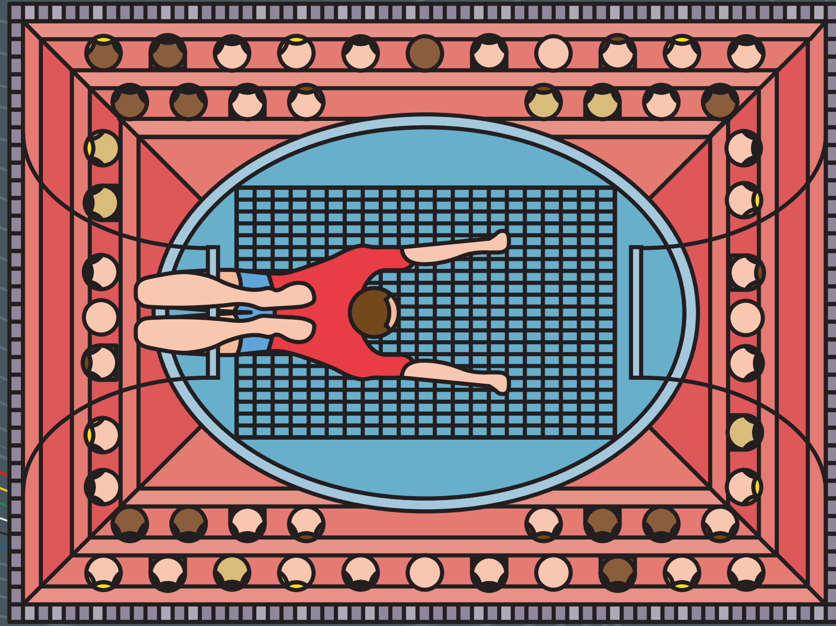

18

INSURANCE

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Introduction

The South African insurance industry boasts a high level of development and sophistication. It is characterised by strong competition that is enlivened by the presence of a large number of major insurers, reinsurers, brokers and intermediaries.

Both the long- and short-term insurance industries are comprehensively and firmly regulated and have good links with the major insurance markets of the United States (US), the United Kingdom and Europe. Certain major European and US insurance and reinsurance companies (notably Lloyd's of London) maintain domestic offices in South Africa.

The South African long-term insurance industry, in particular, enjoys international recognition for its pioneering product development and innovative product marketing strategies.

Sources of Insurance Law

South African insurance law has its roots in Europe's commercial law and, due to its history, both Roman-Dutch and English law are considered to be the primary common law sources of South African insurance law.

Various Acts of Parliament apply specifically to the insurance industry. The most important of these is the Long-term Insurance Act, No. 52 of 1998 (LTI Act), and the Short-term Insurance Act, No. 53 of 1998 (STI Act). Other Acts of Parliament that have a bearing on the regulation of the insurance industry include the Financial Advisory and Intermediary Services Act, No. 37 of 2002 (FAIS Act), the Admiralty Jurisdiction Regulation Act, No. 105 of 1983, the Road Accident Fund Act, No. 56 of 1996, the Unemployment Insurance Act, No. 63 of 2001 and the Companies Act, No. 71 of 2008.

The Insurance contract and different types of insurance

The insurance contract forms the basis of insurance in this country. An insurance contract, in the South African context, denotes a reciprocal contract (other than in life insurance) between an insurer and an insured in terms of which the insurer undertakes to pay the insured an amount of money or its equivalent in exchange for payment of a monetary premium should the risk borne by the insurer on behalf of the insured, materialise by the occurrence of an event in which the insured has an interest.

Given the close ties between the South African insurance industry and its foreign counterparts, insurance contracts and policy forms tend to follow international formats.

Common law largely determines the essential elements for an enforceable insurance agreement as well as the various types of insurance in this country. The most useful classification is between capital (non-indemnity) and indemnity insurance.

Capital insurance relates to instances where a specific amount is paid on the occurrence of a particular event, for instance payment of ZAR 5000 upon the death of the life insured. Indemnity insurance, on the other hand, relates to agreements where the insurer indemnifies the insured against patrimonial loss (reduction in a person's financial position) upon the occurrence of an event described in the policy as the risk insured against.

The basic difference between indemnity and capital insurance is that, with the former, there is a direct link between the amount insured and the actual loss suffered (household, vehicle and home-owners insurance are examples of indemnity insurance). In the latter, the loss suffered and the amount paid by the insurer are not necessarily proportionate (life insurance is an example of non-indemnity insurance).

It is also possible for a person to insure his or her liabilities incurred due to contract, delict or other obligations. This is referred to as liability insurance and is of the same nature as indemnity insurance.

Apart from the above, insurers also develop investment products and then structure these on an insurance platform. These are normally done under a long-term insurance license.

The option of self-insurance is also available through a so-called "cell captive" arrangement with a cell captive insurance company.

