[The role of financial products in creating well-being](#)

Meeting needs

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Authors and contributers

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THE OBLIGATIONS OF PRODUCT PROVIDERS

The first article in this segment called **'Financial products as facilitators of well-being'** considers the shocks that low-income households are typically exposed to and the role of insurance and saving arrangements in enhancing financial well-being. The second article explores how customers might place a value on a product and explains the complex dynamics of markets for financial products. In this chapter, we explain the developing statutory duty of banks, insurers and other financial services entities to provide products that match the needs of their customers. We argue that these obligations should be regarded simply as sound business practice.

One of the themes running through this edition of *Benefits Barometer* is that South Africans cannot be regarded simply as wealthy or poor. A large proportion of people in this country, while battling with poverty, have the potential to lift themselves into a more secure position. However, many of those apparently in a state of sound well-being are actually just one disaster away from falling into great hardship.[2] We consider some of the events or attributes that encourage upward mobility or contribute to downward mobility. And we consider how financial products and services (primarily insurance and savings) that are properly designed and priced could contribute to social progress or protect against adversity, enhancing the financial well-being of South Africans in the process.

Jargon buster
The terms 'policymaker' and 'regulator' are often used interchangeably, confusing an already unclear meaning. This is how we use these and related terms in *Benefits Barometer*:

- Policymaker: establishes the policy or framework under which a market or public service operates, usually at government level
- Regulator: sets the rules under which a market works, generally at the level of a government department like National Treasury
- Supervisor: enforces the rules, often independently of government involvement, and reports to Parliament from time to time

Examples of entities that act as supervisory authorities are the newly created Prudential Authority, the Financial Sector Conduct Authority and the National Credit Regulator. Change is afoot. The legislation establishing these authorities gives these entities extensive power to issue regulations.

The good news for South African customers of financial products is that the regulators of companies that supply these products place several demands on them: they must show that the products meet the needs of their customers and demonstrate that the way they service customers is in the best interests of their customers. Simply put, banks, insurers and other financial services providers must treat (their) customers fairly (commonly referred to as 'TCF').

A brief look back

Credence goods and services […] are those where quality can be ascertained only at some cost after purchase. A frequent characteristic of these goods and services is that the value of the purchase is either spread over a long period of time, or emerges only after a considerable lapse of time. Reversal of such a purchase usually involves considerable loss, both in terms of actual costs and benefits foregone of selecting some alternative. (Financial Services Board, Treating Customers Fairly Discussion Document, April 2010, prepared by Feasibility (Pty) Ltd)

This seems such an obvious duty that it may be difficult to understand why it should only recently have become a legal requirement. Insurance and banking products can be difficult to understand but they are not as complex as the insurers and banks that provide them. Regulatory authorities around the world have focused on this complexity, reasoning that the worst thing that could happen to all of us is the collapse of one of these companies. Regulators typically responded to this risk by requiring these companies to perform financial analyses and submit reports focused on their financial security, often referred to as their solvency. The authorities reasoned that the financial interest customers vest in their products could best be protected by ensuring the safety of the companies providing these products. The practice of focusing on the financial security of product providers is known as **prudential regulation**.

Over the last 10 to 15 years, a number of events have suggested that ensuring the solvency of banks and insurers is not enough to secure the interests of customers in the products provided. The difficulty of understanding these products, which may be referred to as credence goods and services (see explanatory box), is just one of the challenges. Another is that problems may take a long time to arise, or the value of these products can take a long time to become clear. If the value proves to be poor, the cost of unwinding the purchase of the product could make it very difficult to do just that. The high charges levied on changes to retirement annuities in the last decade are a good example of an unwinding cost.

Even where that cost does not take the form of an explicit charge, the inconvenience associated with such a change can be too much for customers to contemplate it. How many customers stay unhappily with their banks because the perceived cost of opening another account, transferring money into the new account and notifying all customers or service providers is regarded as greater than the inconvenience or material loss associated with staying where they are?

