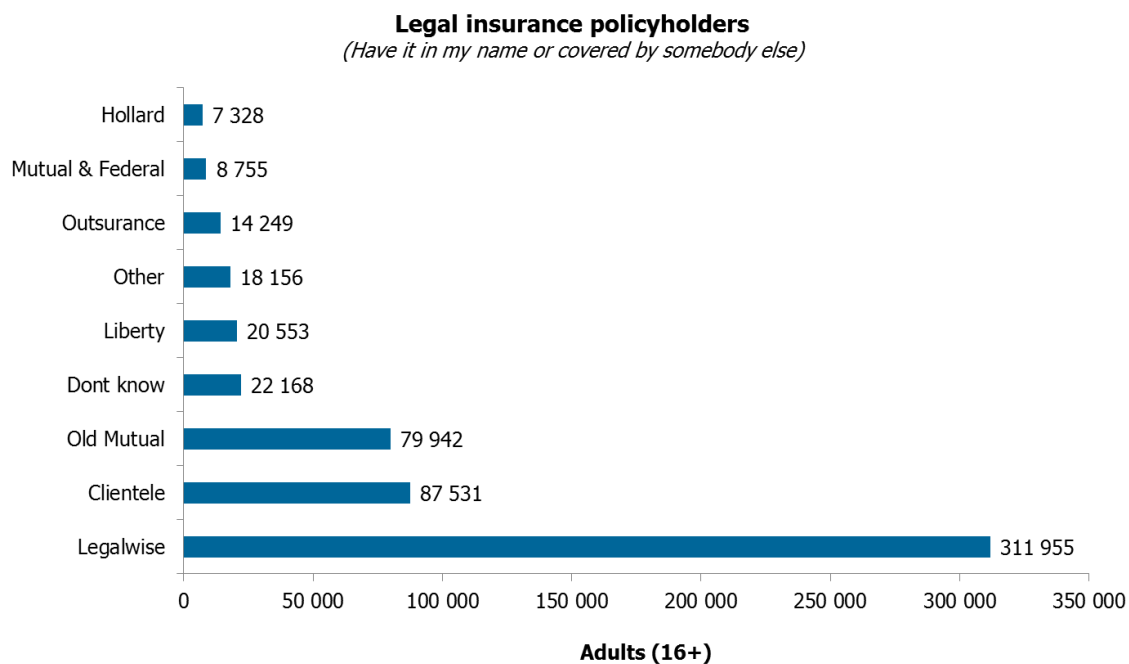
⁹ Aged 16 or older

¹⁰ This corresponds to 84 respondents out of a total sample of 3 900

concerns regarding the survey data; given that many who say they have the product in fact do not, the FinScope estimate should over-state, rather than understate true levels of usage.

While surveys are prone to sampling and non-sampling errors it is also possible that many policyholders do not know they have the product. Given that payroll deduction and debit order are the dominant collections mechanisms, and that many adults do not check salary slips or bank statements¹¹ this is entirely plausible.

Chart 1. Legal insurance policyholders



Source: FinScope 2012

Box 1: Legal expenses insurance question as per FinScope 2012 questionnaire

"We are going to talk about insurance. This is different from funeral cover, which we will speak about soon. Please tell me about your use of each of these insurance products or cover, using the options I am about to show you. Which statement best describes your use of:

Insurance that pays for any legal fees, expenses or legal advice e.g. Legal Aid, LegalWise, Scorpion"

Never had

Used to have

Have it in my name

Covered by somebody else

Don't know

¹¹ According to FinScope, 22% of adults with a bank account in their name do not agree with the statement "You check your bank statements".

Based on discussions with larger providers and returns submitted to the FSB by LegalWise and Clientele, it is estimated that there are roughly 1.4 million legal expenses insurance policyholders. Assuming half of all policyholders have just over one additional dependent, there are approximately 3.0 million individuals with legal expenses insurance cover in South Africa.

Table 2. Large providers and estimated policyholders

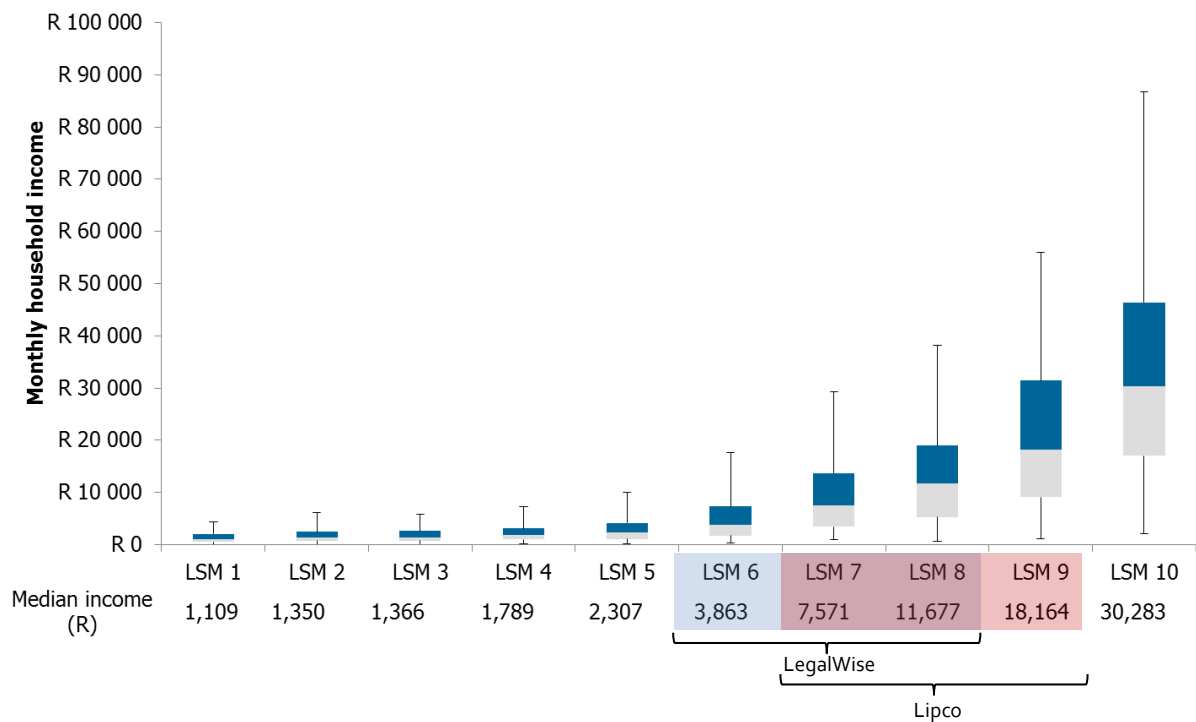
Provider	Main members	Dependents	Total individuals covered	Gross premium income 2012
LegalWise (including Scorpion)	700 000	800 000	1 500 000	R536m
Clientele	120 000	137 143	257 143	R136m
Lexcorp (including Legal Soldier)	100 000	114 000	214 000	
Legal & Tax	80 000	91 429	171 429	
Lipco (including the Foschini book)	80 000	91 429	171 429	
Other small providers	300 000	342 859	642 859	
Total	~1 380 000	~1 576 860	~2 956 860	

Source: Discussions with legal insurance providers & FSB Statutory returns.

Providers do not have accurate data on the income profile of their clients as they do not gather this data during the sales process. Lipco indicated its target market comprises those with a household income of between R7 000 and R15 000¹² per month (shaded blue in chart below), while LegalWise indicated their product range catered for all sections of the market with a focus on the mid to lower income individuals (shaded red in chart below). With regard to LSM, this income range corresponds to LSMs four to nine as summarised below.

¹² Lipco's household income profile corresponds to LSMs 7,8 and the lower end of LSM 9.

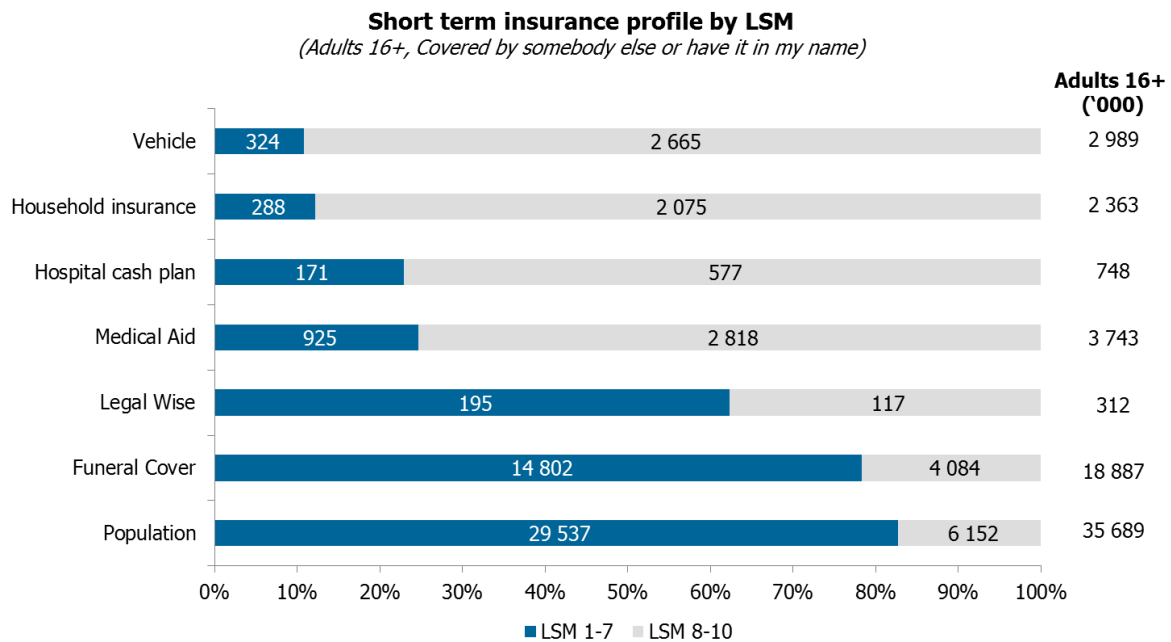
Chart 2. Income distribution by LSM¹³



Source: IES 2010/11

According to FinScope 62% of LegalWise clients are in LSMs one to seven. Of all classes of insurance business, only funeral insurance has a higher proportion of clients in this segment of the market. This, no doubt, reflects the market's perceived need for accessible legal services and the product's relatively affordable premiums. The market profile also highlights the critical challenge of regulating the product effectively without limiting accessibility.

¹³ The whiskers represent the 5th and 95th percentiles of the income distribution for each LSM class. The box comprises the middle 50% of households. The line where the colours meet represents the median of the income distribution

Chart 3. LSM profile of insurance clients¹⁴

Source: FinScope 2012. Note that data is included for LegalWise clients only.

3.1 Core product features¹⁵

As with most insurance products, clients pay a monthly premium in return for a given level of cover. Monthly premiums range from R35 for entry level offerings to R230. With regard to benefits, cover generally starts at one thousand times the monthly premium; this multiple increases the higher the premium. Providers either quote annual cover limits or limits per case with a maximum lifetime value per policyholder. In some cases providers have both an annual and per case limit. It is standard for policies to cover a policyholder's spouse and children¹⁶. Extended family members can also be covered under the policy for an additional monthly fee.

The table below summarises the key product parameters for a number of offerings. While this list of offerings is extensive it is by no means exhaustive; there is no single source that tracks available offerings or providers on an on-going basis. In some cases offerings are not widely advertised and it is difficult to identify them. The list includes both registered insurance products as well as those that do not appear to be registered but are marketed as membership-based offerings. Unless otherwise noted, all providers listed cover civil, labour and criminal matters.

¹⁴ The chart includes data on the profile of LegalWise clients to exclude those who might have legal assistance, but not legal expenses insurance.

¹⁵ Only products offered to individuals are reviewed in this report. Some providers have developed offerings for small businesses. These are not included in this study.

¹⁶ Children are covered up to the age of 18, if they are studying up to age 25. Some policies have no age limit for mentally disabled children.

