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CHARTIS

The Department of National Treasury

Date: 7 May 2012

Director: Insurance
Unit: Financial Sector Policy
Private Bag X115
Pretoria
0001

**By email:**
**LTDemarcation@treasury.gov.za**
**STDemarcation@treasury.gov.za**
**Reshma.seoraj@treasury.gov.za**

Dear Sir/Madam

1.1 We refer to the draft regulations published for public comment in terms of the Long-term Insurance Act no. 52 of 1998 ("**LTI Draft Demarcation Regulations**") and the Short-term Insurance Act no. 53 of 1998 ("**STI Draft Demarcation Regulations**"), respectively, under GNR192 and GNR193 (Government Gazette 35114), dated 2 March 2012 (jointly referred to as the "**Draft Demarcation Regulations**"). The National Treasury invited comments in writing on the Draft Demarcation Regulations on or before 23 April 2012.

1.2 In a letter, dated 23 April 2012, Chartis Life South Africa Limited and Chartis South Africa Limited, requested the National Treasury to agree to an extension of the aforesaid date for comments to 3 September 2012. SAIA and other insurance companies made the same request.

1.3 This request was made to allow for a joint meeting with the National Treasury to (1) bring clarity to what we have determined to be unclear and confusing draft regulations and (2) afford us a reasonable opportunity to deal meaningfully with the Draft Demarcation Regulations. The National Treasury subsequently granted Chartis and the insurance industry only until 7 May 2012 (the 'Revised Deadline'). We respectfully submit this timeframe is wholly inadequate and prejudices market participants.

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1.4 Notwithstanding our efforts to submit comments by the Revised Deadline we wish to record our objection in the strongest terms as members of the industry and the public were not afforded adequate opportunity to comment on the Draft Demarcation Regulations. Accordingly we reserve all our rights to ensure a fair and impartial consultation period is afforded to all market participants. Furthermore, we would like to take this opportunity to seek an extension to the Revised Deadline and ask that your respected office considers extending the consultation period to September 3, 2012 for the same reasons as outlined in our letter of April 23, 2102 and a copy of which is enclosed.

1.5 Before proceeding with outlining our response we wish to respectfully record that we found it extremely challenging to comprehend the **Draft Demarcation Regulations** and many provisions remain vague. In the current form the **Draft Demarcation Regulations** will cause confusion in the market place, unfairly prejudice market participants and consumers alike and potentially be deemed as socially discriminatory.

1.6 Please note that our comments in respect of the **Draft Demarcation Regulations** apply equally, unless otherwise stated, to both the LTI Draft Demarcation Regulations and STI Draft Demarcation Regulations.

## 2. Categorisation of Comments

Our comments have been categorised as follows:

2.1 Inadequate Consultation Period

2.2 Unfounded Policy Considerations

2.3 Vague and Unclear status of the Draft Demarcation Regulations

2.4 Impact of Regulations 7.2 to 7.5

2.5 Impact to the Customer/Consumer

2.6 Impact to Insurers

2.7 Perceived Discriminatory Nature of the Draft Demarcation Regulations

2.8 Conclusion

**2.1 Inadequate Consultation Period**

2.1.1 The explanatory memorandums to the Draft Demarcation Regulations indicate that the Draft Demarcation Regulations are the result of a robust and inclusive consultation process with interested and affected stakeholders following the enactment of Insurance Laws Amendment Act no. 27 of 2008. This is mischaracterisation of the actual consultation process.

2.1.2 To the best of our knowledge the initial process involved a limited and select group; namely, the Association for Savings & Investments South Africa and the South African Insurance Association ("SAIA"). The members of the working group were required to conclude confidentiality agreements, which effectively precluded them from consulting within their respective constituencies. In short, market participants were not involved in the formulation or in any way privy to the contents of the Draft Demarcation Regulations prior to 2 March 2012.

2.1.3 The provision of a reasonable comment period is not only consistent with the requirements of procedural fairness but also with the constitutional principle of participatory democracy.

