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3 May 2012

Dear Madam

GNR 192, BEING LONG-TERM INSURANCE ACT NO. 52 OF 1998: PUBLICATION OF PROPOSED AMENDMENTS OF REGULATIONS FOR PUBLIC COMMENT AS PUBLISHED IN *GOVERNMENT GAZETTE* NO 35114 ON 2 MARCH 2012 ("the LTIA draft regulations")

GNR 193, BEING THE SHORT TERM INSURANCE ACT NO. 53 OF 1998: PUBLICATION OF PROPOSED AMENDMENTS OF REGULATIONS AS PUBLISHED IN GOVERNMETN GAZETTE NO 35114, DATED 2 MARCH 2012 ("the STIA draft regulations")

1 We refer to the above matter.

2 We act for Guardrisk Insurance Company Limited ("our client").

3 We have been instructed to provide comments on the LTIA draft regulations and STIA draft regulations, which we do below in greater detail. In this regard, kindly note that due to the similarities of the wording used in both the LTIA draft regulations and STIA draft regulations, our comments are to be applied equally, unless otherwise stated to the contrary and the text, to both the LTIA draft regulations and STIA draft regulations. The STIA draft regulations and the LTIA draft regulations shall, where appropriate in this submission, be referred to collectively as "the draft regulations".

4 For ease of reference in this document, the Long Term Insurance Act No. 52 of 1998 shall be referred to as "the LTIA" and the Short Term Insurance Act No. 53 of 1998 shall be referred to as "the STIA".

5 This commentary is to be read together with statements dealing with matters referred to in documents accompanying the publication of the STIA draft regulations and LTIA draft regulations, being –

5.1 the media statement entitled "Minister of Finance releases draft regulations on the demarcation between health insurance policies and medical schemes", dated 2 March 2012 ("the media statement");

5.2 the document entitled "Frequently Asked Questions: Demarcation between Health Insurance Policies and Medical Schemes" ("the FAQ document");

5.3 the article published by the Council for Medical Schemes entitled "A victory of the medical schemes regulator", a copy of which is attached marked "A"; and

5.4 Notice 195 of 2012 entitled "Invitation for Public Comment on the Draft Financial Services Laws General Amendment Bill, 2012", published in *Government Gazette* 35132, dated 9 March 2012 ("the Notice"), more particularly, the amendments to the definition of "business of a medical scheme" in section 1(1) of the Medical Schemes Act No. 131 of 1998, as amended ("the MSA").

6 LEGAL COMMENTARY

6.1 The purpose of the draft regulations

6.1.1 In the media statement, the FAQ document, and the explanatory memoranda attached to each of the draft regulations (hereinafter "the accompanying documents"), there are a number of statements made to the effect that the draft regulations are being introduced to support and enhance the objectives and purpose of the MSA.

6.1.2 The MSA is said, in the accompanying documents, to entrench the principles of community rating, open enrolment and cross-subsidisation within medical schemes.

6.1.3 It is also stated that health policies "*may*" (the tentative uncertainty is repeated in various places in the accompanying documents) result in

6.1.3.1 younger and healthier persons terminating, limiting or reducing their medical scheme cover;

6.1.3.2 a negative impact on the life-cycle protection offered by medical schemes; and

6.1.3.3 medical schemes reducing benefits.

6.1.4 The explanatory memoranda and media statement reflect that the Minister is obliged to have regard, in promulgating regulations under the STIA and the LTIA, to the objectives and purposes of the MSA. These documents also profess that "a clear demarcation between our client's Admed Gap policies (providing benefits that appear similar to that of medical schemes) and medical schemes is further necessary to protect consumers/policyholders." It is — again tentatively — suggested that the absence of a clear demarcation may result in consumers believing that our client's Admed Gap policies offer the same protection as a medical scheme and that our client's Admed Gap policies are medical schemes.

6.1.5 The draft regulations are, according to the accompanying documents, intended to forestall these concerns. Whether or not the draft regulations achieve this aim is something we deal with in more detail below; in short, it is contended that they do not.

6.1.6 At the outset, however, on behalf of our client we place on record an objection to the fundamental premise underlying the draft regulations as set out in the explanatory memoranda, media statement and FAQ document. That is, our client disputes the proposition that our client's Admed Gap policies cause general harm or, more specifically, that they cause the harm identified in the explanatory memoranda and quoted above in paragraph 6.1.3.