Table 3. Legal insurance product overview (Formal providers in blue, membership based offerings in red)









Product	Underwriter	Entry level offering			Premium offering		
		Monthly premium	Cover	Other matters covered	Monthly premium	Cover	Other matters covered
Lexcorp	Santam	R35	R55 000 per annum	Family	R85	R100 000 per annum	Family
Scorpion Legal (Entry Level)	Legal Expense	R39	R45 000 per annum	Only civil or only labour	No Premium offering		
Edgars / Jet legal plans	Hollard	R39	R50 000 per matter		R59	R100 000 per matter	
Legal Best		R45	R45 000 per annum	Family	R95	R95 000 per annum	Family
Lipco	Absa Short Term Insurance	R53	R60 000 per annum	Family	R155	R200 000 per annum	Family
Lawyers Voice		R55	R30 000 per annum	Family, Property, Estate, Consumer, Vehicle, Housing, Debt	R120	R100 000 per annum	Family, Property, Estate, Consumer, Vehicle, Housing, Debt
FNB Justice1st	RMB Structured Insurance	R60	R60 000 per matter	Administrative	R190	R200 000 per matter	Administrative
Lesaka	Constantia Insurance Company	R60	R50 000 per annum	Family	No premium product		
Scorpion Legal	Legal Expense	R63	R55 000 per annum	Administrative	R96	R110 000 per annum	Administrative
Legal Defender	Constantia Insurance Company	R65	R200 000 per annum	Family	Only one product offered		
LegalWise	Legal Expense	R67	R67 000 per matter		R150	R150 000 per matter	
Multisure	Guardrisk Insurance Company	R68	R70 000 per annum	Family	Only one product offered		

Product	Underwriter	Entry level offering			Premium offering		
		Monthly premium	Cover	Other matters covered	Monthly premium	Cover	Other matters covered
LegalNexus	Constantia Insurance Company	R79	R80 000 per annum	Family	R105	R120 000 per annum	Family
Legal Edge / Guard	Centriq (cell captive)	R80	R40 000 per matter	Unclear from website	R130	R90 000 per matter	Unclear from website
Legal & Tax	Centriq (cell captive)	R90	R105 000 per matter	Family, Vehicle	R175	R175 000 per matter	Family, Property, Vehicle
Legalex	Guardrisk Insurance Company	R90	R45 000 per annum	Family	R110	R85 000 per annum	Family
My Lawyer		R99	R175 000 per matter	Family (contested divorce included), Vehicle	Only one product offered		
Hollard	Hollard	R120	R120 000 per matter		R200	R200 000 per matter	
Clientele	Clientele	R130	R130 000 per annum		R230	R320 000 per annum	
Legal IQ		No information available					

Source: Provider marketing material and websites as at April 2013 (My Lawyer as at August 2013)

Aside from stipulating annual or case-based limits, premiums are kept affordable by excluding certain matters. Policy documents typically contain a fairly extensive list of exclusions, the most common of which are listed below.

Table 4. Common exclusions

	Pre-existing matters
	Cases that are not deemed to have a reasonable prospect of success
	Cases where the costs are high relative to the value of the settlement
	Business matters
	Collective or group action
	Any matter that could be resolved by paying an admission of guilt fine
	Tenant and landlord related matters (where the client is the landlord)
	A dispute between the member and the legal insurance provider

Some policies specifically exclude family law¹⁷. Offerings that do cover family matters place specific limits¹⁸ on areas such as divorce that could easily lead to excessive claims. Some only cover uncontested divorces to mitigate risk.

While commonly excluded, a number of providers do cover intentional criminal acts, or as LegalWise terms them “serious offences”. These include murder, rape and robbery. In the case of LegalWise serious offences are covered if the policyholder has not claimed for such matters in the past and if he or she has not committed a serious offence in the past six years. Legal & Tax specifically excludes intentional criminal acts.

In some cases legal insurance providers exclude disputes between themselves, their employees or agents and the policyholder. This can be particularly problematic where the provider offers a range of other financial services (as is the case with Hollard) or is part of a bank (as is the case with FNB’s Justice 1st). In these cases, if a policyholder had a dispute relating to other products offered by the provider, they would not be able to use their legal insurance policy to pursue the matter. Some providers, such as LegalWise and Clientele, have avoided this by excluding disputes between themselves and a policyholder only where they arise from the legal expenses insurance policy itself.

¹⁷ LegalWise, Scorpion Legal, Legal & Tax (excluding the Prestige plan), Clientele (excluding unopposed divorce) and Hollard do not cover their clients for matters related to family law.

¹⁸ Lipco limits claims for contested divorces to R20 000 for Platinum policyholders and R10 000 for Gold policyholders.

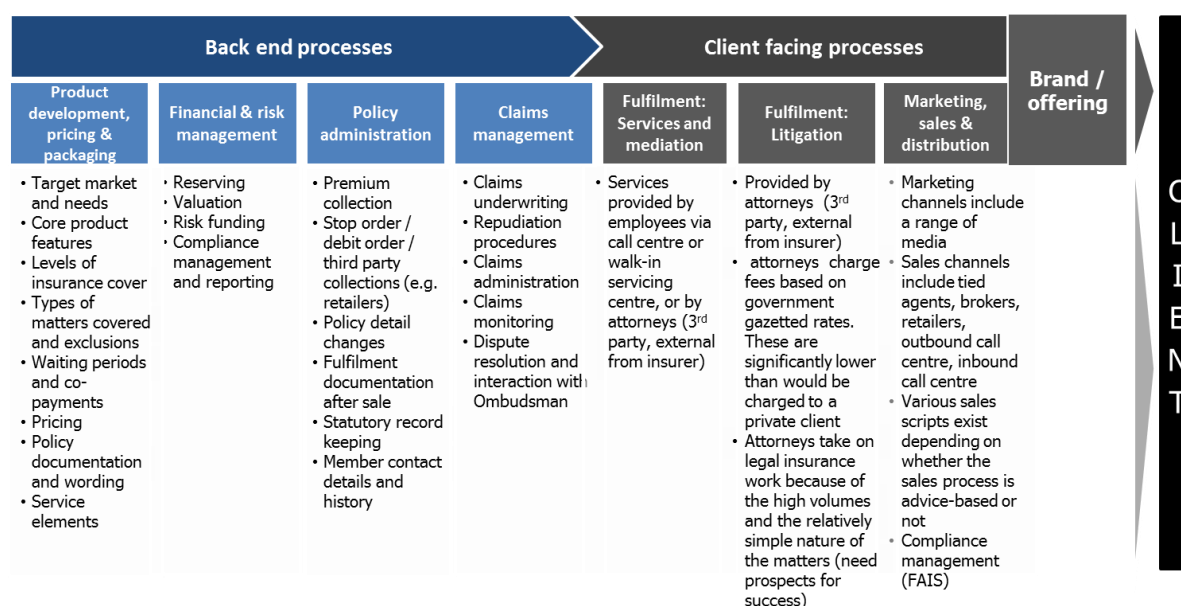
Most offerings do not have an excess or require co-payment when claiming. Where these are in place they are generally low and in some cases they fall away after time. For example, LegalWise has an excess of three months' premiums, which falls away once policy has been in force for 24 months¹⁹. In other cases excesses apply for specific types of matters. For example, Lexcorp has a R250 excess for family matters.

Access to legal advice is available to policyholders immediately after receipt of the first premium. However there is usually a waiting period of between one and three months before litigation cover is available. Extended waiting periods of up to six months are common for family matters such as divorce.

3.2 Key processes

There are a number of processes that underpin the provision of legal expenses insurance. These are split into back end and client facing processes. Key back end processes include product development and pricing, financial risk management, policy administration and claims management. Client facing processes include the provision of legal services as well as marketing and sales. These are summarised in the following framework.

Chart 4. Legal expenses insurance process framework



¹⁹ According to the LegalWise claims procedures, a member's excess will fall away if their first consultation takes place 24 months after commencement of cover. The same will apply if subsequent consultations occur 24 months from the last consultation. A member may still claim if 24 months have not passed but they will be liable to pay the excess.

Various licensing arrangements and operating models exist, and the combination of players and partners involved in delivering the legal expenses insurance offering often makes the term 'provider' an ambiguous one. For the sake of simplicity, and in line with the client-focused nature of this analysis, the 'provider' as referenced in this document is the brand seen and experienced by the client. It is noted that this does not always coincide with the entity that bears the insurance risk.

LegalWise and Clientele have their own short term insurance licenses and are fully integrated, offering an almost end to end service - with the notable exception of litigation services which in line with the existing legislation governing the legal profession must be provided by an independent firm of attorneys.

Hollard also has a short term license and offers products using two business models. The first offering is delivered in partnership with the Edcon Group and Europ Assistance to Edcon clients. Europ Assistance acts as a non-mandated intermediary and administers the product while Edcon markets and sells the product. Servicing is done by a law firm with a close relationship to Europ Assistance. This firm of attorneys is also the UMA.

The second offering is a Hollard branded product which is delivered in partnership with LegalWise. LegalWise does the administration, premium collections and legal servicing through its call centres, while Hollard markets and sells the product. Hollard underwrites the product but also reinsures a portion of this book with LegalWise.

While LegalWise and Clientele report legal expenses insurance activity separately to the Financial Services Board ("FSB"), all other insurers report legal expenses insurance under the 'miscellaneous' category which makes it difficult to get an accurate view on the size and performance of their legal expenses insurance activities.

In contrast, players such as Lipco²⁰ and Lexcorp²¹ are underwriting management agents ("UMAs") who act on behalf of insurers (in this case Absa Insurance and Santam respectively) in the provision of specialist, so-called 'binder' services, including product development, pricing, policy

²⁰ Lipco was started in 1993 as an offering to the security forces (SAPS, SANDF etc.). Currently Lipco has 80 000 main policyholders. It also distributes the product under 'white-labelling' agreements, the most significant of which is the Foschini legal insurance product that has 60 000 policyholders.

²¹ It was started as a cell captive in 1999 with a base of SANDF members under the name Legal soldier and underwritten by Lloyds. In 2005 it restructured as a UMA underwritten by Santam.

documentation, policyholder administration, claims management and the provision of legal services.

Because the UMA acts on behalf of the provider, it cannot at the same time, act as an intermediary on behalf of a client. In order to comply with this Lipco is split into two entities; Lipco General is responsible for administration of policies, premium collection and claims management while Lipco Business is responsible for sales, distribution and marketing.

While clients may view the UMA as the provider, technically the book belongs to the insurer, not the UMA. In theory the insurer could shift the book to another UMA without the consent of the client. Thus a policyholder who has purchased a policy which bears the branding of a specific UMA could end up being serviced by another entity.

FNB Life, a long term insurer (who cannot write short term business) acts as an intermediary for Justice 1st, a product underwritten by RMB Structured Insurance. Aside from distribution, FNB Life manages the claims process and operates a call centre staffed by legally qualified agents who provide some legal services. Its activities are largely the same as those undertaken by Lipco General and Lipco Business but because it is not a UMA it cannot share in underwriting profits. However, it can receive commissions from clients as an intermediary, as well as a range of fees as compensation for fulfilling key binder services.

Other providers such as Legal and Tax²² are structured as third party cell captives. A cell captive is an insurance vehicle created by an insurance company (referred to as the “cell provider” or “promoter”). This vehicle enables the insurer to extend its insurance license for use by another organisation (referred to as the “cell owner”) for the insurance of the organisation’s own assets or the assets and/or lives of its customers or policyholders²³. The cell provider reviews the proposed business to be written in the cell captive and determines the capital the cell owner will need to contribute to establish solvency on an on-going basis. The cell owner’s capital may be removed over time and replaced by accumulated profits. Any surplus may be extracted and any shortfall needs to be filled by the cell owner. The relationship between the cell owner and provider is governed by a shareholder’s agreement. The contents of these agreements may vary but in general they govern operational issues, how profits will be split and how risk is shared. The cell captive structure does

²² In addition to legal insurance Legal &Tax also offers tax advice to all policyholders and tax assistance to their top tier clients

²³ (Alchemy Consulting, 2010) The Role of Cell Captive Insurance in the Development of the South African Microinsurance Sector

provide some protection to the cell provider but ultimately it is responsible for any losses the cell captive or cell owners are unable to cover.

These models are overlaid on the organising framework explained below.

Chart 5. Legal expenses insurance processes and participants

	Back end processes			Client facing processes			Brand / offering
	Product development	Financial management	Claims management	Fulfilment: Legal services and mediation	Fulfilment: Litigation	Marketing, sales & distribution	
Short term insurance licence	Cientele				Outsourced to a firm of attorneys	Cientele call centre	Cientele
	Hollard (reinsured by LegalWise)		LegalWise			Hollard call centre	Hollard
	LegalWise					Worksite agents, LW call centre	LegalWise Scorpion
Intermediary	FNB Life	RMB Structured Insurance	FNB Life		Law firm with close relationship to Europ Assistance (Law firm is the UMA)	FNB Life	FNB Justice 1st
	Europ Assistance	Hollard	Europ Assistance			Edcon (Edgars / Jet)	Edcon (Edgars / Jet)
UMA	Lipco General	Absa Insurance	Lipco General		Outsourced to a firm of attorneys	Lipco Business Agents Foschini, Absa	Lipco
	Lexcorp	Santam, Centriq & Land Bank Insurance	Lexcorp	Outsourced attorneys		Brokers	Lexcorp
Cell captive	Legal Soldier	Centriq	Lexcorp	Outsourced attorneys	Outsourced to a firm of attorneys	Brokers	Legal Soldier/ Legal Access
	Legal & Tax	Centriq	Legal & Tax			L&T call centre, worksite agents	Legal & Tax

Given the focus of this report on the demand side and consumer experience, a number of key client facing processes including marketing, distribution and fulfilment of services (including mediation and litigation), are discussed in more detail below.

