national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

HIGH-LEVEL RESPONSE TO COMMENTS RECEIVED

High-level response to comments received on the draft Regulations under the Long-term Insurance Act, 1998 and Short-term Insurance Act, 1998 published in March 2018 for public comment

May 2018

This document must be read in conjunction with the following documents published together with the final Regulations:

- Responses to comments on Long-term Insurance Act, 1998: Proposed amendment of Regulations made under section 72
- Responses to comments on Short-term Insurance Act, 1998: Proposed amendment of Regulations made under section 70

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1. BACKGROUND AND PROCESS

On 23 March 2018, National Treasury (NT) with the support of the Financial Services Board (now the Financial Sector Conduct Authority, hereafter referred to as the 'FSCA') published for public comment the proposed amendments to the Regulations made under the Long-term Insurance Act, 1998 ("LTI Act") and the Short-term Insurance Act, 1998 ("STI Act") ("draft Regulations"). The purpose of the draft Regulations is to –

- align the LTI Act / STI Act Regulations (specifically terminology) with the Insurance Act, 2017 (Insurance Act) as enacted on 18 January 2018;
- further strengthen policyholder protection by providing for more robust legislative requirements pertaining to the collection of premiums by intermediaries; and
- amend the binder regulations to provide for certain procurement and transformation requirements.

The Insurance Act provides for the prudential legislative framework for insurers. The commencement date of the Insurance Act is still to be determined by the Minister. The Insurance Act repeals all prudential requirements that are currently provided for in the LTI Act and STI Act, but provides for a two-year transition period for insurers to migrate from the existing to the new framework. Non-prudential sections in the LTI Act and STI Act will remain in force in parallel to the new prudential requirements, to provide an interim conduct of business legal framework for insurers pending implementation of the envisaged Conduct of Financial Institutions Act (still in drafting phase).

Over this transition period it is important that insurers are subject to equivalent regulatory requirements for market conduct across the existing and new frameworks, in order to promote regulatory certainty for regulated entities, and ensure a level regulatory playing field across the two frameworks and mitigate the risk of regulatory arbitrage. Regulated entities should not be materially advantaged or disadvantaged by entering into the new framework, relative to those that have not yet migrated across. It is therefore critical that the draft Regulations are made effective as close as possible to the effective date of the Insurance Act in order to preserve the integrity of the conduct of business framework for insurers as encapsulated in the LTI Act and STI Act, including the Regulations and Policyholder Protection Rules (PPRs) made thereunder.

In support of consumer protection, these draft Regulations made in terms of the STI Act and LTI Act also give effect to this "equivalence" across the LTI Act, STI Act and Insurance Act, specifically in respect of premium collection. The draft Regulations improve the premium collection framework for the entire insurance market and compel insurers to have appropriate oversight of independent intermediaries collecting premiums.

In support of transformation of the insurance sector, the draft Regulations also better align the insurance laws to requirements of the Financial Sector Code issued in terms of section 9(1) of the Broad-Based Black Economic Empowerment Act, No. 53 of 2003. The draft Regulations require binder agreements between insurers and third parties to provide for mechanisms and measures that will assist the insurer in meeting procurement, enterprise and supplier development targets aimed at promoting transformation in the insurance sector.

During the course of April 2018, the NT with the support of the FSCA hosted industry workshops with the purpose of positioning the changes proposed in the draft Regulations. The due date for submission of comments was 23 April 2018.

A total of 18 commentators provided feedback on the draft Regulations through the formal consultation process. The NT in conjunction with the FSCA undertook a comprehensive review of all comments received.

The purpose of this document is to provide a high-level overview of the comments that were received on the draft Regulations and to explain the most significant changes that were made to the draft Regulations in light of these comments, subsequent to the public comment process.

The draft Regulations must be read with the proposed amendments to the PPRs. The proposed amendments to the PPRs aim to –

- align the PPRs (specifically terminology) with the Insurance Act;
- provide for certain conduct of business related requirements that will be repealed from the LTI Act and STI Act through Schedule 1 to the Insurance Act, once the latter Act commences, as these conduct requirements are better placed in subordinate conduct legislation; and
- provide for microinsurance product standards by giving effect to the National Treasury's Microinsurance Policy Document (Microinsurance Policy Document) released in July 2011.