2.1.4 We submit that the wording of the Draft Demarcation Regulations require substantial redrafting to avoid interpretational issues which are currently being caused by the vague and unclear language.

**2.2 Unfounded Policy Considerations by the Council for Medical Schemes**

2.2.1 The Explanatory Memorandum to the LTI Draft Demarcation Regulations (the ST Draft Demarcation Regulations contain a similar provision in respect of accident and health policies) state as follows under the heading "Policy Principles that Informed the Draft Regulations":

- *"Health Policies (providing similar benefits as medical schemes) may result in -*
- *Younger and healthier persons terminating, limiting or reducing their medical scheme cover;*
- *A negative impact on the life-cycle protection offered by medical schemes; and*
- *Medical schemes reducing benefits."*

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2.2.2 The Council for Medical Schemes has been advancing the aforesaid policy considerations in favour of demarcation since approximately 2001. However, despite various requests by the insurance industry for factual and empirical evidence justifying the aforesaid considerations these have not been made available by the Council for Medical Schemes. Further, this evidence was also requested by the Demarcation Workgroup for purposes of developing the framework for the Draft Demarcation Regulations, which was not delivered upon. The rationale for the Policy Considerations put forward by the Council for Medical Schemes has not been justified.

2.2.3 In support hereof, the Supreme Court of Appeal (**"SCA"**) in the 2008 decision of *Guardrisk Insurance Co Ltd v Registrar of Medical Schemes and Another*[1], made the following findings, which are relevant in this regard:

- *No evidence was produced at the time of the hearing of the matter before the SCA that motivated the contention that the definition of business of a medical scheme, if not amended, allowed or encouraged "younger and healthier members of a medical scheme to choose to subscribe only minimum benefits of the scheme and supplement their benefits by subscribing to the appellant's cheaper policy.";*

- *The SCA refused to accept that short-term insurance products undermined medical schemes;*

- *The SCA stated that "[p]ractical reality has shown that there exists a need for this type of insurance and there seems to be no reason why it should not be permitted"; and*

- *The SCA recognised that the definition of "business of a medical scheme" was drafted deliberately to take into account the definition of "accident and health policy" in the STI Act and to allow both definitions to co-exist harmoniously.*

2.2.4 To date the Policy Considerations put forward by the Council for Medical Schemes remains unfounded as the evidence in support of their argument has not been furnished. Notwithstanding, the Draft Regulations appear to favour the position of the Council for Medical Schemes, *vis-à-vis*, the insurance industry, which, having regard to the aforementioned, must be questioned.

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[1] 2008 (4) SA 620 (SCA)

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**2.3 <u>The Draft Demarcation Regulations are vague and unclear.</u>**

2.3.1 In present form the Draft Demarcation Regulations will cause significance confusion in the market place including uncertainty as to which products the National Treasury intends to regulate.

2.3.2 Chartis, SAIA and its member companies are of the common opinion that the National Treasury should convene a meeting with SAIA and its members to further clarify the intent of the Draft Demarcation Regulations.

2.3.4 Once clarity is obtained as to the products the National Treasury intends to regulate through the Draft Demarcation Regulations insurers should then be provided with adequate time to obtain expert advice which (amongst others) includes legal and actuarial advice and to perform an extensive due diligence of existing policies in order to assess the full impact of the Draft Demarcation Regulations. Members of the industry further required a reasonable opportunity to properly consult with one another on the issues raised in the Draft Demarcation Regulations.

2.3.5 Furthermore, several terms used in the Demarcation Regulations are ambiguous and capable of various interpretations and same should be clearly defined in the definitions and interpretation section to avoid uncertainty. Examples of such terms include: "introducing", "launching", "net income per day" and "elimination or deferred period".

**2.4 <u>Impact of Regulations 7.2 to 7.5 of the Draft Long Term Demarcation Regulations</u>**

**2.4.1 <u>Regulation 7.2(1)</u>**

2.4.1.1 The policy principles contained in the Draft Demarcation Regulations provide that it refers to policies which provide similar benefits as medical schemes but does not undermine the principles contained in the Medical Schemes Act.