3.2.1 Marketing, sales and distribution

Providers typically follow a multi-channel distribution approach. The primary sales channels used by providers are call centres (inbound and outbound) and sales representatives. Affinity-based marketing is also common. For example, Hollard underwrites legal expenses insurance products offered by Edgars and Jet, and Lipco distributes its products to Foschini and Absa's retail customers. In addition, some providers, notably Cientele and Multisure, distribute the product using network marketing channels which pay referral commissions to various layers within the agent network.

LegalWise, Clientele and Hollard operate inbound sales call centres and generate interest in the product primarily by using infomercials, which typically include client testimonies and endorsements by respected community members or celebrities. Interested prospective clients contact a call centre to purchase the product. Typically inbound and outbound sales calls are recorded. Sales practices can be monitored and calls can be analysed in the case of a dispute.

Another key channel is worksite-based agents. LegalWise have a large number of sales agents who visit worksites in teams, while Lipco Business employs between 50 and 60 agents. Agents present an overview of the product to employees. Lipco agents do not actually sign-up interested clients; rather they assist with the completion of the application form. Once completed, forms are forwarded to Lipco Group (UMA) for capture of the new client's details; policy documents are prepared and premium collection is arranged. Sales representatives are paid a commission on each sale.

Distribution of the product is governed by the provisions of the Financial Advisory and Intermediary Services Act ("FAIS"). The FAIS Act, discussed in more detail in Chapter Five below, regulates the way in which intermediary and advisory services in relation to certain financial products are rendered to consumers. Inter alia FAIS requires that sales representatives who provide advice must write examinations as part of competence assessment. Providers have noted that existing curricula are not well suited to legal expenses insurance and that the additional regulations have made it more difficult and expensive to distribute the product. In light of this, some providers applied for and obtained an exemption²⁴ from the regulator for their agents while others have developed 'no advice' sales processes.

Box 1: Mystery shopping

Eighty20 purchased a number of policies during the course of the project via call centres and the web. Call centre agents described the product features and general terms and conditions. In some cases agents did not highlight exclusions or explain that the policy could be cancelled for a full refund within a certain time frame²⁵.

²⁴ Certain providers have received temporary exemptions from having to write the current RE2 examinations. This exemption is in place until such time as the regulator develops a more relevant examination. Intermediaries are still required to have a matric certificate and must have completed certain NQF levels.

²⁵ This is based on one phone call made to the following providers: LegalWise, Clientele, FNB Justice 1st, Scorpion Legal, Lipco and Lawyers Voice. This may not be the case in general.

While policy documents were often available online or were emailed immediately, in some cases providers could only make documentation available once debit order authorisation was in place. There is a cooling-off period and a no cost refund period. However, the onus is on the policyholder to contact the provider to cancel the policy.

Eighty20 cancelled policies purchased within the refund period. While all products were purchased over the phone, in some cases providers would not allow cancellation over the phone and requested proof by fax before the policy would be terminated and a refund processed.

3.2.2 *Claims and servicing*

Typically, legal expenses insurance providers employ in-house 'legally qualified' staff who offer access to legal advice and assistance as well as mediation services through call centres and in some cases walk-in servicing centres. In-house staff may have LLB degrees and some may have completed their articles. However, there is no industry standard in this regard and the term 'legally qualified' can be used fairly loosely. Because in-house legal services are not performed by a professional firm of attorneys, clients have no recourse to the profession if the quality of legal services or advice is poor.

Where litigation is required, providers refer the matter to one or more firms of attorneys, as legal expenses insurance providers are not able to own or operate a legal practice in line with existing legislation governing the legal profession. This is in contrast with European insurers who can own law firms and litigate directly.

Legal expenses insurance providers work closely with a pre-selected panel of attorneys who render legal services to policyholders when required. Rates are negotiated either per matter for more common claims such as unfair dismissals and contractual disputes, or discounted hourly rates apply based on government gazetted tariffs. The legal expenses insurance provider closely monitors progress and is provided with frequent updates to ensure that costs are contained and clients are provided with satisfactory levels of service.

*Box: Legal Aid South Africa*Organisational overview

Legal Aid South Africa provides professional legal services to individuals who would otherwise not be able to afford it. Each year Legal Aid provides assistance to approximately 250 000 individuals through its 32 Justice centres across the country as well as cooperation agreements with universities and legal clinics. During the 2011-12 financial year the Legal Aid Justice Centres finalised 402 459 matters.

Although Legal Aid South Africa is not technically a firm of attorneys, they have an exemption allowing them to offer articles to candidate attorneys. The organisation is the largest single employer of candidate attorneys in the country (over 600 recruited each year). In total it employs 1 700 attorneys. Legal expense insurers have indicated they would like the same exemption to offer articles.

Qualification for Legal Aid is determined by a means test based on individual and household income as well as the assets they possess. Certain individuals automatically qualify; these include individuals receiving grants, children and the elderly.

For other individuals qualifying criteria include the following:

- Individuals must earn less than R5 500 per month after tax
- Households must earn less than R6 000 per month after tax
- If a household owns its dwelling, its total value must not be more than R300 000. The household must also live in this dwelling and no one in the household may own other dwellings.
- If the household does not own the dwelling then the total value of their belongings must be below R75 000.

For the year ending 31 March 2012 Legal Aid's revenue was R1 159m. Ninety eight per cent of this was funded by grants. Expense totalled R1 130m with 75% going towards personnel and a further 7% towards administration.

While legal expenses insurers can negotiate more affordable rates, the process is not without its disadvantages. When a matter is referred to a panel attorney, the attorney has to deal with two clients; the insurer and the policyholder. The attorney is likely to have to manage two sets of communication, two sets of administration and manage two sets of expectations. This significantly

increases the administrative burden and together with lower negotiated tariffs makes it unattractive for more experienced practitioners, who already have private clients, to take on legal expenses insurance work. Those who do take on this work may well be less experienced and less able to attract fee-paying private clients. While this may not impact on the quality of legal services in simple matters, where matters are complex this can adversely impact on the client.

Box: Claims process description

The claims process is typically initiated by a policyholder who contacts his or her provider's call centre with a legal issue. The provider undertakes a first level of assessment to verify the policy status, determine whether any waiting periods or exclusions apply, and check if the client has reached any cover limits. If a matter is excluded or the policyholder has reached his or her cover limit, the provider may still, at its discretion offer legal advice or services. However litigation cover will be excluded and clients who proceed with litigation do so at their own expense. In some cases, panel attorneys will offer policyholders a discounted rate if a provider refers the case.

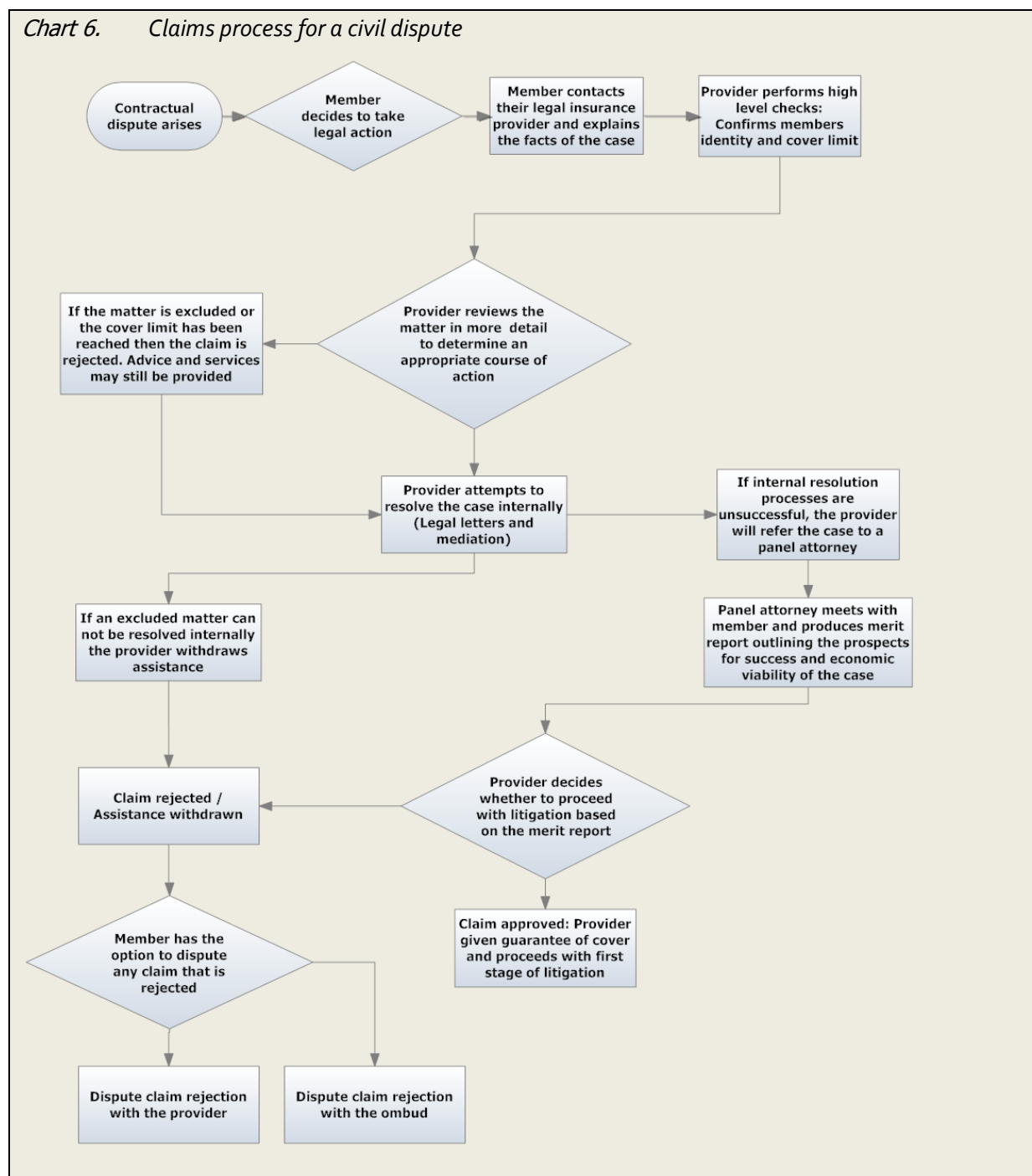
If the client is covered the claim progresses to the second level of assessment; this focuses on the nature of the underlying matter in more detail in order to determine the appropriate course of action.

In most cases providers attempt to avoid litigation as it is more cost effective to resolve the matter directly or to mediate between the parties.

In cases where litigation is required, the provider assesses whether the case has reasonable prospects of success or refers the client to a firm of attorneys to assess prospects of success. If the provider or attorney does not believe the case has merit the claim is rejected. If there are prospects for success the attorney is provided with a guarantee of cover by the provider and proceeds with the first stages of litigation. The provider remains in contact with the panel attorney until the matter is resolved or cover is depleted.