6.1.7 It is not apparent that Treasury has any evidence that such harm is, in fact, caused by our client's Admed Gap policies; indeed, the modal verb *may*, which connotes only the possibility that the statement is true, seems to belie the existence of such evidence. Nowhere in the accompanying documents is it stated that our client's Admed Gap policies *do* cause harm.

6.1.8 To the best of our client's knowledge and belief, there is no empirical evidence at all to support these statements of harm being caused by our client's Admed Gap policies—whether to the medical scheme environment or at all. This is something that our client has repeatedly raised in its discussions with the relevant role players, including the Council for Medical Schemes, the Financial Services Board and Treasury.

6.1.9 Furthermore, the absence of proven harm was a point made by our client in its opposition to the litigation instituted against it by the Registrar and Council for Medical Schemes ("the Council") and which opposition was upheld by the Supreme Court of Appeals.

6.1.9.1 The SCA, in *Guardrisk Insurance Co Ltd v Registrar of Medical Schemes* 2008 (4) SA 620 (SCA) at [19]—[21], considered the argument that had been advanced on behalf of the Council and the Registrar to the effect that our client's Admed Gap policies undermined the purpose and aim of the MSA.

6.1.9.2 The Supreme Court of Appeals expressly and unequivocally rejected these arguments of harm and undermining on the basis that there was no evidence to support them.

6.1.9.3 On the contrary, in paragraph 22 of its judgment, the Supreme Court of Appeals concluded 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."

6.1.10 We point out that the Constitutional Court dismissed an application made to it by the Council and Registrar for leave to appeal against the judgment of the Supreme Court of Appeals.

6.1.11 Against this background, our client is surprised that the documents issued by Treasury still refer to the risk of possible harm arising and to the possibility of medical schemes being undermined, without there being any support for these

statements. The entire basis for the draft regulations therefore lies in unfounded and unsubstantiated speculation.

6.1.12 Indeed, more troubling is the fact that the sole source of this unfounded and unsubstantiated speculation seems to be the Council.

6.1.13 These concerns are borne out by a media statement released by the Registrar on behalf of the Council in response to the publication by your Department of the proposed regulations:

6.1.13.1 that media statement, as well as the accompanying documents, indicate a strong alignment of the draft regulations in favour of the stated aims of the Council, on little more than the Council's say-so that harm will arise; and

6.1.13.2 needless to say, our client is anxious that this approach indicates a process that is neither lawful nor procedurally fair; it reasonably apprehends that there exists a bias in favour of the Council.

6.1.14 The alleged harm that might arise must also be seen in the context that our client is not aware of a single instance in which a provider of an accident or health policy has been successfully challenged—either in a civil or criminal court—for contravening the MSA as a result of its marketing a policy as conducting the business of a medical scheme or for confusing members of the public into thinking that its policies are the business of medical scheme. For that matter, our client is not aware of any such policies being advertised as being a medical scheme or as being an alternative to a medical scheme.

6.1.15 In this regard, and expressly in so far as concerns the policies marketed by our client, it is difficult to conceive of how members of the public could be so confused in circumstances where they must be a member of a medical scheme in order so as to take up one of the policies. The lack of a reasoned rationale for the draft regulations is all the more startling when regard is had to the fact that the requirement that a policy-holder also belong to a medical scheme is one of the items that is specifically to be prohibited.

6.1.16 In the absence of proof of harm and of the type of harm that arises, there is no rational or reasonable relationship between the draft regulations and their stated purposes. Our client cannot accept that it could ever be reasonable to prohibit our client's Admed Gap policy on the grounds that it might cause harm in the absence of any evidence at all of such harm arising in the manner contemplated in the documents published together with the proposed regulations.

6.1.17 Moreover, and assuming that there is any such proof of harm, our client does not accept that it could ever be a reasonable or rational response to the possibility of that harm arising to impose a far-reaching and almost blanket prohibition on all such policies. This is especially so in circumstances where there are less extensive or onerous means of achieving the same result, such as by regulating the manner in which such policies may be marketed, prohibiting the type of potentially confusing or misleading statements that can be made about such policies, or regulating more closely the terms of such policies.

