



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA



ANNEXURE C

SUMMARY OF SIGNIFICANT CHANGES TO THE INSURANCE BILL, 2016

1. PURPOSE

The purpose of this document is to summarise the most significant changes made to the Insurance Bill, 2016 post publication for public comment on 17 April 2015 (“the 17 April-Bill”). These changes are reflected in the Bill tabled in Parliament.

2. DEFINITIONS

Several definitions have been amended to further clarify the intention of those definitions and new definitions have been introduced to facilitate the application and interpretation of the Insurance Bill. The most significant changes to the definitions are discussed below.

2.1 “beneficiary”

Concerns were raised that the definition of “beneficiary” created a contractual relationship between beneficiaries and insurers. The definition has been amended to accommodate these concerns. A distinction has been drawn between a beneficiary under an individual policy and a beneficiary under a group policy. A beneficiary under an individual policy is the person stated in the insurance policy or a person nominated by the policyholder as the person in respect of whom the insurer must meet the insurance obligations. A beneficiary under a group policy is the member of the association or fund, or employee (as the association, fund or employer is the policyholder) or the person nominated by the member of the association or fund, or employee, in respect of whom the insurer should meet the insurance obligations (other than the policyholder). The definition has also been moved to Schedule 2.

2.2 “policyholder”

Concerns were raised that the definition of policyholder did not adequately accommodate a nomination of ownership or cession. The definition of policyholder has been amended to accommodate these concerns. The phrase “conclude an insurance policy” has been changed to “entered into an insurance policy” and the successor in title of an insurance policy has been included in the definition of policyholder.

2.3 “personal lines”

Concerns were raised that the definition of personal lines is too wide and might have unintended consequences as it did not differentiate between a person purchasing insurance in a personal capacity and business capacity, respectively. The definition has been amended to make this distinction and also to align with the definition of personal lines in the Financial Advisory and Intermediary Services Act, 2002.

2.4 “premium”

The definition of “premium” has been refined to ensure that the definition links “consideration payable” to the undertaking to meet insurance obligations. The term “premium” is now defined as a direct or indirect, or partially or fully subsidised consideration given or to be given in return for an undertaking to meet insurance obligations.

2.5 *Definitions relating to insurance policies and insurance business*

The definitions of life insurance policy and non-life insurance policy as contained in the 17 April-Bill proposed a significant shift from the current approach of the Long-term Insurance Act, 1998 ("LTIA") and Short-term Insurance Act, 1998 ("STIA") that relies on the common law principles of what constitutes insurance. The intention was to provide a comprehensive definition of an insurance contract by embedding these common law principles in the definitions. This was deemed necessary because of prevailing legal uncertainties when considering whether or not certain contracts constitute insurance contracts. Common law principles such as indemnity and non-indemnity (capital insurance); insurable interest and the like were incorporated into the proposed definitions. Concerns were raised with this new approach, in the absence a comprehensive review of the possible implications and extensive consultation.

The definitions have been amended to revert back to the existing approach. Some minor elements contained in the previous definitions were however retained (e.g. the reference to indemnification under non-life insurance). Development of a comprehensive definition of insurance may be considered under future regulatory reforms, subject to further research involving an insurance law expert group, and extensive stakeholder consultation.

2.6 *Definitions relating to cell captive and captive insurers*

Concerns were raised that the definition of "cell structure" did not expand on the concepts of first party and third party risks and it was proposed that the latter concepts should be defined. For purposes of providing further legal clarity the concepts "first party risks" and "third party risks", in the context of cell arrangements, and "operational risks" (for purposes of first party risks) have been defined.

3. COMMON LAW

Section 2(7) of the 17 April-Bill provided for the codification of the common law definition of what constitutes insurance. Commentators opposed this in the absence a comprehensive review of the possible implications and extensive consultation. The clause has been omitted from the final version of the Insurance Bill. Codification of the common law definition may be considered under future regulatory reforms, subject to further research involving an insurance law expert group, and extensive stakeholder consultation.