And so, the Financial Services Board, along with regulatory counterparts in other countries, reasoned that more effort needed to be placed on overseeing the behaviour of product providers. This practice is known as market conduct supervision. It is regarded as so important in a number of countries, among them South Africa, that it requires a separate supervisory authority.

In South Africa, the prudential regulation of insurance companies has been moved to the newly established Prudential Authority, based at the South African Reserve Bank, which was already responsible for the financial oversight of banks. The Financial Services Board is being transformed into the Financial Sector Conduct Authority, to oversee market conduct.

Why does good conduct have to be legislated?

It is entirely reasonable for customers to expect financial services providers to offer excellent products and services. For most products, customers themselves are the best judge of whether the product met their expectations. Financial products, however, which fall into the category of credence goods, can be difficult to understand. Even sophisticated customers often do not have the means to know whether the product is meeting their expectations. Many customers of financial services products have an inadequate idea of these expectations in the first place.

Some might suggest that the decision to establish a market conduct regulator proves that banks and insurers have consistently been treating customers unfairly. That is not necessarily the case.

Though there have been instances of unfair treatment, South Africa's policymakers are not saying that every bank or insurer treats its customers unfairly.

Along with their counterparts in other countries, our regulatory authorities recognise that banking, insurance, asset management and other financial services markets are based on trust. Improved trust leads to improved customer confidence. TCF aims to make customer-centricity a competitive advantage.[3] Companies that do a better job of meeting customer needs ought to be the most successful, and reap appropriate rewards in the process, because they contribute responsibly to society-wide objectives of social mobility and social protection, and ultimately to the financial well-being of their customers.

What are regulators looking for?

The objective of the Financial Sector Conduct Authority is to […] (b) protect financial customers by […] (i) promoting fair treatment of financial customers by financial institutions [...]. (Financial Sector Regulation Act, Section 57)

The TCF initiative aims to ensure that customer needs are met through a sustainable industry. Contributing to this overarching objective are six outcomes (see Table 4.3.1), covering:

- the culture of providers
- the products they offer and the performance of these products
- the information and advice given to customers
- how flexibly customers can engage with their providers

Table 4.3.1: Targeted Treating Customers Fairly outcomes

OUTCOME	WHAT DOES THIS MEAN IN PRACTICE?
Customers are confident that they are dealing with companies where the fair treatment of customers is central to the company's culture.	The decisions and actions of product and service providers are based on the needs of their customers, evidenced by written policies and procedures and assessments of whether they have met their goals.
Products and services marketed and sold in the retail market are designed to meet the needs of identified customer groups and are targeted accordingly.	All products and services offered are put together with the evidenced needs of a particular group of target customers in mind. Marketing and sales efforts aim to reach this group of customers. Tests are conducted to ensure the effectiveness of these efforts.
Customers are given clear information and are kept appropriately informed before, during and after the time of contracting.	Clear, understandable information is provided to all customers before they take out a product, while in the process of contracting, and at appropriate intervals thereafter.
When customers receive advice, the advice is suitable and takes account of their circumstances.	All advice provided is appropriate to the needs of the customer, pays due attention to their position and aspirations, and is expressed in a way that is clearly understood by the customer.
Customers are provided with products that perform as companies have led them to expect, and the associated service is both of an acceptable standard and what they have been led to expect.	The investment returns or benefits of a product are in line with the expectation the product description creates at or after the time of sale. Similarly, all communication, documentation and other services are in line with the commitments made by the company, as understood by the customer.
Customers do not face unreasonable post-sale barriers to change a product, switch providers, submit a claim or make a complaint.	Customers do not face unreasonable post-sale barriers to change a product, switch providers, submit a claim or make a complaint.

Source: Financial Services Board^4

That policymakers have framed the initiative in terms of outcomes is important. It means financial product providers cannot merely show that they are taking certain actions. They must also show that these actions are effective in meeting this set of outcomes. Policymakers have not, however, left insurers to work out how to provide evidence on their achievement of a set of outcomes. Rules have also been stipulated in this regard.