Reinsurance, where an insurer takes out insurance with another insurer, and mutual insurance, which exists through an association of members with a common interest collectively insuring that common interest, are also well known and employed in South Africa.

Insurance Acts

Where common law deals mainly with the insurance contract and principles of insurance underlying such a contract, the LTI Act and the STI Act aim largely to regulate the insurers operating in South Africa. These laws deal with, among others, the formation, registration, administration and solvency of insurance companies. They also implement various consumer protection measures and regulate the relationship between insurers, various types of intermediaries and policyholders. The legislation is therefore more focused on regulating insurance than on the underlying insurance principles.

Although the LTI Act and STI Act do not follow the common law distinction between capital and indemnity insurance exactly, long-term insurers generally focus on capital insurance such as life, disability, endowment, health, fund policy, and investment business. On the other hand, short-term insurers focus on indemnity products such as motor and household insurance, indemnity, fidelity, guarantee and liability insurance. They also cover health, accident and disability insurance, but more to the extent that such insurance relates to compensation for patrimonial loss.

The LTI Act and STI Act specify the various classes of insurance. Insurance companies must be licensed to underwrite a particular class of insurance product.

From a regulatory perspective the requirements regarding the financial soundness of long-term and short-term insurers as well as the minimum capital requirements and spread of assets differ significantly.

Both types of insurers act under the supervision of the Registrars of long- and short-term insurance (the Registrars) that form part of the Financial Services Board (FSB). The FSB is a regulatory body supervising most financial institutions in South Africa other than banks and certain institutions (eg the Johannesburg Stock Exchange) which are regulated by other legislation.

The FSB is in the process of developing a new risk-based solvency regime for South African short-term and long-term insurers, known as the Solvency Assessment and Management Regime (SAM) to align the South African insurance industry with international standards. The final date for full implementation of the SAM framework has been set as 1 January 2016.

SAM will be based on the Solvency II capital adequacy, risk governance and risk disclosure regime being implemented for European insurers and reinsurers. SAM will share the same broad features of Solvency II namely being principles-based, having an economic balance sheet as a foundation and using the same three-pillar structure of capital adequacy (pillar one), systems of governance (pillar two), and reporting requirements (pillar three).

The LTI Act and STI Act also specifically regulate the placement of insurance and reinsurance business outside South Africa. Exchange control restrictions limit the free flow of foreign currency between different countries. No foreign exchange commitments may be entered into by residents without prior approval of the Exchange Control Authorities. The Currency and Exchanges Act, No. 9 of 1933, currently regulates this position together with relevant guidelines and regulations published by the National Treasury (Treasury).

The LTI Act and STI Act also address a number of consumer protection issues. It should be noted that these laws contain important substantive provisions that relate to policies and the client-intermediary-insurer relationship.

Brokers, advisers and insurance intermediaries

Insurance contracts in South Africa are often concluded on the initiative or through the assistance of intermediaries (ie insurance agents or brokers). Compensation is usually payable to such intermediaries and is due to the extent that such persons render services as an intermediary as contemplated in the LTI Act and STI Act (which include acts leading a policyholder to conclude a policy, collecting premiums and receiving and processing claims). The payment of consideration for services rendered in respect of a policy (either long-term or short-term) is strictly regulated in terms of the LTI Act and STI Act together with the regulations promulgated in terms thereof.

These Acts prescribe the manner and the maximum amount of consideration that may be paid in respect of the specific type of service rendered in relation to the policy concerned. The FSB is currently reviewing the regime regulating the remuneration structures in the insurance industry, and is expected to release a Retail Distribution Review discussion (RDR) document which seeks to ensure that insurance distribution models are aligned to achieving fair treatment towards consumers, and aims to ensure that financial advisers are remunerated fairly. That is, not excessively in relation to the services they render and therefore prejudicing consumers, while balancing this against ensuring financial advice is a sustainable business.

The FAIS Act is an extremely important piece of legislation in view of the fact that it regulates all distribution channels of financial products, which include both long- and short-term insurance policies. It is important to note that the FAIS Act may also apply to insurance products issued by foreign product suppliers if these products are marketed in South Africa.

The FAIS Act has created a new profession in South Africa and requires that any person providing advice or rendering intermediary services must either:

- be licensed by the Registrar of Financial Services Providers as a qualified financial services provider; or
- act on behalf of such a financial service provider as its representative, mandated in terms of a written agreement with the financial service provider and under the control of the financial services provider.

Both “advice” and “intermediary services” are defined in extremely broad terms and include most dealings with potential clients or policyholders. The terms “advice” and “intermediary services” include, inter alia, the giving of financial advice on a product, dealing with application (proposal) forms, collecting premiums and dealing with queries and claims.

The FAIS Act requires both the financial service providers and their representatives to be fit and proper and have certain prescribed minimum qualifications. The FAIS Act also requires financial services providers to avoid conflicts of interest and also regulates the compensation that may be paid to financial services providers and their representatives.