2. COMMENTS AND RESPONSE

2.1 Alignment of terminology between the LTI Act / STI Act and the Insurance Act

No significant comments were received on amendments dealing with the alignment of terminology between the LIT Act / STI Act and the Insurance Act. Some of the comments resulted in minor changes to the amendments, although these were mostly drafting or technical changes.

2.2 Requirements pertaining to the collection of premiums by intermediaries

The vast majority of comments received on the draft Regulations focused on the proposed amendments to the legislative requirements pertaining to the collection of premiums by intermediaries. Insurers, in general, were not significantly opposed to the proposed amendments although several practical concerns were raised with some of the requirements. The most significant opposition to the proposed amendments to the premium collection framework was received from two premium collection agencies.

The comments received on the proposed premium collection legislative framework are discussed below in more detail. For background and context to the legislative framework for premium collection and the matters that informed the proposed amendments thereto please refer to paragraph 2.3 of Annexure E titled "Statement on the proposed amendments to the

Regulations made under the Long-term Insurance Act, 1998 and Short-term Insurance Act, 1998" that was published by National Treasury together with the proposed amendments to the Regulations on 23 March 2018.

2.2.1 Intermediaries Guarantee Facility (IGF) and/or additional form of security

A number of commentators questioned the removal of the IGF / guarantee requirement and several requested that the IGF requirement be phased out over a period of time. Various arguments were made in this regard. However, the reality is that the IGF (a registered insurer) will not continue to operate as an insurer under the Insurance Act's Solvency Assessment and Management (SAM) framework and will start running off its business as soon as the Insurance Act is made effective. As such, the IGF requirement cannot be retained in the Regulations. Further, the IGF / guarantee requirement has always been there to protect the insurer. There is no rationale for retaining the requirement in legislation that has a conduct of business objective. Consumers are protected against the consequences of misappropriation of premiums by the intermediary by virtue of provisions in the legislation that deem the premium to be received by the insurer upon receipt by the intermediary. Accordingly the risk of misappropriation is borne by the insurer, not the policyholder. The Insurance Act provides a robust governance and internal control framework, inter alia through the SAM framework. The relevant risks to the insurer will therefore be managed through this framework.

2.2.2 Extended authorisation requirement[1]

No significant concerns were raised in respect of the proposed amendment that the premium collection authorisation provided to an intermediary must provide for various matters, save for the issue discussed under "remuneration" below. One commentator submitted that the proposal will lead to a range of different requirements as insurers specify their own preferences. Our view is that insurers should be able to specify their own preferences as long as the intended outcomes are achieved. This is in line with the shift to a more principle and outcome based regulatory and supervisory approach which allows more flexibility for regulated persons.

2.2.3 Remuneration

The proposed regulations 8.1(1)(b) (LTI Act Regulations) and 4.1(1)(b) (STI Act Regulations) provide that the authorisation provided to an independent intermediary to collect premiums must specify the commission payable by the insurer to the independent intermediary for services rendered under the authorisation. A significant number of comments were received on this requirement. Commentators seem to be under the misconception that this requirement changes the nature of the remuneration that an intermediary may receive for performing the function of collecting premiums. According to the existing Regulations, premium collection falls within the definition of "services as

[1] Regulation 8.1(1) (LTI Act Regulations) and 4.1(1) (STI Act Regulations).

intermediary". Remuneration for performing services as intermediary is subject to the commission regulations. It has therefore always been our view that remuneration for premium collection is subject to the commission regulations. Nothing in the draft Regulations proposes any changes in this regard and any contentions by commentators to the contrary which infer that we are proposing to change remuneration structures to the detriment of intermediaries are inaccurate.

A more justified objection to this proposed regulation raised by a few commentators was that the requirement to specify the commission payable for premium collection in the authorisation raised practical challenges in cases where the remuneration for premium collecion was combined with other commission payable to the intermediary for other services as intermediary. Accordingly, due to this latter objection, this requirement has been deleted. We emphasise however that such deletion does not alter the position set out in the preceding paragraph, namely that remuneration for premium collection falls within the ambit of the commission regulations.