4. CONTROLLING COMPANIES OF INSURANCE GROUPS

The 17 April-Bill required that a controlling company (which is the holding company of an insurance group) must be a public company whose only business is the acquiring, holding and managing of another company or other companies (i.e. a non-operating company). After consideration of the comments received, a less restrictive position has been adopted in the Insurance Bill, i.e. –

- controlling companies will be allowed to have a legal status other than a public company;
- controlling companies will be allowed to be operating companies; and
- controlling companies are not limited to the holding companies registered under the Companies Act - other juristic persons (other than holding companies) that control an insurance group may also be regarded as a controlling company.

However, controlling companies must be located in South Africa. Controlling companies must also be licensed (to align with the approach to financial conglomerates set out in the Financial Sector Regulation Bill (“FSR Bill”)). The Prudential Authority may also require a controlling company to be a non-operating company as a condition of licensing.

5. LINKED INSURERS

The 17 April-Bill proposed several requirements applicable to linked insurers. Most significantly, it proposed that linked insurance business may only be conducted under a dedicated linked insurance licence. It was also proposed that a linked insurer may not enter into reinsurance arrangements, other than to reinsure its operational risks. Several commentators opposed these requirements because of the risk of various unintended consequences, for example in respect of the tax treatment of investments in linked policies by retirement funds.

In the tabled Bill, linked insurance and other life insurance will be allowed to be written under the same licence. The supervisory approach will endeavour to manage risks inherent to linked insurance. The requirement that linked insurance business may not be reinsured has also been removed. The intended review of both the licensing and reinsurance framework for linked insurance has been deferred to allow more time for a process of further research and consultation.

6. REINSURANCE AND CELL CAPTIVE INSURERS

The 17 April-Bill prohibited cell captive insurers from conducting reinsurance business. Commentators raised concerns with this approach, as it would have prohibited certain existing practices. To address these concerns, in the tabled Bill provision has been made for cell captive insurers to underwrite inward reinsurance from foreign insurers.

Cell captive insurers are therefore only prohibited from insuring -

- first party risks and third party risks in the same cell structure; and
- the risks associated with the insurance obligations of another licensed insurer.

7. COMPOSITE REINSURERS

The 17 April-Bill provided that reinsurers may not be licensed to conduct business in both life- and non-life insurance (i.e. may not be a composite reinsurer). Several commentators raised concerns regarding this prohibition, specifically insofar as it relates to professional reinsurers (insurers licensed to conduct reinsurance business only).

After further consideration of the benefits and risks, the tabled Bill provides for the licensing of professional reinsurers to conduct both life- and non-life insurance business in the same licence, with the qualification that investment business and risk business may not be reinsured in the same reinsurance licence.

8. LLOYD’S AND BRANCHES OF FOREIGN REINSURERS

The application of governance, security, reporting obligations and the like for Lloyd’s and branches of foreign reinsurers in the 17 April-Bill was not considered appropriate in all instances. These requirements have been refined to ensure that they are appropriate and practical when applied to Lloyd’s and branches of foreign reinsurers,

considering the nature of Lloyd's business model and the way in which branches of foreign reinsurers will conduct business in South Africa.

Refinements made include, amongst others, the following –

- In respect of “board of directors”, a reference the Council of Lloyd's was inserted;
- Lloyd's has been excluded from section 5(4) (prohibition on conducting insurance business outside of South Africa without approval);
- A further qualification has been inserted in section 7(1)(a) (claims against Lloyd's underwriters in South Africa and recognition of such claims by South African courts);
- Lloyd's will be allowed to conduct certain personal lines non-life insurance business, subject to approval by the Prudential Authority (section 24(2));
- In respect of the appointment of an auditor, the previous section 30 has been qualified and the new section 32 provides for more appropriate requirements;
- Lloyd's has been excluded from the requirements relating to information concerning beneficial interest (see previous section 39 and new section 43);
- Lloyd's has been excluded from the requirements relating to financial statements and accounting (see previous section 42 and new section 46). Specific and appropriate accounting requirements have been introduced for Lloyd's. Specific and appropriate requirements relating to what must be audited by Lloyd's have been introduced (see the new section 47(3));
- The required notification of when there is a change in law governing Lloyd's has been refined and its application has been narrowed (see the old section 44(1) and the new section 48(1));
- Lloyd's has been excluded from the requirements relating to acquisition or disposals (old section 47); and
- Lloyd's has been excluded from the application of the Resolution Chapter (Chapter 9) and a new section relating to a Lloyd's trust has been inserted (see Chapter 6, Part 2).