A high level overview of a typical claims process is summarised below for a civil dispute:

Chart 6. Claims process for a civil dispute



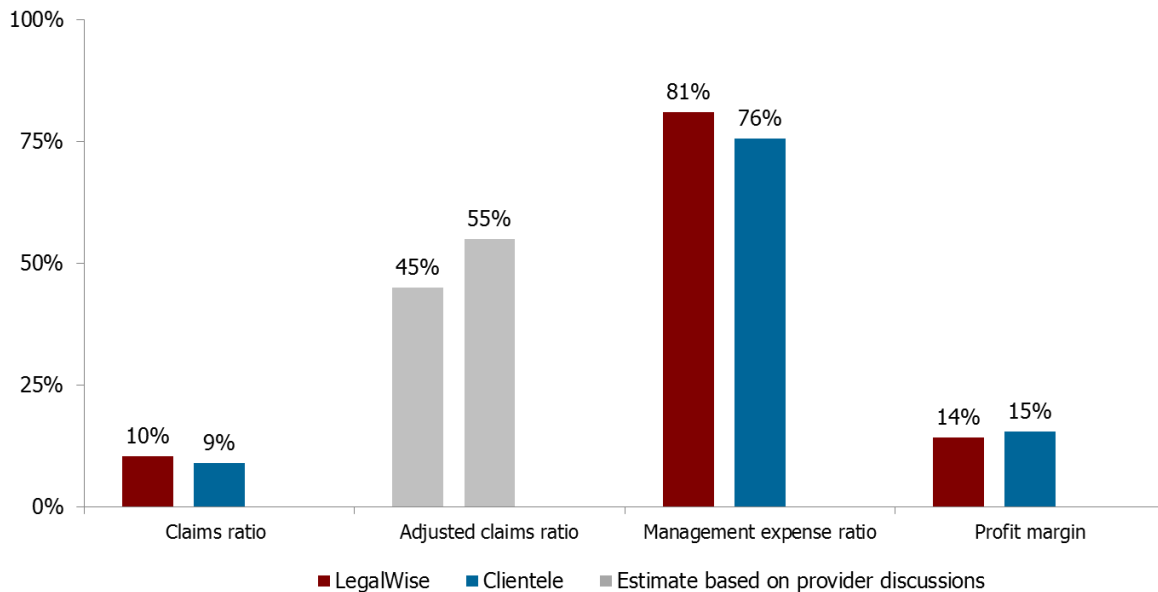
A review of financial results submitted to the FSB by LegalWise and Clientele²⁶ indicates that claims ratios²⁷ are particularly low when compared to other short term insurers; the claims ratios for the legal insurance providers LegalWise and Clientele are 10% and 9% respectively. These are significantly lower than the rest of the short term insurance industry which has an average claims ratio of 63%.

²⁶ Most insurers who offer the product do so as part of a portfolio of products and report on the product under the 'Miscellaneous' category together with other products. It is therefore not possible to explore their claims data. Only two insurers, namely Clientele and LegalWise report separately on this class of business.

²⁷ A claims ratio is calculated as the total value of claims incurred in a given year divided by net premium income

Low claims ratios reflect the legal expenses insurance business model. Only costs associated with litigation are regarded as claims costs, with costs associated with the provision of in-house legal services allocated as an expense. Based on discussions with providers if these expenses were regarded as claims a more comprehensive claims ratio including costs associated with providing access to all legal services would be between 45% and 55% of premiums.

Chart 7. Summary of 2012 financial ratios for LegalWise and Clientele



Source: FSB Statutory returns.

Comparing claims costs across providers is complex as it is not always easy to determine exactly what constitutes a claim and practices vary across providers. For instance, Clientele considers contact with a policyholder to be a claim the moment it moves beyond telephonic legal advice. If Clientele drafts a letter, assists a policyholder with mediation or proceeds with litigation, the value of this service is deducted from the policyholder's annual claims benefit. In contrast, LegalWise considers a matter to be a claim when it grants confirmation of cover to costs levied by an external attorney.

While the claims ratios are lower, expense ratios are much higher for legal expenses insurers compared to other short term insurers. LegalWise and Clientele have management expense ratios²⁸ of 81% and 76% respectively. These are more than double the rest of the short-term insurance industry which has an average management expense ratio of 31%. While this is in part accounted for

²⁸ The management expense ratio is calculated as the sum of "expenses for the acquisition of insurance contracts" and "other expenses" as a percentage of written premium income

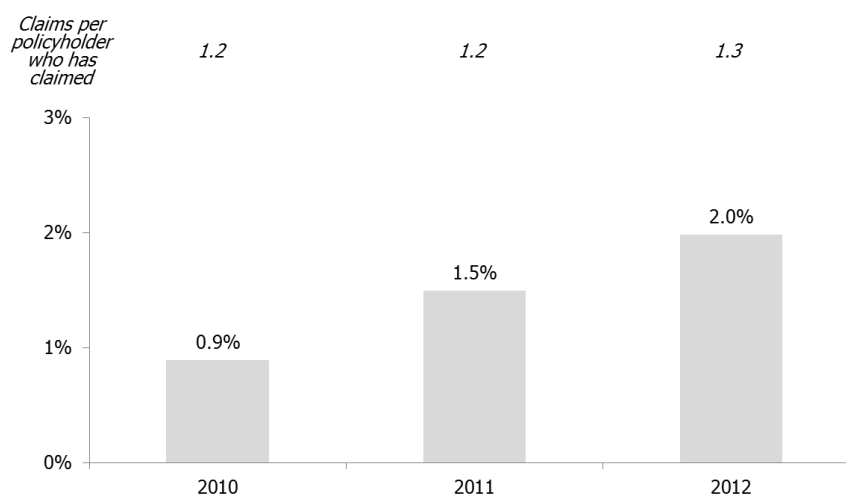
by high marketing and client acquisition expenses, this also reflects the high costs associated with providing in-house legal services.

Based on data submitted for a sample of providers approximately 20% of policyholders in any given year make use of legal services such as telephonic advice, drafting legal documents and mediation. These activities are not generally regarded as a claim by providers. One provider indicated that the number of calls they receive in a monthly is equivalent to roughly one fifth of the number of clients they have although no data was available with regard to the number of unique clients served.

A number of providers were approached to provide additional data to assess utilisation. Data was requested for a specific cohort of clients (those who joined in 2009) to ensure comparability across providers.

Data from providers for the 2009 join cohort of policyholders indicates very low usage of the litigation benefit. In line with reported claims ratios the percentage of policyholders who made use of this benefit ranged between 0.9% and 2% over the period 2010 to 2012. Of those who claimed the average claim per policyholder ranges between 1.2 and 1.3 claims per year.

Chart 8. Proportion of 2009 join cohort policyholders who claimed



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

Based on data submitted by providers, civil matters are the most common type of claim accounting for 48% of the claims in 2012. This is followed by criminal (35%) and labour (17%). Common civil matters include motor vehicle related claims, contractual disputes and debt related matters. According to one provider, the average litigation cost for a civil claim is R14 000. This is significantly

higher than the cost of the average criminal claim at R3 000. Labour related matters such as unfair dismissals, unfair labour practices and gaining access to employee benefits are the most costly to litigate. Depending on their complexity, they could range anywhere between R20 000 and R70 000.

On average 12% of claims are rejected each year. Unfortunately there is no data to assess whether this rejection rate is high or low relative to the short term insurance industry as a whole. Based on provider data, the most common reason for rejection is non-payment of premiums; this reason accounted for 51% of rejections in 2012. The second most common reason for rejection, accounting for 21% of all rejected claims is that the matter has no prospects for success²⁹. Given that the provider has a financial interest and stands to incur costs, which can be substantial where cases are complex, it is arguably unfair to policyholders that the provider assesses whether a case has prospects for success.

Providers have internal processes to review disputed claims. Typically an internal committee reviews the case. In some cases the provider will hire and pay for an external expert to review the case and make a second determination. Once internal dispute resolution mechanisms have been exhausted policyholders can appeal to the short term insurance Ombud. Unfortunately the Ombud does not publish any data relating to issues dealt with, and how disputes are resolved. However, based on discussions with past Ombudsmen, it appears that most disputes relate to claims rejected on the grounds of limited prospects of success.

Aside from reactive responses to policyholders who need legal assistance, some providers communicate proactively with policyholders, providing information in the form of brochures or periodic publications. LegalWise for example publishes a monthly magazine called WiseUp which is sent to policyholders and contains educational information on legal matters as well as marketing material and client testimonials. Providers also have useful information and legal resources on their websites. By way of example Lexcorp³⁰ has interactive online customisable templates for employment contracts, ante-nuptial contracts, wills, loan agreements and so on. While there is no data on how frequently policyholders make use of these services they can help to improve general levels of awareness about legal matters and enable policyholders to resolve some matters directly.

²⁹ This is followed by the cause of action pre-dating the commencement date of the policy accounting for 5% of claims that are rejected

³⁰ Lexcorp's resources are available to the public and not only to policyholders

4 Focus groups

This chapter summarises focus groups conducted in Cape Town, Johannesburg and Pretoria during February and March 2013. In total four discussion groups were held, three with participants that have or have had a legal expenses insurance policy and one with participants who have never had legal expenses insurance. A summary of the participant profiles is included as an appendix to this report. The primary purpose of the discussions with existing or past policyholders was to gain a better understanding of both perceived and actual client value offered by legal expenses insurance in terms of insurance cover and the other services that are offered through these policies. All discussions explored awareness and understanding of key terms and conditions that are typical of the product as well as client awareness of the role of regulators and mechanisms for recourse in the case of dispute with providers.

4.1 Legal insurance: Perceived value

The discussion in each of the four focus groups examined the perceived benefit of having insurance generally - and in the case of the three focus groups with legal insurance policyholders, the perceived benefit of legal insurance specifically. The discussions generated useful insights into the level of satisfaction that legal insurance policyholders have with their policies, and whether or not this level of satisfaction is linked to experience.

4.1.1 'Peace of mind'

Insurance has strong emotional connotations linked to 'peace of mind', and emotional wellbeing, a theme that was apparent in each of the four groups. This feeling was particularly palpable in the three groups of legal insurance policyholders.

Facilitator: "What does it mean guys? What is the benefit?"

R5: "It's the relief"

R6 and R9: "Peace of mind"

Facilitator: "How much value do you put to that peace of mind?"

R5: "You can't fight nobody (sic.) individually ..."

- Cape Town, Legal insurance policyholders

Respondents also associated having the product with a sense of safety and empowerment

R4: "I've got a lawyer on call"

R3: "I'm protected"

Facilitator: "How does that make you feel, the benefit of that?"

R4: "... if I'm in trouble, I know if I pick up the phone, LegalWise is going to help me as best as they can."

Facilitator: "How does that make you feel?"

R4: "Safe"

- Johannesburg, Legal insurance policyholders

"It's almost like having one [a lawyer] on retainer"

- Johannesburg, R1

(Legal insurance policyholder, female, 26, household income: R12 500 – R14 999)

4.1.2 Product satisfaction

In general, respondents with legal insurance policies expressed relatively high levels of satisfaction with the product, although this may partly reflect a survivorship bias in the respondent profile; only two participants across the three groups were lapsed users. Respondents who had received assistance with a legal matter were, in general, happy with the service they had received and the outcome of the matters handled.

"I've got legal insurance, I was retrenched without anything and I went and saw a lawyer that saved me thousands. So, yes, definitely it has helped."

- Johannesburg, R4

(Legal insurance policyholder, female, 44, household income: R15 000 – R17 499)

"I took Lipco out when they first started, I don't know how many years ago that was, I think it was 10, 12 years ago"

Facilitator: "But why?"

"They came to the (police) station to present, I thought that was a good idea because we had a lot of financial problems, like school fees and that weren't paid - everybody knows that. We get all these letters and stuff like that and I thought that could help... Lipco has helped me in about seven cases"

Facilitator: Really? So you're happy.

(All seven cases were successful)

- Cape Town, R5

(Legal insurance policyholder, female, 61, household income: R7 500 – R9 999)

Satisfaction levels were high even among those who never contacted their providers. One respondent in Cape Town had paid premiums for ten years without using any services until the week before the focus group [was the focus group a trigger?]. She maintained the product because she felt sure if she ever needed legal assistance she would be referred to competent lawyers. This was mirrored by other clients in similar positions; policyholders that had not used any services were largely satisfied because they believed providers would assist when they needed access to legal services, which was inevitable in their minds.

"You know, one thing that makes a person keep their insurance or not, is the value they see in it. You know, each time I make a change in my life there's always some legal connotation to it. For example if ... like now, I said earlier I'm in the market to buy property... clearly I will need some legal advice or there will be legal matters, so it's one of those things I definitely need to keep"

Facilitator: "So is there value for you?"

"A lot"

- Pretoria, R6

(Legal insurance policyholder, male, 33, household income: R12 500 – R14 999)

4.2 Legal insurance: Actual value

In some cases satisfaction and peace of mind reflected high expectations of the product, which may not be realistic.

"My expectation [concerning what the legal insurance policy covers] is, basically, everything that I find myself faced with that is a legal problem they should be able to help me"

- Johannesburg, R6

(Legal insurance policyholder, female, 25, household income: R15 000 – R17 499)

The discussions therefore explored the extent to which product user perceptions of value and 'peace of mind' derived from the product were aligned with the actual services offered and legal risks covered. In order to investigate this, a number of themes were explored, including:

- Respondents' understanding of how legal expenses insurance works,
- Respondents' familiarity with policy documents and understanding of the terminology typically used in those documents,
- Respondents' recollection of purchasing triggers and influencers, and
- Respondents' assessment of quality of the legal services

The discussions also included feedback on how the product could be improved.