Related to the issue of remuneration is the issue of interest earned on premiums collected. One commentator inferred that the draft Regulations now propose that interest earned on premiums collected by an intermediary accrues to the insurer. We wish to clarify that the draft Regulations do not address the issue of interest earned on premiums collected.[2]

2.2.4 Authorisation of more than one independent intermediary to receive, hold or in any other manner deal with premiums[3]

Commentators in the long-term insurance industry highlighted that the proposed prohibition on authorising more than one independent intermediary will result in significant complexities in the funeral insurance market and proposed that this requirement is deleted. Commentators in the short-term insurance industry also requested clarity in respect of this requirement. To avoid any potential practical difficulties in complying with the draft requirement, it has been decided to remove the requirement. The relevant risks which this requirement intended to mitigate will be dealt with under the governance and oversight requirements imposed on insurers through the premium collection framework and through the supervisory process.

2.2.5 Separate bank account designated for receiving and submitting premiums only[4]

Several commentators opposed this requirement due to practical challenges. It was, amongst other things, argued that often premiums are collected as part of a bigger

[2] Notwithstanding, it has always been our view that interest earned on premiums should in fact accrue to the insurer concerned as the premiums received by the intermediary are deemed to be received by the insurer in accordance with section 47(3) of the LTIA Act and 54(4) of the STI Act, and therefore the premiums are deemed to be the insurer's money as soon as the intermediary receives same.

[3] Regulation 8.1(3) (LTI Act Regulations) and 4.1(3) (STI Act Regulations).

[4] Regulation 8.2(1) (LTI Act Regulations) and 8.2(2) (STI Act Regulations).

amount which comprises various other payments (e.g. a credit insurance premium collected together with a credit agreement instalment). In these instances it was argued that a requirement for the premium to be split out and transferred separately would be extraordinarily difficult to comply with and would lead to an undue administrative burden and costs. It was also argued that the negative practical impact is disproportionate to the risk this requirement seeks to mitigate. We acknowledge that the requirement might pose practical difficulties in various instances. However, we still maintain that there must be a separate collection account ring-fenced from other operational activities to ensure the premium collector's business operations and own funds are kept separate from premiums. For this reason this requirement has been amended to provide that the intermediary must still maintain a separate bank account for the collection of premiums, but that other collections from financial customers can also be received into this account. In addition, the account cannot be used for the premium collector's operational purposes.

2.2.6 Premiums may only be transferred to the insurer to whom the premium is intended and may not be utilised for any purpose other than remitting the premium to the insurer concerned[5]

Various arguments were raised raising concerns with some of the aspects of this requirement. One commentator stated that the requirement will add unnecessary complexity and will result in legitimate current practices becoming impossible of performance. It was also argued that the wording of this requirement is very restrictive and a greater degree of flexibility needs to be provided for. The intention behind this requirement was to avoid the untenable risk created by persons collecting premiums and using them for inappropriate purposes such as personal investment purpose and in business ventures (a known practice), or generally as a source of profit. It has come to our attention that premiums are used not only for inappropriate operational purposes but are in some instances also invested in instruments which are insufficiently liquid or used to fund loans to third parties. The insurer to whom the premium belongs is also not aware of the practice and has not given its permission for these specific uses. We are therefore of the opinion that there is a real need for this requirement. We do however acknowledge that practical difficulties may arise and that the requirement as proposed might be overly restrictive. For this reason this requirement has been deleted and a requirement has been added under the extended authorisation requirements which provide that the authorisation provided by the insurer must specify for which purposes the premiums may be used. An additional requirement has also been inserted which states that the purposes for which premiums may be used may not put the insurer at risk. It is therefore in the discretion of the insurer to specify for what additional purposes, if any, premiums in the collection account may be used. This requirement will mitigate the relevant risk to a large extent but still provides the necessary flexibility.

[5] Regulation 8.2(3) (LTI Act Regulations) and 4.2(5) (STI Act Regulations).