The changes alluded to above apply equally to branches of foreign reinsurers in the majority of instances.

9. FAILURE TO MAINTAIN FINANCIAL SOUNDNESS

The implications and process to be followed when an insurer or insurance group fails to maintain a financially sound condition have been clarified. Distinct processes following a breach of the MCR or the SCR have been provided for.

10. RESOLUTION

Lloyds's and branches of foreign reinsurers

The Resolution Chapter of the 17 April-Bill (Chapter 9) did not exclude Lloyd's or branches of foreign reinsurers from its ambit. After considering comments in this regard, Lloyd's and branches of foreign insurers have been excluded from the Resolution Chapter in the Bill, except from a new section which has been inserted for the winding up of trusts established in South Africa by Lloyd's or a branch of a foreign reinsurer.

The Chapter on resolution may be amended subsequent to the finalisation of a broader resolution framework that is in the process of being developed by the National Treasury, in consultation with the SARB and FSB.

Preferred claims for policyholders

The 17 April-Bill introduced a creditor hierarchy in insolvency, which hierarchy provided for the preference of certain policyholders claims. This requirement has been removed in the tabled Bill as the creditor hierarchy of policyholder claims will be addressed as part of the broader resolution framework referred to above.

11. EQUIVALENCE OF FOREIGN JURISDICTIONS

The 17 April-Bill required that a branch of a foreign reinsurer must, before it can be licensed under the Bill, demonstrate that the regulatory framework of the foreign jurisdiction in which it operates is equivalent to that established by the Bill. The prudential standards will also provide for the different treatment of reinsurance placed in an equivalent jurisdiction from that placed in a non-equivalent jurisdiction when calculating financial soundness. The onus to demonstrate that the regulatory framework in the foreign jurisdiction is equivalent to South Africa's regulatory framework was therefore placed on the foreign reinsurer or insurer. Several commentators raised a concern with this requirement and submitted that it places an onerous and very difficult task on foreign reinsurers. To alleviate this onus, provision has been made for the Prudential Authority to determine and publish a list of foreign jurisdictions that are considered equivalent to South Africa in respect of its insurance regulatory framework.

12. POWERS AND FUNCTIONS OF REGISTRAR (NOW PRUDENTIAL AUTHORITY)

The 17 April-Bill provided the Prudential Authority with several regulatory powers. As a final version of the FSR Bill was not finalised at the time when the 17 April-Bill was published, full alignment of regulatory powers as provided for in the FSR Bill and Insurance Bill could not be achieved at that time. However, as the FSR Bill has since been tabled, the Insurance Bill has now been amended to fully align with the provisions of the FSR Bill insofar as it relates to regulatory powers (also see below).

13. GENERAL ALIGNMENT WITH FSR BILL

Similar to the explanation provided in respect of the alignment of regulatory powers insofar as it relates to the FSR Bill and Insurance Bill, all other provisions in the Insurance Bill that are similar to or are linked to provisions contained in the FSR Bill have been aligned. This includes, amongst other things, the following –

- All references to “Registrar” have been replaced with “Prudential Authority”;
- The definitions of “person” and “significant owner” have been amended to refer to the FSR Bill;
- The interpretation clauses relating to the superiority of the Insurance Bill when there is an inconsistency between the Insurance Bill and other legislation in certain circumstances has been amended to exclude the FSR Bill and the Financial Intelligence Centre Act;
- Requirements relating to significant owners and group structures have been aligned to the FSR Bill and references to financial conglomerates have been omitted from the Insurance Bill as the regulatory framework for financial conglomerates is contained in the FSR Bill;
- The consultation requirement for making prudential standards has been deleted as consultation will occur in terms of the provisions of the FSR Bill with respect to the making of regulatory instruments.