4.2.1 How does the product work?

Respondents in each of the three legal insurance policyholder groups seemed to be aware that their policy incorporated the provision of on-going legal services, typically provided in-house by legally

qualified employees of the company, as well as professional legal services provided by lawyers on a referral basis. Policyholders also distinguished between resolution of legal matters through mediation and discussion, and going to court.

"You pay a premium, and if your matter is covered, they refer you to a lawyer."

Facilitator: "And then?"

"You must see a lawyer and your lawyer either tries to sort it out amicably..., if that doesn't work you go to court"

- Johannesburg, R4

(Legal insurance policyholder, female, 44, household income: R15 000 – R17 499)

There was, however, some confusion in the Johannesburg legal insurance policyholders group as to the distinction between the service offering associated with the products, and the insurance component. While providers typically categorise a 'claim' based on referral to an external attorney, some respondents felt that any legal service received, irrespective of who had provided it, had an associated monetary value, and was therefore a claim.

R4: "You don't claim back, they'll refer you to a lawyer and you just don't pay that lawyer"

Facilitator: "Is that a claim?"

R4: "Yes, that's how it worked with me..."

Facilitator: "Is that the claim?"

R4: "Yes"

Facilitator: "So, is it the same as getting advice, or is the claim different to getting advice?"

R4: "I don't understand?"

Facilitator: "You also said you'd phoned for advice?"

R4: "Yes"

Facilitator: "Do you see that phoning in for advice is a claim?"

R6: "Yes, there's a value attached to it [calling in for advice]"

Facilitator: "So it's a claim?"

R1, R2, R6: "Yes"

R4: "I don't know if you can call it a claim. It's a service that you're getting because you're paying for it. You're just picking up the phone and asking for legal advice"

- Johannesburg, Legal insurance policyholders

4.2.2 *Familiarity with policy documents and understanding of the terminology typically used in those documents*

A consistent finding throughout all four groups is that respondents do not read the terms and conditions of their insurance policies.

Facilitator: "Do you read everything on your policy?"

R1, R5, R6: "No"

Facilitator: "So, how do you expect to know how it works?"

R1: "We have a general idea"

R2: "I'll read it, only when it happens and you need to get money out of it, and then they throw the fine print at you"

- Johannesburg, Legal insurance policyholders

In some cases this was a function of the language in their policy documents, which many indicated was too difficult to understand.

R3: "There's language in contracts, especially with the fine print that would normally need a legal advisor to tell you what is meant by it. Where there is sometimes a Spanish code or whatever..."

Facilitator: "Spanish code? Is that how it feels to you?"

R3: "No, there is Latin code where they would maybe say section B05 and whatever. I don't know the Act, because I don't read or make it my deal to know the Act"

Facilitator: "But you all read your policy documents?"

R6: "As far as we can understand"

R3: "As far as we can understand, that's the actual truth"

Facilitator: "Do you read your policy documents?"

R6: "...You know what, I first think about what I need to be covered on... then I go look at the policy document if that's there, if it's there, the rest is ok."

- Pretoria, Legal insurance policyholders

This was evidenced by respondents' lack of understanding of some of the complex terminology extracted from legal insurance policy documentation. The focus group moderator read out clauses from a LegalWise policy document to explore reactions:

Facilitator: "Here's another one [what does this mean?]. 'We do not pay legal expenses, if the matter arises out of, or is based on, or relates to any of the following: a cause of action which is vexatious or malicious, or the proceedings themselves are vexatious or malicious.'

R3: Is that French?

R5: (laughs)

R4: Malicious we understand, 'fictitious' what?

R5: 'Fictitious?'

- *Pretoria, Legal insurance policyholders*

Facilitator: "Period of indemnity? What is a period of indemnity?"

R6: "No idea"

R1, R4: "I don't know"

R2, R3, R5: (silent)

- *Johannesburg, Legal insurance policyholders*

Facilitator: "We don't pay legal expenses that are punitive cost awards [what does this mean]?"

R6: "Sho" (laughs)

Facilitator: "So no, we have no idea"

(Nobody in the group knew)

- *Pretoria, Legal insurance policyholders*

While it is to be expected that policyholders would not understand complex terminology, it appears that even basic insurance and legal terminology is not well understood.

Facilitator: "What are waiting periods?"

R1: "It's the cooling off period, so if you sort of..."

R1: (pause, confused)

R1: "I don't want to sit in jail for five weeks while somebody tries to get their papers together"

Facilitator: "Is that what you think of waiting periods?"

R6: "The processes that need to take place"

Facilitator: "... the legal processes?"

R7: "Wouldn't the waiting period mean you've got an existing thing you're not allowed to claim on that? ... With a medical aid, a waiting period is if you've got a condition now you can only apply for that condition to be paid in a year's time."

Facilitator: "So that's with if you have a case at the moment, you can't have another case?"

R7: "Yes"

- Johannesburg, Non users

Facilitator: "What is the difference between civil, criminal, labour?"

R5: "Civil is in the family, criminal is when there's a crime committed and labour is work related"

Facilitator: "... If I slap my sister around, is that civil, in the family?"

R5: "Yes"

R2: "No, that must be criminal, you'll go to jail"

- Johannesburg, Legal insurance policyholders

Facilitator: "What exactly is litigation?"

R2: "Litigation, litigation" (thinking)

R1: "Isn't that where you're being sued or suing or you're going through a legal proceeding? Isn't it something along those lines?"

R2, R3, R4, R5, R6: (unsure)

- Johannesburg, Legal insurance policyholders

Facilitator: "Firstly, what is litigation? Do you know?"

R1: "No, I don't"

R5: (Shakes head)

Facilitator: "What is litigation?"

R2, R3, R4, R6: (silence)

Facilitator: "Don't know"

(Nobody in the group knew)

- Pretoria, Legal insurance policyholders

It is noted that the word 'litigation' is used in the description of policy benefits by most providers (for example: "Our Classic Product: R60 000 Litigation cover per year").

Given that the majority of respondents either admitted to not reading the fine print in their policy documents or not understanding the fine print if they did attempt to read it, it is not surprising that there is often a gap in understanding of the policy benefits and exclusions. In some cases specific examples of matters that are excluded were cited as examples of how policies can help.

Facilitator: "Do they keep you out of jail?"

R4: "Yes, they do, absolutely"

Facilitator: "What other things?"

R4: "Motor car accidents, drunken driving..."

Facilitator: "Will they help you with drunken driving?"

R4: "Absolutely"

Facilitator: "Even if you're guilty? ..."

R4: "Yes, absolutely"

- Johannesburg, R4

(Legal insurance policyholder, female, 44, household income: R15 000 – R17 499)

Respondents discussed anecdotes of people they knew of who had had a poor experience with a legal insurance policy as a result of misunderstanding the terms and conditions of their policy.

"My mother has legal insurance, and when she had a divorce first thing she thought was, let me go to my insurance. And she gets there and they said, no sorry, she's not covered. She spent quite a lot of money in that whole process and she still is. Like I said, it's part of the fine print as well, but she didn't understand that from the beginning, you know, she wasn't aware"

- Johannesburg, R6

(Legal insurance policyholder, female, 25, household income: R15 000 – R17 499)

Most respondents were not aware that if a 'reasonable prospect of success' does not exist, their legal insurance policy would not cover the case. However during the course of discussion, many felt this was a positive aspect of their policy; they appeared to be satisfied that providers would fairly and professionally assess the merits of any case and that rather than prejudicing their interests, this assessment would protect them from entering into lengthy court battles that had little chance of success.

4.2.3 Distribution

A common theme within the legal insurance policyholder focus groups was that the purchase of the product had been triggered as a result of an experience where legal assistance was required but was not accessible without a legal insurance product. In some cases this had led to clients taking up legal insurance but having their claims rejected because the cause of action relating to their claim had arisen prior to the commencement of their policy.

"I wanted to fight them in court, ... so I got Legal & Tax ... So I took out Legal & Tax and I let it build up a little bit and I phoned up Legal & Tax and said, listen here, this is the situation... So they said to me, sorry, we can only help you if it happened while you were with Legal & Tax. You know what, something can still happen, so I'm going to still keep my Legal & Tax, I'll continue paying you guys, but you know what screw you, because you said to me in the beginning that you'll cover this - and then I paid and I paid and I paid and then they wouldn't cover it. So now I'm going to Legal Aid lawyers...."

Facilitator: "... are you not suing Legal & Tax?"

"No no no, I'm not suing them I'm still going to carry on paying them"

Facilitator: "Why, Why are you going to carry on paying them?"

"Because something is going to happen, just wait, you'll see. They'll cover it..."

- Cape Town, R1

(Legal insurance policyholder, female, 22, household income: R20 000+)

In contrast, the respondent below allowed her policy to lapse as a result of having misunderstood the exclusion of pre-existing matters.

Facilitator: "Why did you take out your insurance?"

"In 2010 I was working in a certain company. I had to come back and work for them for a year. I never came back and I went to another hospital in 2011 so I took out LegalWise in 2011 and the company started to sue me last year December. When I consulted my LegalWise they said that they don't cover the pre-existing events."

Facilitator: "Oh, okay. So you were sued and then you took out the insurance"

"No"

Facilitator: "You took it out first and then you got sued"

"I took it first in 2011, but I left the company in 2010. Last year they started to sue me but they said they could not cover me because it was a pre-existing problem."

- Pretoria, R5

(Lapsed legal insurance policyholder, female, 27, household income: R10 000 – R12 499)

In other cases, respondents had sought out a legal insurance policy after they had had to deal with a legal matter. In the instance below, the respondent had to make use of a microloan in order to pay off legal expenses on behalf of a family member (prior to purchasing legal insurance). Subsequently, she obtained a legal insurance policy.

Facilitator: "Just refresh my memory, how did you buy your legal insurance? Who sold it to you?"

"My dad came to me and told me that we have to have a legal protection plan"

Facilitator: "Because of what happened to your brother"

"Yes"

Facilitator: "But then how did you go about getting it?"

"My dad saw someone that he talked to. I think those guys who walk street by street and talk to you about the legal plans. "

Facilitator: "So one of those guys?"

"Yes"

Facilitator: "And did you at that point of time ask any questions about the company? I mean Scorpion... hello, Scorpion is a thing that stings you. Did you ask them anything about Scorpion?"

"Yes, I did. I asked them if they will give me any advice if I needed any advice. They told me that if I needed advice I can come."

Facilitator: "Did you ask any questions about the actual business that is going to give you this advice and all that?"

"No, I did not"

Facilitator: "You didn't. So the guy was good"

"Yes, the guy was good"

Facilitator: "Was he good looking?"

(laughter). "He was good, he was selling the company good."

- Johannesburg, R3

(Legal insurance policyholder, female, 34, household income: R12 500 – R14 999)

In many cases the legal insurance purchase decision was triggered by the respondents' sense of vulnerability with regard to legal matters. As is the case with many insurance products, this fear is referred to in the sales process.

"You know, they call you and make you see the bigger picture... you know what actually happens is that they make you so scared that you don't want to not have it."

- Pretoria, R1

(Legal insurance policyholder, female, 33, household income: R12 500 – R14 999)

Some of those who did not have legal insurance expressed feelings of vulnerability regarding legal issues;

"I can't understand, I'm a reasonable educated person and if I go to the post box or somebody's there and there's a summons, it puts the fear of God into me. I don't know why, but it does. It's the fear of an unknown. You don't know what it is. I don't know enough about legal things to know what my rights are."

Johannesburg, R7 (Non-user, female)R7: "I'm beginning to think that if you've got a legal problem and you've got a lawyer you don't need to worry about it."

R2: "we fear to go to jail..."

R5: "It's true, hey, it's very true."

R2: "If you're not having a lawyer, you'll wait in jail until the son of Jesus comes."

- Johannesburg, Non-users

4.2.4 Quality assessment

The discussion explored participants' perceptions of the quality of service. In general the discussion focused on indicators such as turnaround time, frequent progress reports and staff attitude, which are fairly transparent.

Facilitator: "How do you rate the service at the legal insurance?"

"With me, when I needed advice from Scorpion, I decided I like to have physical contact with someone"

Facilitator: "Yes, face-to-face contact"

"So I phoned them and asked them, where are you? They told me, then I went to Belville. When I got there, there were a lot people there, so I had to wait for a long time before I could be helped. But, when I went there, the guy was in a hurry. I was not like I feel happy that he had enough time to sit there and listen to my case ... after waiting for a long time"

- Cape Town, R7

(Legal insurance policyholder, female, 56, household income: R10 000 – R12 499)

Users were less clear as to how to assess the quality of legal advice. Respondents in the Pretoria focus group appeared to place a large amount of trust in the advice they receive through the legal insurance call centres that their policies provide, without being particularly sure of the qualification of the person that they speak to when calling in for advice.