2.2.7 Allowable deductions[6]

Several commentators requested that provision be made for additional deductions from the premiums collected, specifically the deduction of commission payable to other intermediaries under the relevant policies and deductions for binder and other outsourcing fees. The comments were noted but as this is an existing requirement under the STIA Act Regulations and because we would first like to have a better understanding of what potential conduct of business risks could arise if the requirement is extended, we are not amenable to changing this requirement at this stage.

2.2.8 Exemption mechanism

Commentators raised several practical issues relating to complying with the draft Regulations. Although the draft Regulations were amended to accommodate these practical concerns as far as possible, there is still a risk that the revised draft Regulations might not in all respects accommodate certain legitimate business models operating in the market, leading to practical difficulties in complying with the Regulations. Where practical difficulties with specific legitimate business models still arise, and the business model does not pose a significant risk to insurers or policyholders, we recognise that there should be a mechanism to deal with this practical difficulty. For this reason the draft Regulations have been revised to provide for an exemption mechanism. The Authority will have the discretion to exempt an insurer or independent intermediary from compliance with a specific requirement contained in the premium collection legislative framework, on conditions, if the criteria provided for are met.[7] .

2.2.9 Transitional arrangements

Specific inputs were requested on proposed transitional arrangements relating to the premium collection legislative framework. A variety of proposals were received, some of which proposed an unduly long transitional period.

We acknowledge that insurers will need some time to renegotiate agreements with intermediaries and to formulate controls and systems to comply with the new requirements. After considering the comments, it was deemed appropriate to have a transitional period of 12 months apply to all the new requirements relating to premium collection, with the exception of the following provisions which will take effect immediately on the effective date of the amended Regulations –

- regulation 4.1(4) of both the LTI Act and STI Act Regulations; and
- the requirement under the LTI Act Regulations that the authorisation must be in writing.[8]

[6] Regulation 8.2(5) (LTI Act Regulations) and 4.2(7) (STI Act Regulations).
[7] Which, amongst other things, provides for practical considerations.
[8] This is a new requirement in the LTI Act Regulations but seeing that section 47A of the LTI Act will be effective and already provides that an independent intermediary must be authorised to collect premiums, there is no harm in making the requirement that the authorisation must be in writing effective immediately.

All premium collection requirements in relation to short-term insurance that are already contained in the existing STI Act and Regulations will be made effective immediately.

2.3 Maximum commission payable on motor policies exceeding R120,000 underwritten by microinsurers

To align with the proposal in the Microinsurance Policy Document, the proposed amendments suggested that microinsurers will not be subject to commission caps when underwriting non-life insurance business. However, at the time of publishing the proposed amendments the benefit limit for microinsurers underwriting non-life insurance business, as published by the Prudential Authority in the draft Prudential Standards, was R120,000. This limit has since been increased by the Prudential Authority to R300,000. As policyholders purchasing motor policies between R120,000 and R300,000 are within the target market of both microinsurers and traditional insurers, the increase in benefit limit coupled with the proposed uncapped commission for microinsurers has led to a potential commission arbitrage between microinsurers and traditional insurers operating within this market. For this reason the proposed amendments have been revised by imposing normal commission caps on motor policies exceeding R120,000 written by microinsurers.

2.4 Binder Regulations – Procurement and Transformation requirements

No significant comments were received on the proposed amendment requiring that binder agreements must provide for certain procurement and transformation requirements. The comments mainly requested clarity on certain aspects and one comment enquired whether the requirement will apply to new binder agreements only, or also to existing binder agreements.

This requirement will become effective immediately for all binder agreements entered into after the effective date. However, the revised draft Regulations now contain a transitional period for binder agreements that existed before the effective date. Existing binder agreements will have until 31 December 2018 to comply with this requirement. This transitional deadline was deemed appropriate as it aligns to the timeline within which insurers must amend their binder agreements to comply with certain requirements that were provided for in the Tranche 1 amendments to the Regulations.[9]

3. CLOSING

The final Regulations will become effective on 1 July 2018, subject to the transitional provisions stipulated in the Regulations. National Treasury and the Financial Sector Conduct Authority would like to take this opportunity to thank all commentators and industry participants for the positive and collaborative approach adopted in formulating these Regulations.

[9] That was published on 15 December 2017.