6.1.18 Instead, the effect of such far-reaching restrictions on the type of policies that can be made available and the prohibition on providing any policies except those contemplated in the proposed regulations, is to restrict opportunities for access to healthcare, restrict property rights, and equality and trade under the Constitution.

6.1.19 For this reason, because the draft regulations are overbroad they are in any event unlawful and fall to be struck down under the Constitution.

6.1.20 In the circumstances, our client's fundamental objection against the proposed regulations lies in relation to the underlying motivation that our client's Admed Gap policies need to be strictly curtailed or effectively prohibited or both in order to protect medical schemes.

6.2 The definitions

6.2.1 The introduction of amendments to substitute part 7 in the existing regulations under the LTIA and the STIA, respectively, introduces a number of definitions and substantive provisions into the existing regulations under both the LTIA and STIA, respectively.

6.2.2 The most obvious difficulty with the proposed amendments, in the LTIA draft regulations and STIA draft regulations, occurs in proposed regulation 7.2. This proposed regulation purports to introduce a further definition of the term "health policy". The introduction of a definition is apparent from the express wording used in proposed regulation 7.2: "[a] contract *is a health policy* under paragraph (b) of the definition..." (emphasis added). It is accepted and is trite in South African law that regulations may not purport to apply or be applied to amend statutes. In both the LTIA and STIA there are existing definitions of the term "health policy" (in the LTIA) and "accident and health policy" (in the STIA). In this regard, we record that –

6.2.2.1 the term "health policy" in the LTIA is recognised by and its definition is set out expressly in the explanatory memorandum to the draft LTIA regulations at page 15, being Annexure 1 to Schedule B;

6.2.2.2 the term "accident in health policy" is recognised by and its definition is set out expressly in the explanatory memorandum to the draft STIA regulations at page 16, being Annexure 1 to Schedule B.

6.2.3 There are therefore competing definitions between the existing definitions referred to above and those now proposed in proposed regulation 7.2. To introduce such definitions in the proposed regulations causes a conflict between the proposed regulations and the prevailing legislation. Accordingly, it is not competent for definitions to be imposed in the proposed regulations that are different to the existing definitions in the primary pieces of legislation, being the LTIA and the STIA. The definitions therefore in proposed regulation 7.2 are susceptible to a legal challenge.

6.3 Vague provisions

6.3.1 The provisions of proposed regulation 7.2 also rely on information contained in tables in the draft regulations. The tables identify the information provided into three columns: dealing with the identification of certain policies, in a category format, policy benefits and criteria.

6.3.2 Whilst the intention behind the using such tabulated regulation is not clear from the draft regulations, it appears that one is required to use the table to ascertain whether or not one's policies are capable of being classified into one or more of the categories identified. In this regard, we refer you to the various statements in the explanatory memorandum – page 11 in respect of the draft LTIA regulations and page 12 in respect of the draft STIA regulations.

6.3.3 The application of the criteria in the tables appears to be exhaustive in respect of the type of policy identified in the first column. However, in so far as the express criteria are to be applied to determine whether or not a particular policy falls within a particular category, the criteria are unusually restrictive and thus exclusive. Therefore, the application of the criteria, for example to a so-called "lump sum of income replacement policy" may lead to certain of these policies falling outside of the scope of particular category due to the slight alteration of the policy's terms and conditions, i.e. the policy benefits are limited to 75% "of the policyholder's net income per day." The potential for the draft regulations to be applied in this manner -

6.3.3.1 creates artificial distinctions between policies; and

6.3.3.2 differentiates unfairly between fundamentally identical policies. This type of differentiation is without reasonable and justifiable grounds and renders the draft regulations susceptible to challenge in terms of, at least, the provisions of sections 7, 9, 18, 33, 195 and 237 of the Constitution of the Republic of South Arica, 1996 ("the Constitution") and the provisions of the Promotion of Equality and Prevention of Unfair Discrimination Act No. 4 of 2000 ("the Equality Act")

6.3.4 The legislative rationale for imposing the criteria is not apparent from the draft regulations, as the explanatory memoranda simply state that "a contract is a health policy only if that contract *matches* any one of these categories of contracts." (emphasis added). Accordingly, the lack of explanation for the criteria used in the tables in the draft regulations undermines the rationality of the draft regulations and renders the draft regulations susceptible to challenge pursuant to the provisions of section 33 of the Constitution read together with section 3 of the Promotion of Administrative Justice Act No. 3 of 2000 ("the PAJA").