Facilitator: "How do you know you spoke to a lawyer?"

R2: "Well that I cannot confirm that I spoke to... but I believe I spoke to somebody who knows about [law]"

Facilitator: "When you phone in do you speak to a lawyer?"

R3: "I don't know, but I don't think so, I think it's a call centre"

Facilitator: "What do you say?"

R4: "I think it's people that do practise law, because how else would they know all these things that you ask, you know what I mean?"

- Pretoria, Legal insurance policyholders

There was also limited ability to assess the quality of panel lawyers that clients are referred to:

Facilitator: "What is the quality of the lawyers that these legal insurance companies refer you to?"

R5: "They are professional, professional"

All: (general agreement)

R9: "Yes, they're advocates"

- Cape Town, Legal insurance policyholders

The quality of the panel lawyers that clients are referred to were most often assessed according to aesthetic indicators – whether or not they had offices, how professional those offices appeared and whether they had a secretary.

Facilitator: "... Is it important that they have offices?"

R3, R6: "Yes"

Facilitator: "What would you think if they didn't have an office? If he just consults you at the Wimpy?"

R3: "I would be concerned; I would be worried, I would be skeptical"

Facilitator: "Could be dodgy now, so he should have offices. Should he have a secretary?"

R3: "... Presentation, the way they present themselves to me, you know, that is the first thing I'm going to look at. They've got nice offices, they look professional, when I get there they are busy, you can see people are coming in and out there working..."

Facilitator: "Are those things important guys? Does it add to our perception that I'm going to get quality?"

R1: "It puts you at ease"

- Pretoria, Legal insurance policyholders

4.2.5 Improving the offering

A respondent in the Pretoria discussion group, summarized how he felt legal insurance companies could improve their service offering.

"... I would agree 100%, because honestly I'm not sure [of the full extent of my policy]."

Facilitator: "Whose job is it to tell you how all of these things work?"

All:(silence)

"I think the service provider, you know the service provider should be able to be open with me. And open I mean, for example all of those things, when you sign a contract nobody's sitting there with you, they all tell you we've got a cool off period maybe of seven or ten days, take the contract with you. You have signed it, take it home with you, if you need to cancel, you can do it within ten days or whatever. But, the bottom line is most of the time nobody sits with you and goes, like we went through this, this is what 'vexation' means, this is what 'indemnity' means, this is what 'litigation means, you know. They didn't do that with me..."

- Pretoria, R3

(Legal insurance policyholder, male, 34, household income: R12 500 – R14 999)

Many respondents indicated that they felt their legal insurance policy should have a role in empowering them and educating them about legal issues rather than focusing only on solving problems.

Facilitator: "I hear education, what do you say they can do more to add value to your life?"

R4: "Bursary"

R5: "I would also say education"

Facilitator: "Educate me. Tell me about my rights. Tell me about my rights, tell me where I stand"

R3: "Education and information"

Facilitator: "Education and information"

R1: "I agree with that 100%"

- Cape Town, Legal policyholders

Interestingly, participants highlighted the value of the focus group discussion in helping them to think about how to get the best value from their legal insurance policy.

"This is eye-opening..."

Facilitator: "Do you think people should be shaken up about legal insurance?"

"Yes, I think more educated on what you can phone for, what you should [do], you know, just to get advice"

- Johannesburg, R1

(Legal insurance policyholder, female, 26, household income: R12 500 – R14 999)

4.3 Accreditation

Respondents were asked how they would identify a proper insurance company. In three of the four focus groups the regulator was only brought up in discussion when respondents were prompted. This section explores two topics: (1) how respondents would identify a 'proper' company when purchasing an insurance product, and (2) what role the regulator and ombudsman play according to the opinions of the focus group respondents.

4.3.1 What is a proper company?

Respondents from each of the four groups linked the notion of a 'proper company' to advertising campaigns. Some of these advertising campaigns reinforce the emotional sense of empowerment that many respondents felt was a benefit of owning a legal expenses insurance product.

Facilitator: "What should an insurance business do for us to get the message that they are proper and legit and credible?"

R6: "They've got to have a reputation"

Facilitator: "How do they get that reputation?"

R6: "Word of mouth"

R2: "Been in existence for a couple of years"

R9: "Established company"

Facilitator: "Established"

R5: "You have to know, this is Christine she's with LegalWise and I can speak to her in her office"

Facilitator: "Word of Mouth"

R5: "Not word of mouth"

Facilitator: "A representative"

R5: "Face-to-face consultation"

Facilitator: "So they should have an office, offices"

R9: "Offices"

R2: "Preferably all over the country"

Facilitator: "So they represent a footprint, in other words"

R5: "LegalWise is in Johannesburg as well"

Facilitator: "What about the advertising thing, should they be visible?"

R5: "They are, they do, LegalWise, two years ago was in the mall in Mitchells Plain... and then they're youngsters, different Coloureds and Blacks, and then they advertised LegalWise and then I [signed up]"

- Cape Town, Legal insurance policyholders

The most common reference made was to LegalWise's campaign, even in the discussion group without any legal insurance policyholders:

Facilitator: "It's expensive to go the legal route. So what do we do? How do we handle these things?"

R4: "Don't get into trouble"

R5: "... behave"

R6: "Get insurance, that's the bottom line"

R5: "Don't talk to me, talk to my lawyer"

- Johannesburg, non-users

4.3.2 *The role of the regulator and ombudsman*

In some cases Financial Service Provider registration was cited as a method of identification of a 'proper' insurance company, however when prompted, respondents acknowledged that in practice they did not use this information. Even those respondents who were aware that insurance companies need to be registered as Financial Service Providers still found advertising, company reputation and word of mouth to be the key indicators they considered when assessing whether an insurance company was legitimate.

Facilitator: "How do we know, how we assess an insurance company to know it's a proper insurance company?"

R4: "Prime time advertising time, those adverts cost hundreds of thousands"

R3: "Google it..."

R4: "How long have they been around for?"

R1: "A registration number, to make sure that they're registered, as a company.... I think you can look it up"

R6: "...FICA numbers, the financial ...FSP..."

R4: "You belong to a board"

Facilitator: "Do you look at that before you pay your money over?"

R3, R4, R6: "No"

Facilitator: "So is it really that important?"

R4: "To me that wasn't"

R2: "It is important but we don't look at it"

Facilitator: "So let's get real, what are the things that are really important?"

R1: "It's in your face"

R4: "It's advertising"

Facilitator: "Anything else?"

R4: "And I also wanted to know how long they'd been around for. If LegalWise had been up and running for a month I might have reconsidered, but I know for a fact they've been around for many, many years and they're still going strong"

R5: "It's word of mouth as well because I know people that belong to that same insurance company"

- Johannesburg, Legal insurance policyholders

The Pretoria focus group participants had fairly high levels of education, and were quick to mention the regulator. However, they did acknowledge that they simply assume that insurance companies are regulated without checking.

Facilitator: "Ok, I'm just talking now, are they regulated?"

R4: "I mean, we assume they're regulated, I mean the fact that they've been there the longest and what not... and we haven't heard in the media stories of them doing this and that, so you assume."

R5: "We just assume."

Facilitator: "We just assume. So if we're really honest with ourselves, we just assume..."

- Pretoria, Legal insurance policyholders

5 Regulatory review

The legal expenses insurance industry is currently governed and affected by two key pieces of legislation; the Short-term Insurance Act and the Financial Advisory and Intermediary Services Act ("FAIS") as well as the regulations made in terms of this legislation. Within the regulations to the Short-term insurance act, the Policy Holder Protection Rules ("PPR"), Binder Regulations and Outsourcing Directive 159.A.i have the most significant impact on consumers.

In addition to these acts, two additional proposed pieces of legislation could have implications for the legal expenses insurance industry. These are the Micro Insurance Act and the Treating Customers Fairly ("TCF") initiative launched by the FSB.

Each of these regulations and their implications for legal expenses insurance are explored in more detail below.

5.1 *Short-term insurance act*

Short-term insurance is principally regulated by the Short-Term Insurance Act No. 53 of 1998. The act seeks to regulate the industry from both a prudential and a market conduct perspective. The act provides for the registration of short-term insurers and prohibits any person or entity from carrying on the business of short-term insurance without being properly registered. The Act defines certain types of policies but does not define legal expenses insurance specifically; the product is regarded as a 'miscellaneous' product. Extensive regulations have been promulgated by the FSB in terms of Section 70 of the Act which are increasingly focused on governance and risk management, but also the regulation of the relationship between insurers and intermediaries, as well as outsource service providers rendering services to the insurance industry.

5.1.1 *Policy holder protection rules*

The Policy holder protection rules ("PPR") were primarily introduced to provide similar protection to consumers who interact with direct marketers, as the FAIS Code of Conduct offers to policyholders who interact with insurers via intermediaries or brokers and to provide certain minimum safe guards. Unfortunately the relationship between the FAIS Act and the Policyholder Protection Rules has never been clearly defined; this creates the potential for confusion and uncertainty between PPR and the FAIS Code of Conduct.

The Policyholder protection rules stipulate a minimum grace period for the payment of premiums of not less than 15 days after the relevant due date. In addition they govern claims processes and include the following:

- Insurers must adjudicate a claim within a reasonable time period
- Where claims are rejected policyholders are entitled to reasons and can appeal within 90 days
- The insurer must notify policyholders of the right to lodge a complaint under the FSOS Act (which provides for access to a voluntary Ombud) in plain and understandable language
- Policyholders can institute legal proceedings within six months after the insurer finally informs the policyholder of its decision in relation to the matter

While these rules provide some measure of protection for legal expenses insurance policyholders they do not cater for the specialised nature of the product. PPR governs short term insurance contracts, not the provision of legal services. While policyholders are made aware of their right to approach the statutory or voluntary Ombud if they are dissatisfied they are not necessarily informed of their right to approach the Law Society or Bar Council if they believe their attorney or advocate has not acted in their best interests or has acted unethically. The relationship between the insurer and the person/s providing legal services is often little understood and the potential conflict of interest this creates is seldom, if ever, addressed.

5.1.2 *Binder regulations*

The binder regulations introduce the concepts of a mandated intermediary³¹, a non-mandated intermediary³² and an underwriting management agent ("UMA"). Intermediaries previously functioning as "administrators" for insurers now have to choose whether they wish to function as a non-mandated intermediary or a UMA.

An "underwriting manager" is an entity that performs one or more of the binder functions on behalf of an insurer. These functions are:

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

³¹ A mandated intermediary is defined as an independent intermediary that holds a written mandate from a policyholder to perform any act, including termination, in relation to a policy that legally binds that policyholder

³² A non-mandated intermediary is defined as a representative or an independent intermediary, other than a mandated intermediary or an underwriting manager. In the retail environment intermediaries are non-mandated

- the settlement of claims under a short-term policy

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

The Binder Regulations have attempted to regulate the payment of fees and other considerations by insurers to intermediaries. An insurer is entitled to pay to a binder holder a reasonable fee for services rendered under the binder agreement. In addition to this fee for service, a UMA is entitled to share in the profits of the insurer attributable to the type and kind of policies covered by the binder agreement. However mandated and non-mandated intermediaries may not share in the profits.

These regulations may have inadvertently led to a situation where intermediaries are now able to receive greater remuneration than they previously did. Remuneration of intermediaries can incorporate fees relating to the performance of certain designated functions as well as commissions and can include:

- fees negotiated with client for intermediary services rendered to the client, such as advice
- statutory commissions
- binder fees for the performance of binder functions, payable by the insurer
- outsource fees for the performance of outsourced functions, payable by the insurer

A drawback of the binder regulations in the case of low value premium products such as legal expenses insurance lies in the difficulty and cost of distribution. Because UMAs cannot act as intermediaries they must rely on brokers to sell the product. However given the low potential commissions or fees generated by the product, brokers have little incentive to do so. The cost of complying with regulatory and other obligations imposed upon both the broker and the UMA may render it uneconomic to market low premium products. This will be aggravated by the full introduction of the Insurance Laws Amendment Bill, 2013 and the Pillar 11 Interim Requirements on Governance, Risk Management and Internal Controls.

The binder regulations also appear to have created considerable confusion. By way of example, Lipco, which previously functioned as an “administrator” restructured its business into two separate

legal entities, one dealing with administration and servicing of claims and the other with sales. However, in the eyes of the consumer there is no distinction between the two entities and the potential for conflicts of interest between the roles remains. Further, while the name of the short term insurer is disclosed on policy documents, policyholders are unlikely to be aware that they are not insured by the UMA with whom they interact but with the insurance license holder and would in all likelihood be surprised to find that the insurer can place the book of business with another UMA, or can bring the binder activities in-house.