Table 4.3.2 provides a sample of these rules to illustrate what is now expected of insurers. Some of these rules may have far-reaching consequences. Loyalty benefits and no-claim bonuses, for example, may no longer be positioned as free add-ons to products, as they come at a cost to the customer. Product providers may raise their hands in surprise but critics point out that these incentives distort competitive dynamics and make pricing (and value) unclear to customers.

Banks can anticipate falling under similar requirements now that the Financial Sector Conduct Authority has been established. There's also a strong argument for non-bank lenders to be bound by the same set of obligations, but it's less clear how this is to be implemented.

At the heart of the Treating Customers Fairly initiative is the culture of an organisation: Inspire a customer-centric culture by setting the right tone from the top and using the right incentives at every level of the organization.[5]

To the boards and executives of all financial services companies, putting customers first must run through the culture of your company, affecting everything you do. What do our regulators consider evidence of an appropriate culture? The answer to that is very simple. If your customers believe that you put their needs first, then your culture is probably appropriate because you demonstrate it to them with consistency. The supervisor has indicated it will expect every bank and insurer to be able to show that its customers indeed have this belief and, if they don't, that product and service providers are taking action.

If you have the culture of your organisation right, the other five outcomes are likely to come easily. You will design products that meet an identified customer need. You will reach customers through channels that are most appropriate to your target market, and check that they are working as intended. You will test customer satisfaction and act to address any concerns identified.

All of this brings us back to customer need. You will find it difficult to convince your employees to prioritise the needs of your customers if these needs are not central to the culture of your organisation. If they are, though, your products, service, advice and customer information are more likely to meet the outcomes expected of you.

Table 4.3.2: Selected obligations of insurers, as set out in the Policyholder Protection Rules

	Reference
'An insurer must have appropriate policies and procedures in place to achieve the fair treatment of policyholders.'	1.4
'An insurer must in developing products … (a) make use of adequate information on the needs of identified types, kinds or categories of policyholders [...].'	2.2
'An advertisement that references a loyalty benefit or no-claim bonus must not create the impression that such benefit or bonus is free […].'	10.14.1
'Any communication by an insurer to a policyholder in relation to a policy must […] (a) be in plain language; (b) not be misleading; [and] (c) be provided using an appropriate medium, taking into account the complexity of the information being provided […].'	11.3.1
'An insurer must establish, maintain and operate an adequate and effective claims management framework to ensure the fair treatment of policyholders and claimants that […] (d) does not impose unreasonable barriers to claimants […].'	17.2.1
'The board of directors of an insurer is responsible for effective claims management and must approve and oversee the effectiveness of the implementation of the insurer's claims management framework.'	17.4.1
'An insurer must ensure that its claims processes and procedures are transparent, visible and accessible through channels that are appropriate to the insurer's policyholders and claimants. All communications with a claimant must be in plain language.'	17.8.1 17.8.2

Source: Long-term Insurance Act: Replacement of Policyholder Protection Rules^6

Putting customer need first

Treating customers fairly is a legislative requirement. Banks, insurers and other financial services providers must demonstrate they are putting customers first by showing they are meeting six specified outcomes. We've shown how customer need is central to this process. We now ask how that need might be identified and met.

Neglecting to understand customer need has implications not just for the financial institutions failing to attract customers or providing inappropriate products: society suffers as well. Rabelani Dagada asks whether South African banks are paying enough attention to understanding (and meeting) the needs of low-income customers:

Unless the formal banking industry comes to terms with the financial needs of the poor, the state's various attempts to change the material circumstances of the majority of South African citizens always will be limited.[7]

Recent signs are encouraging, with at least one bank making good progress in growing its low-income customer base on the back of a stated focus on meeting customer need.

Hougaard and Chamberlain[8] describe a number of products in global microinsurance based on careful research into market need. For example, in Côte d'Ivoire, UNACOOPEC-CI (Union Nationale des Coopec de Côte d'Ivoire), a microfinance institution with more than 800 000 customers, gives policyholders the choice of a voucher or a cash payment, or a combination of the two, to cover funeral expenses. The details of the outcome are not as important as the way in which it was developed.