6.3.5 In certain instances, there is a disjunct between the name of the policy in the table and the benefits that are to be provided. This occurs most notably in the first category dealing with so-called "lump sum or income replacement policy benefits payable on a health event". The "policy benefits" portion of the tables describe only the second of the type of insurance contract described in the first column, being the income replacement policy benefit, and does not address or set out any criteria applicable a lump sum-type contract. The income replacement policy benefit does not set out any criteria in respect of the payment of a lump sum. The reason for this disjunct or omission is not apparent from the draft regulations. Accordingly, the lack of particularity in the tables in proposed regulation 7.2 renders the provisions of proposed regulation 7.2 susceptible to challenge pursuant to sections the provisions of sections 7, 9, 18, 33, 195 and 237 of the Constitution, the Equality Act and the PAJA. This is especially important in relation to the application of proposed regulation 7.2(2)(d)(i) in so far as this proposed regulation singles out the contracts that fall into category one of the table stipulated in proposed regulation 7.2.

6.3.6 The terms "introducing" and "launching" are not defined in the draft regulations but much turns on these terms in so far as proposed regulation 7.5 is concerned. The

draft regulations are therefore entirely vague on what is meant by these terms and the distinction that is intended by the use of these terms in the proposed regulations.

6.3.7 Due to the vagaries imported into the proposed regulations by the abovementioned terms, the draft regulations are so vague as to be unenforceable and susceptible to challenge pursuant to the provisions of the Constitution and the applicable provisions of South African administrative law concerning the legality of legislation that is vague and unenforceable as set out in the decisions of *Minister of Health and Another v New Clicks SA (Pty) Ltd and Others (Treatment Action Campaign and Innovative Medicines SA as* Amici Curiae*)* 2006 (1) BCLR 1 (CC) and *Hospital Association of SA ltd v Minister of Health and Another; ER24 EMS (Pty) Ltd and Another v Minister of Health and Another; SA Private Practitioners Forum and Others v Director-General of Health and Others* 2010 (10) BCLR 1047 (GNP).

6.3.8 The use of the abovementioned terms, being "introducing", "launching", "introduced" and "launched" occurs in primarily proposed regulations 7.4 and 7.5. The importance of meaning of these terms is pronounced in so far as the provisions of proposed regulation 7.5(1) are concerned, which creates the transitional provisions for the draft regulations.

6.3.9 The use of these undefined terms makes it impossible to determine whether or not one has to comply with the provisions of proposed regulation 7.5(1) in relation to policies that are being sold or entered into, to use terminology already in use within the LTIA and STIA, respectively, before and after 15 December 2008. We reiterate the comments made about the vagaries of legislation and the susceptibility of such legislation to review pursuant to the Constitution and applicable principles of South African administrative law.

6.3.10 Accordingly this vagueness, in part, is attributable to the conflict that arises between the definitions in the legislation – including the definition of "business of a medical scheme" – as compared with the policies that are sought to be prohibited or permitted, as the case might be, by the draft regulations. In light of the contents of paragraph 6.1 above, there is no justification for any attempt to differentiate between one policy and another, as the mischief sought to be prevented is not identified and does not, in reality, exist.

6.4 Unlawful exclusions and exemptions

6.4.1 In relation to the identification of policies in proposed regulation 7.2, certain statements are made in the explanatory memoranda to the LTIA draft regulations and STIA draft regulations, respectively.

6.4.2 Of concern in these explanatory memoranda, more particularly, in relation to the STIA draft regulations, is an assumption that certain of the contracts referred to in the draft regulations constitute the business of a medical scheme but will not be considered to fall within the scope and ambit of the MSA and will be treated as exempt for this purpose:

> "Contracts that relate to [Categories 2, 3, 4, 5, 6 and 7] *unambiguously* constitute the business of a medical scheme as defined in the [MSA]. These categories of contracts, however, are excluded from the definition of the business of a medical scheme as they are deemed not to be harmful to the medical schemes environment." (at page 12) (emphasis added)

6.4.3 It is not competent for the STIA draft regulations or the LTIA draft regulations to create and impose exemptions or exclusions for contracts or products that otherwise fall into the scope and ambit of the MSA. In so far as such contracts or products are to be treated as exempt from the MSA, then an exemption in terms of section 8 of the MSA must be sought and obtained in respect of each of the contracts or products concerned. It is therefore *ultra vires* the provisions of section 70(2A)(a) of the STIA and section 72(2A)(a) of the LTIA, respectively, to assume such exemptions or exclusions may be brought into existence in the draft regulations.