14. SPECIFIC EXEMPTIONS FOR CERTAIN INSURERS

The Insurance Bill provides that an insurer (other than a microinsurer) must be a public company or state owned company registered under the Companies Act. However, several insurers have operated in a specific legal form (other than a public company) for an extended period of time and due to the nature of their business it would be impossible for such insurers to convert to public companies. For this reason these insurers have been granted a special exemption from the requirement to be a public company or state owned company. These insurers are –

- (a) insurers that are mutual associations licensed under section 30(1) of the Compensation for Occupational Injuries and Diseases Act, 1998 (Act No. 130 of 1998);
- (b) the AVBOB Mutual Assurance Society established in terms of the AVBOB Mutual Assurance Society Incorporation (Private) Act, 1951 (Act No. 7 of 1951);
- (c) the Attorney Insurance Fidelity Fund NPC (registration number 1993/03588/08) for as long as it remains registered as a non-profit company under the Companies Act; and
- (d) the Home Loan Guarantee Company NPC (registration number 1990/001845/08) for as long as it remains registered as a non-profit company under the Companies Act.

15. ACCIDENT AND HEALTH CLASS OF NON-LIFE INSURANCE BUSINESS

The 17 April-Bill did not allow non-life insurers to underwrite life, death or disability events. This brings a change from the current position as short-term insurers can currently write death and disability events under an accident and health policy as defined in the Short-term Insurance Act. It is worth noting that the current definition of accident and health policy is however ambiguous and although it appears as if it might have been the intention that accident and health policies under the Short-term Insurance Act should be limited to accidental death and disability, the way in which the definition is currently worded does not express this intention clearly. The rationale for disallowing non-life insurers from underwriting life, death or disability events was that the skills required to underwrite “life risks” such as death and disability is well embedded in the life insurance industry and forms the basis of what constitutes life insurance, and that short-term insurers, skilled at writing indemnity based risks, do not have the necessary skills to underwrite such life risks.

Commentators in the short-term insurance industry opposed the proposed change to disallow the underwriting of death or disability events because of existing industry practices. The tabled Bill refines this approach by allowing non-life insurers to underwrite death and disability events in the case of an accident (see definition of “non-life insurance policy” and “accident”). This approach gives effect to the intention of accident and health policies (which has always been understood to mean that only accidental death and disability are covered). The risks associated with accidental death and disability are of a nature more familiar to the shorter-term insurance sector and can be properly managed in a non-life insurer environment.

16. GENERAL - CLASSES / SUB-CLASSES

Several amendments have been made to the authorisation classes and subclasses in Schedule 2 to further clarify the intention of the respective classes and sub-classes. Changes entail –

- a refinement of the descriptions under some of the classes and sub-classes;
- refinement and consolidation of some of the subclasses (see for example the Risk class and related sub-classes);
- insertion of a fund risk class (this previously formed a sub-set of the individual investment class, where a fund is the policyholder of the individual investment policy, but this has now been separated out into a distinct class to allow for specific authorisation);
- alignment of the credit life class with the wording of a credit life policy as contained in the National Credit Act, specifically by making provision for payment of benefits in the event of unemployment;
- creating more specific sub-classes under non-life insurance to provide for separate reporting for personal and commercial lines (and Group where applicable).

17. GROUP POLICY STRUCTURES

The intention behind introducing definitions for “individual” and “group” policies in the Insurance Bill was to address certain abuses and regulatory challenges that have been identified. These include, amongst others, arguments made by some insurers that the members in certain group policies (dependent on the structure) are not viewed as policyholders for purposes of the Long-term- and Short-term Insurance Acts (specifically in the case where the contract does not allow members a direct claim to policy benefits). These arguments result in practices that have a negative impact on the protection of members of a group insurance policy, as the members are deprived of certain basic rights that they otherwise would have enjoyed if they were recognised as the indirect policyholder. Further problem areas in this regard relate to remuneration, intermediation, conflict of interests, misleading advertising and increased premiums. In respect of the latter, quite often the main policyholder in a group scheme (e.g. a funeral parlour or administrator) will add additional amounts to the premium determined by the insurer and therefore charge members higher premiums than the insurer in actual fact requires. The abuse is most prevalent in the wholesale funeral insurance market, targeting the lower income segment market.