Asking customers to describe their desires or aspirations is not the only way to identify needs. Customers have complex lives and may not even completely understand their needs. They also find it difficult to turn intention into action, particularly when this calls for making a financial commitment. Microinsurance veterans Aparna Dalal and Michal Matul, writing for the Consultative Group to Assist the Poor (CGAP, a global partnership of more than 30 organisations, housed at the World Bank), ask whether there are other ways to understand customer needs, particularly among low-income policyholders.[9] They argue that insurers can learn a great deal from observing their customers more closely by collecting claims-related data in health insurance products. But they point out that the richest lessons are learned by those prepared to supplement such insights with direct engagement with their customers. The answer to the 'what' question (the product or solution), in other words, is most useful when a 'why' (the need it is designed to meet) is added to it.

Building trust

Trust is a precious commodity in financial services. Meeting needs is the best way to build trust. EY's global survey of banking customers shows the low level of confidence customers have in their banks' ability to meet their needs. Given the opportunity to pick one of five statements best describing their financial services provider, only 27% of respondents selected *'[…] understands the needs of customers like me'.*[10] Worse, a large majority of customers felt their financial services provider was primarily concerned with its own interests, not those of its customers. Only 21% of respondents trusted their provider to **'[…] [tell me] if there is a better product for my needs or situation even if it means less money for them'.**

The Financial Brand's 2015 global survey of the satisfaction of banking customers suggests that customers are not happy.[11] Over three-quarters of respondents stated that bank performance fell short of their expectations. Banks appear to have disappointed their customers the most in areas where they should be listening the most.

Respondents indicated that banks were providing convenience and connectivity facilitating digital payments effectively and were meeting product innovation expectations. They were not:

- recognising customer value and loyalty through rewards
- anticipating the future needs of customers

- doing enough to help customers achieve their goals
- focusing sufficiently on customisation

Worse, the fairness, reliability and transparency of banks did not meet the expectations of these customers.

Loyalty and rewards programmes play an interesting part in financial services. This chapter notes the decision of the regulator to clamp down on the way loyalty programmes are presented. They complicate product offerings and make value hazier to customers. This survey suggests that bank clients are increasingly demanding tangible benefits for themselves, an expectation that these programmes themselves may have generated. The corresponding EY global survey of insurance customers found low levels of trust in these companies – lower than supermarkets, online shopping sites, banks and car manufacturers. It also found that customers wanted more frequent, meaningful and personalised communication from their insurers.[12] This suggests that a remarkable opportunity is being missed. Insurers need to know their customers better. These customers want to hear from their insurers, as long as the communication is helpful and engaging. Putting customer interests first, then acting on these interests, could help providers to bridge the trust gap and develop more appropriate products.

Detailed research on the level of trust that South African customers put in their financial services providers is more difficult to find, but brand surveys make it clear that not all banks and insurers enjoy high levels of trust by their customers.

Employers have an opportunity to assist by identifying the key needs of their employees and vetting the products offered by financial services providers to meet these needs. Concerning the ethical, business and legal obligations on product providers discussed in this chapter, perhaps the most effective contribution employers can make is to understand the obligations and insist on them being soundly met. Raising the confidence of their employees in the quality of these products may increase how effectively they are used.

Concluding thoughts

Understanding customer needs and aspirations should not be a mere regulatory requirement. It's good for the provider's bottom line. Business Australia[13] points out that understanding their customers helps product providers to:

- build relationships with customers
- determine the best price for products and services
- decrease the costs incurred in attracting new customers
- increase sales and profitability

It goes on to describe how to understand customer need better, for example by profiling customers, analysing customer interactions with the business, conducting market research and using existing customer information.

Consistently meeting customer needs, and building and earning trust in the process, would go a long way to establishing a healthy financial services industry that plays a positive role in enhancing the financial well-being of its customers.

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