6.4.4 The *ultra vires* character of the draft regulations renders both the LTIA draft regulations and the STIA draft regulation susceptible to review in terms of the Constitution, the PAJA and the applicable provisions of South African administrative law relating to the required element of legality in legislation.

6.5 **Faulty transitional arrangements**

6.5.1 In so far as the application of the transitional arrangements is concerned, the draft regulations fail and/or neglect to deal with policies in existence prior to 15 December 2008.

6.5.2 In so far as a policy was "introduced or launched", as the case may be, prior to the date specified in proposed regulation 7.5(1), the draft regulations to not explain what is to happen to such a policy. The failure of the draft regulations to deal with these policies creates a regime in terms of which there are now two categories of policies differentiated on the basis of the date in the proposed transitional provisions. The draft regulations do not justify the differentiation, which renders the differentiation susceptible to review pursuant to sections 9 and 33 of the Constitution read together with the applicable provisions of the PAJA and the Equality Act.

6.5.3 Presumably, the draft regulations do not intend to assail or prohibit policies implemented prior to 15 December 2008 in accordance with the principle of the interpretation of statutes that legislation is not be interpreted so as to remove existing rights.

6.5.4 In relation to the powers afforded to the Registrar of Medical Schemes ("the Registrar") by proposed regulations 7.4(2) and 7.5(2), the creation of such powers must be used in terms of the provisions of the MSA exclusively. The creation of such powers is *ultra vires* the STIA and the LTIA and renders the allocation of such powers to the Registrar susceptible to review in terms of, at least, section 33 of the Constitution read together with section 3 of the PAJA and the applicable principles of administrative law.

6.5.5 Accordingly, the powers afforded to the Registrar in the draft regulations should be removed. In addition, the proposed powers afforded to the Registrar to make representations to the Registrar of Long-term Insurance and the Registrar of Short-term Insurance, is also *ultra vires* the provisions of the STIA and the LTIA, more particularly, those provisions of the STIA and the LTIA, respectively: which permit Minister of Finance to create only regulations contemplated and dealt with in the applicable sections of STIA and LTIA, respectively, concerning "regulations identifying *a kind, type or category of contract* as a health policy" (emphasis added).

6.6 **The explanatory memoranda**

6.6.1 As stated above there is an explanatory memorandum attached to each of the STIA draft regulations and LTIA draft regulations, which purports to detail the purpose of

the draft regulations. The explanation at page 9 of the STIA draft regulations, dealing with "Policy Principles that Informed the Draft Regulations", states unequivocally that:

> "A clear demarcation between accident and health policies (providing benefits that appear similar to that of medical schemes) and medical schemes is further necessary to protect consumers / policyholders. The absence of a clear demarcation *may* result in consumers *believing* that –
>
> - that health policies offer the same protection as a medical scheme, when in fact the protection is partial and conditional; and/or
>
> - that health policies are medical schemes." (emphasis added)

6.6.2 No evidence is proffered, either in the draft regulations or the explanatory memoranda, to support the statements quoted above, more particularly, in so far as the use of the word "may" within the statement quoted indicates clearly that the results identified in the two bullet points, quoted above, have not yet occurred and are not intended to occur.

6.6.3 There is therefore no need to legislate in the LTIA or the STIA, in the manner contemplated in the explanatory memorandum, for may be perceived to be a problem when there is no evidence that such a problem exists.

6.6.4 In addition to what is set out above, the current provisions of the MSA in sections 7(a), (c), (g) and (h) afford the power to the Council for Medical Schemes to ensure that members of and prospective members of medical schemes are protected. This object is achieved by the Council of Medical Schemes by ensuring –

6.6.4.1 that the rules of medical schemes are clear – see sections 29 and 31 of the MSA;

6.6.4.2 that medical schemes and their products are marketed in a particular manner – see sections 20, 21 and 21A; and

6.6.4.3 the enforcement of the prohibition, in terms of sections 20(1), 26, 27 and 43 of the MSA, on persons from conducting the "business of a medical scheme" as this term is currently defined in the MSA.