2.4.1.2 The broad grouping of (a) lump sum and (b) income replacement benefits in category 1 of the Draft Demarcation Regulations may include policies which fall outside the scope of the definition of "business of a medical scheme" in that it does not contain any of the elements of the said definition. This is the case even on the revised definition of "business of a medical scheme" as proposed in the Financial Services Laws General Amendment Bill, 2012.

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2.4.1.3 Furthermore, category 1 of the Draft Demarcation Regulations may include policies that provide benefits that are clearly not similar to benefits provided by a medical scheme. For example, benefits offered in terms of income replacement type products and the benefits offered by medical schemes are distinctly different. The same would apply to the hospital cash plans and policies offering critical illness and dread disease benefits.

2.4.1.4 This broad grouping of lump sum and income replacement benefits in the same category also leads to various issues of interpretation.

2.4.1.5 As a general comment, there appears to be a disconnect between the name of the policy and the benefits that are to be provided in terms of the policy as contained in the table. This is especially evident in category 1, where the policy benefits portion of the table describes only the second type of insurance contract described in the first column, namely income replacement policies. The policy benefits column accordingly appears to be silent on the benefits to be provided in terms of a lump sum type policy.

2.4.1.6 The criteria stipulated in category 1 of the table appears to have been specifically drafted to address income replacement polices only, as evident from the fact that it seeks to limit the policy benefits offered in terms of these types of policies to 70% of the policyholder's net income per day.

2.4.1.7 This limitation in 2.4.1.6. is inappropriate for policies which provide for lump-sum type benefits or contingency expenses as there is no link between these types of expenses and a person's income.

2.4.1.8 We submit that policyholders should not be denied the opportunity from insuring themselves for their full loss of income. The limitation placed on these benefits effectively results in the low income, unemployed, dependents and retired consumers not being able to obtain this type of cover, which is inherently unfair.

2.4.1.9 The regulation of policies in the Draft Demarcation Regulations, which fall outside the scope of "business of a medical scheme" as contemplated in the Medical Schemes Act and do not provide benefits that are similar to the benefits provided by medical schemes is not only undesirable, but falls outside the intended purpose of the Draft Demarcation Regulation.

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0860 002526
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2.4.1.10 The broad grouping of lump sum and income replacement benefits in the same category creates uncertainty and may well have unintended consequences and should be removed from the Draft Demarcation Regulations.

2.4.1.11 With regards to HIV/Aids related policies in category 3 of the table of the LTI Draft Demarcation Regulations and category 4 of the STI Draft Demarcation Regulations, there appears to be no rationale for restricting cover to employee groups only. It is submitted that the cover should not be restricted to employer groups but should also be extended to individual consumers.

**2.4.2 Regulation 7.2(2)**

2.4.2.1 In terms of the Explanatory Memorandum to the Draft Demarcation Regulations the policies identified in the table in regulation 7.2(1) have been found by the legislator not to undermine the objectives and purpose of the Medical Schemes Act although such policies may offer benefits similar to that offered by medical schemes. Despite the aforesaid the proposed regulation 7.2(2) (b) imposes conditions which would make the underwriter of the affected insurance policies behave more like a medical scheme, which includes not entitling insurers to refuse a claim for policy benefits on the basis that the insured life experienced as health event prior to the commencement of cover. This would have the effect of disavowing insurers of their underwriting judgement and discretion which in our view is unacceptable.

**2.4.3 Regulation 7.3 of the Draft LT Demarcation Regulations**

2.4.3.1 The term "Hospital Cash Plan" is well established in the market and the benefits provided in terms thereof is distinctly different from benefits offered by medical schemes.

2.4.3.2 We submit that the risk of confusion or inappropriate marketing is extremely low and that insurers should be allowed to continue to identify their policies by using the term "hospital".