5.1.3 *Outsourcing directive*

The Outsourcing Directive acts as a complementary measure to the Binder Regulations and deals with matters other than the performance of binder functions. It aims to prevent the abuse of insurance licenses where insurers have little infrastructure or ability to conduct the business of an insurer, but effectively operate as a franchise module by lending out their license to others.

The Directive applies to all aspects of the business of insurers which may be outsourced to another person, but specifically does not apply to intermediary services. It sets out the general “over-arching requirements” that an insurer must comply with when outsourcing any aspect of its insurance business.

As a key principle the Directive requires that the Board of Directors and managing executives of an insurer remain responsible for the insurance business of the insurer, regardless of any outsourcing. It also states that an insurer may not outsource any function or activity if the outsourcing may materially cause risk to the insurer, materially impair the quality of the governance framework of the insurer, impair the ability of the Registrar to monitor the insurer’s compliance with its regulatory obligations or compromise the fair treatment of and satisfactory service to policyholders.

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

It is not clear whether the outsourcing directive would apply to legal expenses insurers with regard to the provision of litigation legal services provided by attorneys. On the one hand, the insurer has an obligation to fund, rather than provide, legal services. Further, because the insurer cannot by law provide the litigation services the function cannot be thought of as ‘outsourced’. On the other hand

because the insurer is, in most cases, fully in control of the process of selecting and managing attorneys, it is more than just a funder. While further clarity is required on this matter from the regulator it is not clear what additional operational obligations there would be for insurers if the directive did apply. While insurers already closely monitor the litigation process from a financial perspective, they may well have to monitor the professional conduct of attorneys more closely. In addition the regulator may need to inspect processes and ensure compliance with this requirement, placing additional strain on both insurers and the regulator.

5.1.4 General comment: Impact of the Short Term Insurance Act on the industry

Given that the focus of this study is on market conduct and the consumer, prudential regulations were not explored in detail. However providers highlighted that requirements in this regard are onerous and arguably overly cautious given the mechanisms that are embedded into contracts to limit the liability of the insurer. They highlight that loss ratios are generally lower, the risk spread is far wider and the individual claim exposure more limited than is the case with short term insurance more generally. Providers also highlighted that the requirements for registration are onerous, and that the costs involved in establishing and complying with regulations are high. This acts as a significant barrier to entry leading to the limited number of specialised legal expenses insurers in the South African market, and the relatively high proportion of providers who operate as UMAs, intermediaries or cell captives. Together with relatively poor enforcement, it is also a factor leading to the emergence of unregulated providers.

5.2 The Financial Advisory and Intermediary Services Act (FAIS)

The FAIS Act No. 37 of 2002 governs the activities of financial services intermediaries and brokers. It introduced statutory obligations on the part of the financial services intermediaries which are to be regarded as minimum standards aimed at the protection of consumers. Where factual information is given relating to the description of any financial product or when answering to routine administrative queries, or information is disseminated through the display or distribution of promotional material, this does not constitute advice (as defined) and such activities fall outside the scope of the FAIS Act.

5.2.1 Fit and proper requirements

In order to obtain a license an applicant must satisfy the Registrar that he / she complies with the requirements for fit and proper status for financial services providers. This includes:

- Personal character qualities of honesty and integrity

- Financial soundness and competence
- Operational ability to fulfil the responsibilities imposed by the FAIS Act

Intermediaries must write exams to obtain accreditation. The syllabus for short term insurance accreditation does not however deal with legal expenses insurance and is in the main irrelevant for this class of business. The Registrar is empowered to exempt certain activities from the provisions of the FAIS Act. This provision allows some flexibility in certain areas.

Legal expenses insurance providers have responded to FAIS in various ways. Some have obtained a temporary exemption for intermediaries who sell their products from having to write the current RE2 examinations. In order to obtain this exemption, insurers have to prove that the current examination is not well suited to the product they provide. This exemption is in place until such time as the regulator develops a more relevant examination. Although intermediaries are exempt from this examination, they are still required to have a matric certificate and certain NQF levels.

These exemptions are not universally applied across the industry. Other providers have adopted no-advice sales processes while others have developed multiple-stage processes comprising a no-advice pre-sale process that generates leads followed by a call centre based sales process conducted by accredited agents.

According to providers, costs to comply with FAIS are high. This has a material impact on the costs of distribution and by extension, on the premiums associated with the product. Further, because FAIS requirements are not aligned with the needs of the product this additional cost comes with limited commensurate benefit to consumers.

5.2.2 General code of conduct for authorised FSPs

In addition to the fit and proper requirements, the regulation of the relationship between intermediaries and their clients was further enhanced through the introduction of the General Code of Conduct for authorised FSPs and representatives. The Code sets out the minimum standards for the rendering of advice and associated services between financial services providers and their clients. The general duty of the provider in terms of the Code is at all times to render financial services honestly, fairly with due skill, care and diligence and in the interests of clients and the integrity of the financial services industry. When a provider renders a financial service any representations made or information provided to a client must be factually correct, *must be*

provided in plain language to avoid uncertainty or confusion and not be misleading, must be adequate and appropriate in the circumstances of the particular financial service *taking into account the factually established or reasonably assumed level of knowledge of the client*, and must be provided timeously so as to afford the client reasonably sufficient time to make an informed decision about the proposed transaction (italics added).

The requirement for representation to be in plain and simple language is of specific importance in the legal expenses insurance industry. In addition to generally poorly understood financial and insurance related terminology common to insurance contracts in general, these policies have the added complexity of legal terminology. Consumers are therefore at even more risk of not understanding exactly what they are purchasing and what they are covered for.

5.2.3 Statutory OMBUD

The FAIS act provides for the creation of a statutory Ombud. The role of the Ombud is to enforce the provisions of the FAIS Act, including the Code of Conduct, and provide a cost free mechanism for consumers with complaints or disputes to obtain redress through alternative dispute resolution mechanisms.

The FAIS Ombud may also award an amount as fair compensation for any financial prejudice or damage suffered. The Ombud is also entitled to make any other order which a court may make, including the granting of costs. Any determination made by the Ombud is regarded as a civil judgement of court and is only appealable to the Board of Appeal with the permission of the Ombud or Chairperson of the Board of Appeal.

Where a consumer concludes a contract of insurance with a Short Term Insurer who is a member of The South African Insurance Association (SAIA) they may in addition, in the event of a complaint or dispute, also approach The Ombudsman for Short Term Insurance, or if the contract is one relating to long term insurance, then the Ombudsman for Long Term Insurance. This plethora of Ombuds, some with voluntary based jurisdiction and some with statutory jurisdiction, however further serves to create confusion in the minds of consumers, especially as the FAIS Ombud can exercise simultaneous jurisdiction with other Ombud schemes. This may lead to “forum shopping” and the undermining of confidence in the financial services sector. This is a problem that requires urgent rectification.

5.3 Proposed Micro Insurance Act

The objectives of the proposed Micro Insurance Act are to extend access / enhance inclusion, to formalise informal provision, to encourage competition while protecting consumers through prudential and business conduct regulation and to improve enforcement and consumer education specifically in the low-income population.

The Micro Insurance Act will fall within the greater insurance regulatory framework. However, there will be less stringent capital adequacy requirements (minimum capital adequacy requirement of R3 million with a build up over three years). Micro insurance will also have its own definition of fit and proper for the purposes of applying for a license to be a financial services provider.

Micro insurance will not be defined with reference to a specific target market. Rather, contracts with sums assured below a certain size will be regarded as micro insurance contracts. Based on currently available draft documentation, the proposed caps on benefits range between R50 000 and R100 000 per insured life depending on the type of insurance being offered. In the case of death, the proposed cap is R50 000 per insured life per insurer. For asset insurance the cap is R100 000 per insured life per insurer. In the case of other contracts, including legal expenses insurance the proposed cap is R50 000 per insured life per insurer. It is difficult to reconcile this proposed cap with the existing structure of legal expenses insurance contracts that typically cover policyholders and dependents with claims limits per matter or per year, typically with a lifetime cap. For instance, in the case of Lipco the entry level product with a monthly premium of R53 provides up to R60 000 litigation cover per year. In the case of a policyholder with no spouse or other dependents, this policy exceeds the current micro insurance cap.

Assuming that the cap can be aligned with legal expenses insurance contracts, the less stringent regulations and capital requirements may incentivise some providers who currently operate as UMAs, intermediaries or cell captives to restructure as micro insurers. It may also encourage entry into the industry of new players, and the formalisation of membership-based offerings. However it will not address regulatory challenges that impact on the development of premium products.

5.4 Treating Customers Fairly ("TCF")

The TCF initiative outlines six customer outcomes that should apply throughout all stages of interaction with the client. These are listed below:

1. Customers are confident that they are dealing with firms where the fair treatment of customers is central to the firm culture
2. Products and services marketed and sold in the retail market are designed to meet the needs of identified customer groups and are targeted accordingly
3. Customers are given clear information and are kept appropriately informed before, during and after the time of contracting
4. Where customers receive advice, the advice is suitable and takes account of their circumstances
5. Customers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and what they have been led to expect
6. Customers do not face unreasonable post-sale barriers to change a product, switch provider, submit a claim or make a complaint

TCF is principles based rather than rules based. The principles outlined above are fairly high level and open to interpretation. It is not clear what recourse policyholders will have if they believe they have not been dealt with fairly, whether these principles will override contract provisions and who will adjudicate the process, although it is to be expected that these matters will be investigated by the Ombud Schemes whenever a complaint or dispute is considered. Nevertheless as they stand, some processes that are common across the industry appear to be at odds with these principles. For instance, during mystery shopping exercises some providers could not make available policy documents without capturing banking details and getting authorisation to process debit orders. In addition, shoppers were required to cancel policies in writing despite the fact that policies were purchased telephonically. Perhaps most importantly, given the inherent conflicts of interest, the process of adjudicating whether a case has prospects of success is at odds with the TCF principles. In addition, given that legal expenses insurance is a service intensive offering, TCF may encourage providers to be more explicit regarding standards and quality of legal services offered in line with principle 5 above.

6 Conclusion

A number of issues were highlighted during the course of this research relating to the various stakeholders, including clients, industry players, regulators and the legal profession. These are summarised below together with some recommendations going forward.

6.1 Client issues

1. Legal and financial literacy

The qualitative focus group research highlighted that legal insurance policyholders have low levels of legal literacy and few individuals understood basic legal terminology. For example, the terms 'litigation' and 'civil law', which appear in all legal insurance policy documents, and are fundamental to the description of the product, are poorly understood. Aside from a lack of understanding of legal terminology, policyholders also do not understand the basic financial terminology that is standard in insurance contracts. The qualitative research also highlighted that those individuals who have legal insurance policies have severely limited knowledge of their rights and avenues for recourse. Taken together it is unlikely that policyholders fully understand their legal insurance policy benefits and exclusions. While policyholders may have a general understanding of how the product works they often have unrealistically high expectations of what the product can deliver.

Policyholders also admitted in focus groups that they do not read policy documents. In part they indicated this was because documentation was overly complex. But they also admitted that they were negligent in this regard.

Coupled with a lack of knowledge, focus group research highlighted an inherent fear of legal issues. This fear is easily exploited by providers to sell products that prospective policyholders don't fully understand. In such cases, the product is often purchased on an emotional basis rather than on an informed basis. It is therefore critical that exclusions and limitations of the policy, as well as its benefits, are explained in plain language. In addition there is a clear need for a countrywide campaign to educate the public about key legal concepts that could be launched together with the legal profession.

2. Inability to assess quality and value of legal services

Unsurprisingly given low levels of legal literacy clients are not able to assess the quality of legal services they receive either from in-house legally trained personnel or from panel attorneys. Legal expenses insurers indicate that those employed in-house are “legally qualified” but there is no industry standard on what this is and policyholders simply believe that internal legal resources are well informed.

Given that the legal expenses insurance industry operates largely outside of the legal profession, some minimum industry-wide standards with regard to qualifications and experience of in-house legal personnel would be useful. In addition, policyholders should be able to access information relating to the qualifications and experience of those who provide advice and services.