6.6.5 In addition to what is set out above, the explanatory memoranda also set out how the draft regulations will apparently "achieve the policy principles". In this regard, at pages 10 and 11 of the STIA draft regulations, it is stated that:

> "The policy principles referred to in paragraph 3 above are achieved by –
>
> 4.1 Identifying those categories of health policies *as may be interpreted* as doing the business of a medical scheme, *but will not undermine the principles of open enrolment, community rating and cross-subsidisation*;
>
> 4.2 prescribing the policy benefits that *may* be provided under these categories of health policies, to further protect the business of medical schemes *of being undermined*;

4.3 prescribing clear criteria that must be met by contracts under these categories of health policies, which criteria relate to the purpose for which policy benefits may be paid and to whom such policy benefits may be paid;

4.4 prescribing matters relating to the marketing of these categories of health policies;

4.5 prescribing matters relating to the disclosures that must be made by insurers and intermediaries relating to these categories of health policies;

4.6 prescribing requirements for reporting product details of these categories of health policies to the Registrar of Short-term Insurance ... and the Registrar of Medical Schemes, so as to facilitate the adequate supervisory oversight; and

4.7 prescribing transitional provisions for regulating existing health policies that are inconsistent with the draft regulations" (emphasis added).

6.6.6 Once again, in relation to the quote set out in the immediately preceding paragraph, no evidence is proffered that supports or remotely indicates that any one or more of the consequences set in paragraphs 4.1 and 4.2, respectively, have occurred or will occur. There is therefore no basis to accept that paragraphs 4.1 to 4.7 reflect accurately or at all current market conditions. Consequently, there is no basis on which to accept that the aforementioned paragraphs form a rational basis in law for the existence of the draft regulations. On this basis alone, the draft regulations are vulnerable to challenge in terms of the Constitution read together with the PAJA.

6.6.7 The draft regulations are entirely silent on the existence of a particular problem with which the draft regulations will deal by the introduction of the amendments. Accordingly, the proposed draft regulations have an alterior purpose in relation to the attainment of the objectives for which they are supposedly designed and the objectives that they in fact achieve. This purpose is to subject certain policies into the scope and ambit of the MSA, being those policies in existence before 15 December2008 and which fall outside of the draft regulations, under the direct power of the Registrar. This alterior purpose of evident when one takes into account what is set out above, more particularly, the statements in the explanatory memoranda and the proposed amendments to the term "business of medical scheme", which appears at page 17 of the explanatory memorandum to the STIA draft regulations and page 16 of the explanatory memorandum to the LTIA draft regulations. In this regard, we also refer you to the following statements in the documents referred to above in paragraph 4 above, which are also made without any evidence or substantiation –

6.6.7.1 the reference to "the risk of possible harm" caused by health insurance products" in line 4 of the media statement;

6.6.7.2 the reference to "consideration will be given to its impact on medical schemes" in lines 27 to 28 of the media statement;

6.6.7.3 the reference to "the current or potential harm that a health insurance policy may cause to medical schemes environment" in lines 29 to 31 of the media statement;

6.6.7.4 the reference to "critical to prevent regulatory arbitrage between health insurance and medical scheme products in South Africa" in lines 35 to 36 of the media statement;

6.6.7.5 the references to "cause harm" in paragraph 3 of the FAQ document and "if left unchecked could result in increasing costs";

6.6.7.6 the references to "current or potential harm that a health insurance policy may cause to [the] medical schemes environment" in section 4 of the FAQ document;

6.6.7.7 the reference to "anti-selective behaviour" in paragraph 5 of the FAQ document;

6.6.7.8 the references to "directly linked to costs of medical care must not cause harm to the medical schemes environment" in paragraph 6 of the FAQ document read together with the statement that "[t]he net effect is that costs begin to rise for older/sicker individuals as the cross subsidisation principle is undermined." Also in paragraph 6;

6.6.7.9 the references to "exceptions" in paragraph 7 of the FAQ document;

6.6.7.10 the contents of paragraph 12 of the FAQ document read together with the provisions of paragraph 13 of the FAQ document dealing with transitional arrangements.