The definition of a “group” policy in the 17 April-Bill attempted to provide a solution to the existing lack of clarity and abuse taking place through group structures. Subsequent to the Bill being made available for public comment, it was identified that the proposed definition of “individual” and “group” policy could allow room for circumvention of this intention, with the risk that insurers would be able to perpetuate existing poor practices with respect to group structures through writing such policies as “individual” policies, as the definition of “individual” was not sufficiently restrictive.

For this reason the definitions of “group” and “individual” have been revised. It is believed that this will help address the most problematic business models supported by existing group structures. The essence of the new definitions is as follows (please note that the definition of “group” remains largely unchanged) –

Group

- An insurer will still be able to conclude a “group” (as defined) policy with an employer or a fund or an association of persons. However, the association of

persons with whom an insurer may conclude a group policy must meet certain criteria, namely it must be autonomous; must be united voluntarily to meet common or shared economic and social needs and aspirations (other than obtaining insurance); and must be democratically controlled. This definition of association of persons would for instance cover burial societies, but would not include insurance business conducted through commercial funeral parlours;

- The association, employer or fund must hold the policy exclusively for the benefit of a beneficiary (the beneficiary for purposes of a “group” policy is the member of the association or fund, or employee, or a person nominated by any of the aforementioned).¹

Individual

- An individual policy is a policy entered into with a person (natural or juristic) and includes a policy underwritten on a group basis;
- The definition of “individual” has been restricted to ensure the current group policies cannot be written as “individual” policies. This was achieved by providing that an “individual” policy excludes a policy where the lives insured under the policy are two or more persons without an insurable interest in each other. This means that a juristic person cannot be the policyholder on a policy and reflect numerous unrelated persons as lives insured under that policy;
- Notwithstanding the above restriction, a special dispensation has been allowed to include the following under the definition of “individual” policy –
 - Credit life policies: A credit life policy is where a credit provider is the policyholder and the person in respect of whom the insurer must meet insurance obligations, and the persons who are the lives insured under the policy are debtors of the credit provider; and
 - Employer policies: This will entail a policy where an employer is the policyholder and the person in respect of whom the insurer should meet insurance obligations, and the persons who are the lives insured under the policy are directors or employees of that employer.

The special dispensation does not extend to allowing for individual policies in which a funeral parlour covers the lives of its customers, as such an approach was deemed not to provide sufficient consumer protection to the underlying individuals.

18. TRANSITIONAL PROVISIONS

The transitional provisions have been extended. They now include explicit transitional arrangements for financial soundness requirements.

19. OTHER NOTEWORTHY CHANGES

19.1 Insourcing: The concept of insourcing has been removed from the regulatory framework contained in the Insurance Bill.

¹ Therefore, association, employer or fund concludes the group policy on the basis of a *stipulatio alteri* (third party contract) and the members will have a direct claim against the insurer.

- 19.2 *Microinsurance classes of business:* The classes of insurance business allowed as microinsurance business have been refined to ensure alignment with the National Treasury's Policy Paper on Microinsurance that was released in 2011. This includes the inclusion of the legal expense insurance class and the omission of the agricultural class of business. The latter class involves risk exposures that would be difficult for microinsurers to cover in a sustainable manner.
- 19.3 *Criteria when determining the level of add-on capital to be imposed:* Section 34 of the 17 April-Bill provided that the Registrar can require that a capital add-on be applied to the MCR or SCR of an insurer. Concerns were raised that the provision did not set out the criteria to be used to determine the level of the capital add-on. Accordingly, section 37 of the tabled Bill provides for certain criteria that must be applied by the Prudential Authority when determining the appropriate level of capital add-on.
- 19.4 *Notice of non-material acquisition or disposal:* Section 47(1)(b) required an insurer or controlling company to inform the Registrar prior to making any acquisition or disposal (other than a material acquisition or disposal as these require approval). Practicality concerns were raised and it was submitted that this requirement is too burdensome. As a result, the requirement has been removed.
- 19.5 *Demarcation between health insurance and the business of a medical scheme:* The tabled Bill makes provision for the Minister to make regulations that, despite the definition of the business of a medical scheme, allows for the identification of a kind, type or category of contract as an insurance policy. This addresses an omission from the 17 April-Bill and allows for the continuation of an appropriate demarcation framework in the regulatory authorisation of insurance business.