6.2 Provider issues

1. There is no industry body to represent the interests of the industry to regulators and to set standards for industry participants³³

While the market is currently dominated by LegalWise, there are a number of other product providers who are structured in several ways; some are registered as short term insurance companies, while others are cell captives, UMAs or intermediaries and even non-insurance member based organisations. There is no industry body representing these providers and current industry structures have not adequately represented their needs. For instance not all legal expenses insurers belong to SAIA, and some would not be eligible to join as they are not insurers. It would be in the interests of the industry to create such a structure to ensure that the views of providers are communicated to insurance regulators and to the legal profession. An industry body or Forum could also set appropriate standards with regard to product features, key processes, disclosure and qualifications of in-house legal staff. A proposed list of activities for such a body could include the following:

- Develop a code of conduct for providers
- Drive awareness campaigns relating to legal and insurance matters

³³ It should be noted that, at the time of writing, a SAIA Legal Expenses Insurance Forum was in the process of being established which may address some of these issues.

- Develop standardised reporting, support data collection, consolidation and dissemination of industry data
- Develop standards and processes around repudiation of claims, particularly with regard to prospects for success, and ensure effective structures are put in place whether internal or through an Ombud to deal with disputes fairly
- Develop standards with regard to disclosure of and qualification of in-house legally qualified employees
- Engage with the Legal Practices Bill and LSSA on industry structure (e.g. allowing ownership of legal firms)
- Track providers and available products
- Develop standards with regard to product benefits and exclusions to make it possible for consumers to compare different products easily
- Support SAIA with TCF, SAM, Micro insurance, Outsourcing directive and binder regulations.

Box: International Association of Legal Protection Insurers (RIAD)

RIAD is the International Association of Legal Protection Insurers and service providers. Its mandate is to promote via its members easy, affordable and high quality access to justice and the law.

RIAD achieves this goal by monitoring and taking a stance on initiatives that may impact legal expense insurers, by providing members with relevant information and by promoting and reinforcing the overall image of the industry.

It has more than 60 insurance companies as members from Europe, North and South America as well as South Africa (LegalWise is a member of RIAD).

All members voluntarily undertake to comply by the guidelines laid down in RIAD's code of conduct.

The code aims to insure the proper execution of legal expenses insurance policies. The code covers the following areas:

- Transparency of contracts and scope of coverage
- Prompt, fair and efficient dispute resolution
- Avoiding conflicts of interest
- Ensuring high quality of service

Source: RIAD website (<http://www.riad-online.net/>)

2. Simplifying policy documentation

The terminology used in policy documents is often cumbersome, and in many cases overly complex. Based on feedback from policyholders gathered during focus group discussions it appears that most do not understand the legal terminology used and only discover the implications of the 'fine print' when their claim is disputed. Simplifying policy documents, and where possible providing examples to illustrate the meaning of legal terminology, would aid the client's understanding of their legal insurance policy.

3. Aligning current practices with Treating Customers Fairly (TCF) initiative

A number of the practices currently employed by certain legal insurance providers are not in line with the principles of the TCF initiative. Examples that should be rectified include requiring a potential client to supply banking details prior to receiving policy documentation, not fully disclosing all the exclusions during the sales process and requiring policyholders to cancel a policy in writing where the policy was initiated over the phone.

Perhaps most important of all, the process of adjudicating whether a case has reasonable prospects for success is arguably at odds with TCF principals. On the face of it there is an insufficient segregation of duties; the provider decides on the merit of the case and is responsible for payment of legal expenses on behalf of the client. There is therefore an incentive not to pursue cases that will be time consuming and costly, even if they do have reasonable prospects of success. Providers have noted that in most cases clients can appeal to an internal committee if their claim is repudiated and if they remain unsatisfied can approach the Ombud. However, given the imbalance in legal knowledge between providers and clients, many clients may not appeal and simply accept the judgment of the provider. It would be in the interests of clients to create a standard review process for all claims rejected by the provider on the grounds of no prospects of success.

6.3 Regulatory issues

A review of the regulatory environment has highlighted a number of shortcomings within the currently regulatory framework. While some of these shortcomings may be addressed by the

proposed Micro Insurance Act, the Act will operate within the broader existing regulatory environment which will not address some shortcomings discussed below.

1. The Short Term Insurance Act is overly complex and is not well suited to the specifics of legal expenses insurance

The current short-term insurance regulatory regime was not designed with today's highly complex and varied insurance policies in mind. It has a 'one size fits all' approach despite the very varied nature of insurance contracts that operate within it. Legal insurance is an example of an industry that has had to fit into a framework that is not entirely applicable, both with respect to prudential requirements as well as market conduct requirements. This increases the costs of operations which are eventually passed on to the consumer, and effectively limits access to the product. Furthermore the high costs and complexity of regulatory compliance have resulted in many smaller providers working outside of the framework. These providers are not technically insurance providers but offer insurance products as membership-based organisations. Because they operate outside the regulatory framework, their members are not accorded the same protection as insurance policyholders.

The extensive regulations promulgated in terms of Section 70 of the Short-term insurance Act have resulted in a complex regulatory environment, in some cases resulting in confusion within the industry and the market. For instance, the introduction of the policyholder protection rules created some confusion as they overlapped with FAIS and it is unclear in certain cases which piece of regulation would apply.

The binder regulations have gone a long way in regulating the relationship between insurers, intermediaries and underwriting managers but they have also led to some unintended consequences; in some cases it is possible for intermediaries to earn more in fees than they would have previously. Further, because UMAs are no longer allowed to distribute products and perform binder functions on behalf of the provider brokers become critical. However, because most legal expenses insurance contracts have low premiums there is insufficient incentive for brokers to actively sell the product and with the focus on low or no-advice the brokers adds little value but adds cost.

There is some confusion as to whether the outsourcing directive applies to the provision of legal services, especially with the different models that are in practice from the compulsory panels of attorneys (which may be seen as a form of outsourcing) to those models where the client is free to choose an attorney of their choice. If it does apply this could place additional obligations on providers to monitor the quality of legal services provided by attorneys. It could also require regulators to audit current provider practices to ensure that existing monitoring processes are adequate. Arguably, insurance regulators would not be well placed to assess this. If this is required, the legal profession would be better placed to fulfil this role.

With regard to prudential requirements, providers indicate that this places a significant burden on their businesses which will be exacerbated with the introduction of SAM. Given that loss ratios are generally lower, the risk spread far wider and individual claims exposure more limited and also capped, a less stringent approach is justified.

2. The FAIS Act places a significant burden on providers and does not provide adequate protection for consumers of this product

The 'fit and proper' requirements for intermediaries place a significant burden on providers who must either develop no-advice models or ensure that their sales teams comply with the requirements of FAIS. The syllabus of FAIS examinations is not aligned with the specific nature of the legal expenses insurance product and does not accord consumers the kind of protection envisaged by the Act. Furthermore, FAIS accreditation for funeral insurance has been used by one unregistered legal expenses insurance provider to imply that the business as a whole is registered.

3. Collection of data by the regulator does not take into account the nature of services provided and utilised. In addition, data collected by the regulator for entities other than dedicated short term insurers is not disseminated

There is no specific guidance given to providers on what costs constitute a claim. Claims data submitted by insurers to regulators typically, although not universally, include costs associated with litigation benefits only. There is no additional indication of the extent to which policyholders benefit from legal services provided in-house by the legal expenses insurer directly.

Providers, including short term insurers, UMAs, cell captives and intermediaries submit detailed data to the regulator on an on-going basis. However, with the exception of annual financial statements for two dedicated short term insurers, this data is not made available for public scrutiny. Furthermore it appears that much of this data is not captured and/or maintained in an accessible way, but remains within specific departments. This is a missed opportunity; data could be used to establish the size and growth rate of the industry, understand usage patterns in more detail, identify key trends and establish how the different providers are structured. It could also enable improved enforcement and inform future policy.

6.4 Legal profession

1. Integration between the legal profession and the legal insurance industry

In line with existing legislation governing the legal profession, attorneys can only be employed by independent firms of attorneys and cannot be employed by companies including legal expenses insurers. Thus, if a matter proceeds to litigation, a legal insurer has to approach an external attorney or firm of attorneys. While insurers typically negotiate reduced tariffs for their clients, if this function were to be performed by attorneys employed by the legal insurer, providers believe costs could be reduced further.

In addition, legal graduates cannot be articulated while working for a legal expenses insurer. It is therefore not attractive for graduates to work at legal expenses insurance providers despite the breadth of experience the opportunity could offer.

Finally, while legal expenses insurance policyholders have recourse to professional bodies if advocates or attorneys provide act improperly, they have no recourse to the profession if in-house legally qualified staff of legal expenses insurers proffer poor service.

2. Access to the legal system

Relatively few South Africans have the financial means to access the legal system. Individuals who earn below R5 500³⁴ per month can theoretically access free legal services from the Legal Aid Board. However, participants in one focus group perceived these services to be sub-standard, delivered by poorly qualified attorneys. In addition, there is a significant market comprising those who earn above the qualifying threshold for Legal Aid but who still do not earn enough to be able to afford a lawyer. Legal expenses insurance can potentially provide a funding mechanism to close this gap by providing affordable access to the profession for the majority of South Africans.

6.5 *In conclusion*

How these issues are dealt with by the industry, regulators and the legal profession is largely a function of the ultimate vision for the product and the role it could play in enabling access to the law for citizens in South Africa. It can remain a niche product, attracting a small but not insignificant number of clients. Providers can continue to market and service the product despite a number of onerous regulatory requirements, without formalised engagement with the legal profession. Alternatively, the product could become the primary mechanism that enables access to the law for those who are not poor enough to qualify for Legal Aid, but not rich enough to be able to afford to hire an attorney at standard market rates. To create this reality, the industry needs to organise itself and represent its interests to regulators, to engage with the legal profession and to develop strategies to capacitate clients. It also needs to ensure its products, levels of disclosure, operating processes and standards of service are of high quality.

³⁴ Qualification criteria for Legal Aid for individuals: Net monthly personal income below R5 500. Legal aid for households: Net monthly household income below R6 000. If an individual/ household owns a house: the value of the house and all belongings must be under R300 000. If an individual/ household does not own a house: the value of all their household belongings must be less than R75 000

7 Appendices

7.1 *Focus Group participant summary*

7.1.1 *Cape Town: Legal insurance policyholders/ Lapsed legal insurance policyholders*

Respondent	Legal insurance policy	Age	Gender	Population Group	Marital status ³⁵	Household income
R1	Yes	22	Female	White	Single	R20 000+
R2	Lapsed	50	Female	White	Single	R7 500 – R9 999
R3	Yes	26	Female	White	Married	R17 500 – R19 999
R4	Yes	62	Female	Coloured	Single	R5 000 – R7 499
R5	Yes	61	Female	Coloured	Widowed	R7 500 – R9 999
R6	Yes	56	Female	White	Married	R15 000 – R17 499
R7	Yes	56	Female	Black	Single	R10 000 – R12 499
R8	Yes	54	Female	Coloured	Divorced	R10 000 – R12 499
R9	Yes	38	Male	Coloured	Married	R12 500 – R14 999

³⁵ Note: Married indicates individuals who are either married or living with their partner. Single indicates individuals who are single and have never been married

7.1.2 Johannesburg: Legal insurance policyholders

Respondent	Legal insurance policy	Age	Gender	Population Group	Marital status	Household income
R1	Yes	26	Female	White	Married	R12 500 – R14 999
R2	Yes	47	Male	Coloured	Married	R10 000 – R14 999
R3	Yes	34	Female	Black	Single	R12 500 – R14 999
R4	Yes	44	Female	White	Married	R15 000 – R17 499
R5	Yes	40	Female	White	Single	R12 500 – R14 999
R6	Yes	25	Female	Black	Married	R15 000 – R17 499

7.1.3 Johannesburg: Never had a legal insurance policy

Respondent	Legal insurance policy	Age	Gender	Population Group	Marital status	Household income
R1	No	30	Male	White	Single	R12 500 – R14 999
R2	No	35	Male	Black	Widowed/ Divorced/ Separated	R5 000 – R7 499
R3	No	32	Male	Black	Single	R12 500 – R14 999
R4	No	29	Female	White	Single	R10 000 – R12 499
R5	No	30	Female	White	Single	R12 500 – R14 999
R6	No	34	Male	Black	Married	R15 000 – R17 499
R7	No	40	Female	White	Married	R10 000 – R12 499

7.1.4 Pretoria: Legal insurance policyholders/ Lapsed insurance legal policyholders

Respondent	Legal insurance policy	Age	Gender	Population Group	Marital status	Household income
R1	Yes	33	Female	Black	Married	R12 500 – R14 999
R2	Yes	40	Male	Black	Married	R12 500 – R14 999
R3	Yes	34	Male	Black	Married	R12 500 – R14 999
R4	Yes	35	Male	Black	Married	R15 000 – R17 499
R5	Lapsed	27	Female	Black	Single	R10 000 – R12 499
R6	Yes	33	Male	Black	Married	R12 500 – R14 999