6.6.8 The statements referred to above are enhanced by statements that appear in the explanatory memoranda as follows:

STATEMENT	**REFERENCE IN THE EXPLANATORY MEMORANDUM TO THE STIA DRAFT REGULATIONS**	**REFERENCE IN THE EXPLANTORY MEMORAND TO THE LTIA DRAFT REGULATIONS**
Paragraph 3 in relation to the benefits provided by health policies and their alleged impact on medical schemes.	At the foot of page 9	At the foot of page 8
The intended scope of the draft regulations.	Paragraph 5 on page 11	Paragraph 5 on page 10
The reference to so-called "interpretational difficulties" in relation to Category 1 policies.	The second paragraph under the heading referring to draft regulation 7.2 on page 12	The second paragraph under the heading referring to draft regulation 7.2 on page 11

6.6.9 In relation to the contents of the FAQ document and the media statement, the draft regulations, once again, fail to meet the aspirations of these documents. These documents do not provide the means by which the mischief referred to in these documents can either be identified or combated by the draft regulations.

6.6.10 Accordingly, without proper substantiation, in respect of the matters referred to above, the introduction of the draft regulations is entirely without merit or rational

grounds. Therefore, the draft regulations lack the elements of rationality and reasonableness required by the Constitution and the South African common law in relation to the introduction for proposed legislation. For this reason alone, the draft regulations are susceptible to legal attack.

6.7 **Conclusion**

6.7.1 For all of the reasons set out above, substantial revisions of the draft regulations are required in order to align the draft regulations, in so far as this is possible, with the requirements of Constitution and South African law concerning the contents of proposed legislation.

6.7.2 In relation to the role of the explanatory memorandum, we advise that –

6.7.2.1 the explanatory memoranda cannot modify or supplement the draft regulations and cannot cure any deficiencies in the draft regulations. Hence, the draft regulations must be self-standing and cannot achieve the aims alluded to in the explanatory memoranda unless and until the draft regulations adequately provide for everything contemplated in the explanatory memoranda;

6.7.2.2 the draft regulations do not presently reflect the necessary content required to fulfil the purposes assigned them under the explanatory memoranda. In particular, the draft regulations do not adequately or properly describe those policies that promote what the explanatory memoranda identify as being the mischief that it is intended the draft regulations will forestall;

6.7.2.3 the draft regulations do not adequately achieve the policy principles and do not fulfil the expectations set out for the draft regulations in the explanatory memoranda;

6.7.2.4 the cryptic and vague draft regulations do not come close to satisfying the aspirations of the Minister in so far as those aspirations are reflected in the explanatory memoranda.

7 We trust that the above is in order. Kindly note that the status of the draft legislation is of crucial importance to our client. We would be grateful if your offices would keep us advised of the status of the draft legislation in order for our client to ensure that it is able to exercise its constitutional rights to participate effectively in this process. In this regard, our client's rights remain reserved.

8 Kindly note further that our client will be making separate comments in respect of the Draft Financial Services Laws General Amendment Bill, 2012 in terms of the invitation published as Notice 195 of 2012, in *Government Gazette* 35132, dated 9 March 2012.

9 We look forward to your acknowledgment of receipt of these comments.

Yours faithfully

Werksmans Attorneys

"A"

▼ GENERAL

A victory of the medical schemes regulator

6 March 2012
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A couple of years ago the Council for Medical Schemes (CMS) tackled one of South Africa's leading diversified financial services groups in an attempt to dissuade it from offering so-called "top up" or "gap" insurance products. In its simplest form "gap" cover is sold by a short-term insurer to medical scheme members to cover the shortfall between what their scheme pays for in-hospital specialists versus what the specialists charge. The Registrar felt this type of cover undermined medical schemes by doing the business of a medical scheme among other concerns. A lengthy legal wrangle ensued, with the CMS failing in its attempt to close down the "gap" product offered by Alexander Forbes' subsidiary, Guardrisk. Both the High Court and Supreme Court (on appeal) ruled that the Guardrisk product did not satisfy the "conducting the business of a medical scheme" test.