**2.4.4 Regulations 7.4 and 7.5 of the Draft Demarcation Regulations**

2.4.4.1 The proposed regulation 7.4, rather innocuously entitled "*Reporting of product information*", requires summaries of all health policies to be submitted to both the LTI Registrar and MS Registrar prior to the launch of the policies. It goes on to provide that:

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- the MS Registrar may "*at any time*" advise the LTI Registrar that the former "*is of the opinion*" that, amongst others, the benefits, terms and conditions of the policy are "*contrary to the objectives and purpose of the Medical Schemes Act as set out in that Act, with specific reference to section 72(2A)(b)(i)(cc)(A) to (C) of the Act*";

- the LTI Registrar may, either of his or her "*own accord*" or after considering the MS Registrar's opinion, "*object*" to any benefits, terms and conditions of a policy, and may: (a) prohibit the introduction or launch of the policy; (b) direct the insurer to stop offering or renewing those policies and to terminate the policies; or (c) require the insurer to amend any benefits, terms or conditions in accordance with the requirements of the LTI Registrar.

2.4.4.2 Regulation 7.5 goes on to provide a similar regime in relation to existing policies (if the policies were introduced or launched after 15 December 2008), summaries of which must be submitted to the Registrars within three months of the Regulations coming into operation.

2.4.4.3 In short, the construct of 7.4 and 7.5 is unacceptable. The provisions as drafted will cause insurers to change terms and conditions for insurance policies that are already in force and expose insurers to a subjective decision making process for which there appears to be no right of appeal; for example, in situations where the LTIA Registrar directs that the insurer to terminate a policy or amend benefits, terms or conditions.

2.4.4.4 An arbitrary enforcement regime with retroactive effect will operate harshly against any insurer in particular where such insurer will most likely would have incurred significant upfront expenditure in developing and preparing to launch a product. This includes not only the insurer's investment in establishing the infrastructure to offer the policy and marketing it to the public but also costs relating to the conclusion of individual policies, such as the payment of commission to brokers or agents and other inception costs (e.g. the cost of underwriting, medical testing and issuing the policy). The insurer would have incurred these costs in the expectation that they would be recovered over the duration of the policy. Chartis alone estimates that this investment for policies issued post December 2008 totals R209 million in marketing expenses, general expenses and claims payments. In addition, up to R126 million per annum in premiums could be affected. Claims payments, in isolation total R58.6 million reflecting the importance of this cover to hundreds of thousands of South African Consumers.

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The quantum involved reflects the importance of proper consultation taking place, The above notwithstanding, the potential reputational damage that may arise for Insurance Companies should any retrospective cancellation or re-underwriting of policies take place also needs to be taken into account.

2.4.4.5 Bluntly, 7.4 and 7.5 as drafted contain several issues of legality and authority as detailed hereunder.

2.4.4.6 Uncertainty created by the wide discretion afforded to the (i) Registrar of Medical Schemes ("**MS Registrar**") to object to the products and (ii) Registrar of Long-term Insurance ("**LTI Registrar**") and the Registrar of Short-term Insurance ("**STI Registrar**") to prohibit insurers from introducing or launching specific policies and to instruct insurers to stop offering or renewing policies identified by it.

2.4.4.7 The LTI Act (the same principle applies to the STI Act) does not empower the Minister of Finance to enact regulations which confer to the LTI Registrar extensive and far reaching powers to, in effect, ban specific health policies and to, amongst others, instruct insurers, not to offer; to terminate; or amend those policies. On the contrary, section 72(2A) of the LTI Act envisages that *the Minister* may make regulations which identify "*a kind, type or category of contract as a health policy*" (and thus impliedly prohibit those policies that fall outside the regulations and which fall within the meaning of "*business of a medical scheme*" in the MS Act). It is noteworthy that section 72(2A) sets out the envisaged scheme of the regulations in some detail, including the considerations to which the Minister must have regard in making the regulations, the provision of specified information to the Registrars and matters relating to the design and marketing of a health policy. The section, however, makes no mention of empowering the LTI Registrar to decide to prohibit products despite those products constituting health policies as prescribed by the Minister. The proposed regulations 7.4 and 7.5 therefore go beyond the regulation-making power conferred in section 72(2A) of the Act and would thus be unconstitutional (or ultra vires). These provisions would, if promulgated, violate the well-established constitutional principle of legality, which stipulates that public power may only be exercised in accordance with law. In other words, the exercise of a public power or the performance of a public function must be authorised by law and must not go beyond the functionary's powers.