Not one to give up easily the Registrar set about tackling the problem from a different angle. Because the Court decision hinged on the definition of "business of a medical scheme" as contained in the Medical Schemes Act, the CMS set about altering this definition. But their plan fell flat when a 2008 draft amendment to the Medical Schemes Act was withdrawn to allow government and the Department of Health (DoH) to focus on the groundwork for National Health Insurance (NHI) instead. There's a great English idiom that goes: "If at first you don't succeed – try and try again!" And the CMS certainly deserves praise for its bulldog determination to safeguard the medical schemes environment. Their next "salvo" focused on a provision in the Insurance Laws Amendment Act, 2008, that allows the Minister of Finance to indicate what category of health insurance product may be sold to the public, despite such product constituting the "business of a medical scheme" as defined in the Medical Schemes Act.

Another draft regulation

Thus the latest CMS effort to prevent insurers from stepping into the medical schemes space masquerades as the 2 March 2012 National Treasury release titled: *Draft Regulations on the Demarcation between Health Insurance Policies and Medical Schemes*. The Regulations are the outcome of a joint process between Treasury, the DoH, the Financial Services Board (FSB) and the CMS. The Association of Savings and Investments South Africa (ASISA) and the South African Insurance Association (SAIA) represented the long and short-term industry respectively. The draft document has been released for public comment which can be forwarded to Dr Reshma Sheoraj, Director: Insurance at the National Treasury before 23 April 2012.

The CMS claims that the draft regulations "seek to find a better balance between medical schemes and health insurance products". However, they quickly return to their initial argument against certain "gap" and hospital insurance policies. "The Regulation also seeks to address the risk of possible harm caused by health insurance products drawing younger and healthier members away from medical aid schemes to health insurance products," they said. Journalist Laura du Preez encapsulated these concerns in an article published on iol.co.za, 20 February 2011: "The registrar's office is of the view that health insurance products undermine medical scheme cover, because they can be offered at cheaper rates, typically to healthier people, who then buy into cheaper medical scheme options. As a result, it costs medical schemes more to provide cover to the sicker members, who remain on more comprehensive options."

The Regulator expands on this concept in their press release (Press Release 3 of 2012) announcing the Demarcation Regulations. They believe the additional regulation will "strengthen and preserve the social solidarity principle that underpins medical schemes". Medical schemes rely on the cross subsidization of sicker scheme members by healthier ones to keep costs down. Because insurance companies are not regulated by the Medical Schemes Act they can bypass this solidarity requirement. Health insurance products typically "select" policyholders based on age, income and health status as well as incorporating various exclusion clauses.

How will the regulations affect insurers?

Once the Demarcation Regulation is in force the confusion over the type of health policies that short and long-term insurance companies can sell will be settled, once and for all. And then the difficult administrative task begins – because the country's insurers will have to bring their "in force" health policies in line with the new regulations, revise

existing product offerings to comply and implement strict marketing conditions to boot.

The CMS provides a Frequently Asked Questions document to clarify which products will be allowed to be sold in terms of the Regulations. "To protect the risk pooling achieved through medical schemes, the Regulations provide that a health insurance policy must not be directly linked to the cost of the medical care and must not cause harm to the medical schemes environment," they write. The idea is to "outlaw" products that offer policy benefits relating to actual medical expenses associated with a health event... A comprehensive table of allowable policies (including benefits and policy conditions) appears in the Government Gazette notice of the proposed amendments.

Short-term "accident and health" policies must be in one of the following seven categories (subject to conditions): Lump sum or income replacement policy benefits payable on a health event, Motor: Third Party Liability, Property: Third Party Liability, HIV and Aids, International Travel Insurance, Domestic Travel Insurance and Emergency Evacuation or Transport. It seems the "gap" covers mentioned in the opening paragraph are doomed! Under the Demarcation Regulation a lump sum or income replacement policy "may not provide policy benefits relating to medical expenses associated with a health event!" Any confusion in this regard is quickly dispelled by the specific criteria for this category of short-term policy: "The policy may not provide benefits that fully or partially indemnify the policyholder against medical expenses".

Editor's thoughts: After a lengthy legal battle (beginning 2008) it seems the Council for Medical Schemes (CMS) has finally got the jump on insurers selling so-called "gap" cover policies. If the regulation goes through "as is" then your clients will have to rely on income replacement type policies to cover the expenses their medical schemes fail to pay. There are concerns the change will result in lower income earners being unable to purchase adequate cover. Has the CMS used the Insurance Laws Amendment Act to consolidate their position in the medical schemes space? Add your comment below, or send it to

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