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2.4.4.8 The discretionary powers conferred on the Registrars in the proposed regulations 7.4 and 7.5 are overly broad, and thus, in our view, violate the guidance principle. According to the Constitutional Court, it is unconstitutional to confer a discretionary power on an administrative functionary (such as the Registrars) without circumscribing the manner in which that power is to be exercised. In other words, adequate guidance should be provided as to the exercise of discretionary power. The objectionable breadth of the Registrars' powers is illustrated by the following aspects of proposed regulations 7.4 and 7.5:

- the MS Registrar may opine that the policy is contrary to the objectives and purpose of the MS Act. A perusal of the MS Act reveals that the "*objectives and purpose*" of that Act is a vague concept. The preamble to the MS Act suggests, for example, that the objects of the Act include "*to protect the interests of members of medical schemes; to provide for measures for the co-ordination of medical schemes; and to provide for incidental matters*". The reference to the objectives and purpose of the MS Act thus provides no clarity as to how or on what basis the MS Registrar would advise the LTI Registrar;

- the addition of the phrase "*with specific reference to section 72(2A)(b)(i)(cc)(A) to (C) of the [MSA]*" adds to the uncertainty. It seems to suggest that the MS Registrar must base his or her advice on the broad objectives and purpose of the MS Act, while placing particular emphasis on the principles referred to in paragraphs (cc)(A) to (C). In addition to the difficulty of reconciling the general reference to the objectives and purpose of the MS Act with the specific reference to these paragraphs, we note that the principles in these paragraphs (community rating, open enrolment and cross-subsidisation) are themselves open-ended;

- the LTI Registrar may "*object*" to any benefits, terms and conditions and marketing material, but no guidance is given as to the circumstances in which the LTI Registrar may wield this far-reaching power. No requirements are specified for the exercise of this power, and no relevant considerations are specified;

- the LTI Registrar may decide to object to a policy either on his or her own accord or after considering the opinion of the MS Registrar; and

- both Registrars may exercise their powers under these regulations at any time, notwithstanding that the relevant policy may have been launched or that the affected policies

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may have been concluded, well before (in fact, even several years before) the Registrar's decision to prohibit the particular policy.

2.4.4.9 The proposed regulations 7.4 and 7.5 do not provide for the relevant insurer and affected policyholders to make representations prior to the Registrar deciding to prohibit, or to instruct the insurer to amend, the policy. This is contrary to the requirement of procedural fairness. Affected persons must be given a reasonable opportunity to make representations prior to decisions that adversely impact on their rights.

2.4.4.10 The impact of 7.4 and 7.5 needs no further explanation other than for it to be said that the impact of this will be disruptive, likely to be outside of the statutory authority of the Minister as described above, potentially discriminatory for consumers and insurance companies alike and will bring the entire industry into a state of confusion. Accordingly, we submit that these extensive powers conferred to the Registrars are objectionable in the strongest terms therefore requiring a review in the context described above.

**2.5 <u>Impact to Customers/Consumers</u>**

2.5.1 The Draft Demarcation Regulation may restrict customer product choice and the ability to select products that meet individual needs.

2.5.2 Provisions of the Draft Demarcation Regulations will lead to an increase in the cost per policy, which will lead to increase costs to the consumer

2.5.3 It is submitted that the proposed regulations will in all likelihood result in an increase in the costs to insurers, specifically due to the reporting requirements in the proposed regulations 7.4 and 7.5 namely the requirement to report to both the LTI Registrar and the Registrar of Medical. These costs will ultimately get passed onto consumers

2.5.4 The proposal to introduce limitations on the value of the benefits in category 1 of the table contained in the proposed regulation 7.2 (1) will furthermore add to the costs at the underwriting stage of the products that are subject to regulation in terms of the Draft Demarcation Regulations. 2.5.5 Currently, these products are introduced into the market without any underwriting relating to the determination of income

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2.5.6 The Draft Demarcation Regulations provide in regulation 7.2.2 that an insurer may not refuse any claim for policy benefits on the grounds that the policyholder or insured person experienced a health event prior to the commencement of the applicable cover, unless a material misrepresentation or non-disclosure in regard to such health event has occurred. This provision will require insurers to underwrite policies that are subject to regulation in terms of the Draft Demarcation Regulations on an individual basis leading to further increase in costs to consumers

2.5.7 The products offered by Chartis and certain other companies in the Insurance Industry can NOT be considered as undertaking the business of a Medical Aid. Additionally, health insurance products, similar or identical to those marketed in South Africa, exist side by side with private or national health schemes (NHS) in dozens of other markets throughout the world, without detrimental impact on them. In some cases governments actively support these as complementary to their NHS.

2.6 <u>**Impact to the Insurers**</u>

2.6.1 The Draft Demarcation Regulations will, if promulgated in their present form, have a dramatic impact on long-term and short-term insurance business in South Africa. The fact that it will not only strictly regulate certain types of insurance business, but will preclude insurers from underwriting certain types of insurance business, which they have been underwriting for many years and in respect of which they spend substantial funds to develop and promote products that give customers choice and meet market needs. Although it is not clear, due to the vague and unclear wording of the Draft Demarcation Regulations which products the National Treasury intends to regulate in the Draft Demarcation Regulations, we estimate that this could affect millions of policy holders across the insurance industry and possibly more than 200,000 Chartis insured persons.

2.6.2 It is submitted that the limited number of categories contained in the Draft Demarcation Regulations will un-intentionally, severely inhibit the new design of insurance products. The extremely wide and vague wording of category 1 will further exacerbate the situation.

2.6.3 A significant number of jobs in the insurance industry could be directly affected, the true impact of which can only be determined following clarification and promulgation of the Draft Regulations.

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0860 002526
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## 2.7 Perceived discriminatory nature of Draft Demarcation Regulations

2.7.1 The criteria stipulated in category 1, which seeks to limit the policy benefits offered in terms of these types of policies to 70% of the policyholder's net income per day is in our view discriminatory in nature in view of the fact that consumers that are low earners will be restricted from choosing a suitable benefit level and non-income earners (which include pensioners and housewife's) will not be allowed to attain cover in terms of these types of policies.

2.7.2 Also hospital cash plans and cash income plans are not currently related in any way to salary levels as is common practise in the worldwide insurance industry.

2.7.3 We accordingly do not support the rationale behind the Draft Demarcation Regulations in view of the National Treasury's failure to share factual and empirical evidence supporting its policy considerations underlying the Draft Demarcation Regulations.

2.7.4 It is submitted that the aforesaid position prejudices consumers that are unfairly denied access to policies that may provide essential cover.

2.7.5 It is further clearly discriminatory in nature to identify AIDS/HIV as the only disease in respect of which insurers may provide cover for medical treatment. It is proposed that the identification of AIDS/HIV as the only disease for which one may provide cover is insensitive and unfair and contravenes the provisions of, at least, section 9 of the Constitution read together with the provisions of the Promotion of Equality and Prevention of Unfair Discrimination Act No. 4 of 2000, ("the Equality Act").

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## 2.8 Conclusion

The comments herein presented set out Chartis rationale for the substantial review and redrafting of the Draft Demarcation Regulations.

Chartis confirms its amenability to further engage with the office of the National Treasury on the Demarcation Regulations.

We reserve the right to amend our submission insofar as changes in legislation or in light of any further information that may in our view, warrant further comment.

Insurance Fraudline
0860 002526
insurance@fraudline.co.za