Various codes of conduct have also been issued in terms of the FAIS Act. These regulate the way in which financial services providers and representatives render financial services to clients.

As a result, in 2011, the Treasury together with the FSB undertook to reform the financial system structure such that there will be a shift to a Twin Peaks model that involves separate prudential and market conduct regulators. The Twin Peaks approach entails creating a prudential regulator housed in the South African Reserve Bank (SARB), and transforming the FSB into a dedicated market conduct regulator.

All financial institutions, which include banks, insurers, financial advisers, financial intermediaries, investment institutions and the broader financial markets, will be regulated by both the prudential regulator and the market conduct regulator.

The prudential regulator’s objective will be to maintain and enhance the safety and soundness of regulated financial institutions and will be responsible for the prudential regulation and supervision of banks, insurers and other regulated financial institutions, accounting to the SARB.

The market conduct regulator’s objective will be to protect consumers of financial services and promote confidence in the South African financial system. This responsibility will be carried out by the FSB which will be transformed in order to meet its revised mandate with regards to market conduct regulations.

The Twin Peaks model will be implemented in two phases:

- the first will run during 2013-2014 and will support legislation and be tabled in Parliament to enable both the SARB and the FSB to assume their additional responsibilities; and
- the second will be implemented over the next several years, and will consist of a broader harmonisation process of specific financial-sector regulatory and supervisory systems and frameworks.

These reforms will be complemented by ongoing modifications, such as:

- a formal framework for insurance group supervision to enable the FSB to ascertain the overall risk exposure of South African insurance groups and financial conglomerates, especially as they affect the regulated entities operating within South Africa; and
- the programme for regulating the market conduct of financial services firms, called Treating Customers Fairly (TCF), which is aimed at implementing the principles of fair treatment towards consumers. TCF will fall in the market conduct regulator "peak" of the future Twin Peaks model of financial regulation.

TCF is a regulatory approach that seeks to ensure that specific, clearly-articulated fairness outcomes for financial services customers are demonstrably delivered by regulated financial institutions.

Binder services and outsourcing arrangements

The South African LTI Act and STI Act contemplate a scenario where a person is authorised by an insurer to act on behalf of the insurer as its agent to perform specific services which include entering into, varying or renewing a policy, as well as determining the wording, premiums, values and claims settlement.

The LTI Act and STI Act, together with the regulations promulgated in terms thereof, strictly regulate various aspects of the relationship between the insurer and its binder holders including the form and contents of the binder agreement to be concluded, the type of services that a binder holder may perform and the remuneration payable to the binder holder.

Binder services differ from intermediary services in that they relate to services rendered by a person (the Binder Holder) as agent of the insurer, thereby binding the insurer (such as the act of entering into a policy on behalf of an insurer). Intermediary services relate to the act of interposing between the insurer and the policyholder (such as the act of marketing and promoting an insurer's policies).

After the promulgation of the Binder Regulations, the FSB issued a policy document during 2012 referred to as the Outsourcing Directive 159A.i. which sets out the general and overarching requirements that an insurer must comply with when outsourcing any aspect of its insurance business.

Outsourcing in South Africa is defined as "an arrangement of any form between an insurer and another person in terms of which that party performs a function or an activity... that would otherwise be performed by the insurer itself" and is regulated in terms of a directive issued in terms of the LTI and STI Act.

This Outsourcing Directive applies in addition to the existing regulatory framework and its requirements must be read, for example, in conjunction with the requirements stipulated in the Binder Regulations. The services performed by the Binder Holder are seen as a subset of outsourcing.

Outsourced services can be of an intermediary nature requiring intermediation or interposing between the insurer and the policyholder, but must not render services as an intermediary. The insurer will remain liable for the services so outsourced.

The Registrar of Insurance has to be informed prior to the conclusion of any outsourcing arrangements where a control, management or material function is outsourced and certain regulatory requirements have to be met. A material function so outsourced refers to a function that if disrupted is likely to have a significant impact on the insurer's business operations or ability to manage risks effectively.

The draft regulations on the demarcation between health insurance policies and medical schemes

The South African regulatory framework contemplates, in draft regulations, a demarcation between what constitutes insurance business (namely "health" and "accident and health policies") and what constitutes "business of a medical scheme", as regulated by the Medical Schemes Act.

The philosophical distinction lies in that medical schemes, which operate in a comparable function to trusts, are underpinned by the principle of "social solidarity". By pooling healthier and sicker individuals, cross-subsidisation is made possible through medical schemes. Those of poor health do not pay contributions according to their health status. Health insurance products, on the other hand, operate on the basis that the policyholder pays a premium that is determined by the policyholder's age, health status or income. Health insurance policies also have exclusionary clauses, which can limit who the policy can be sold to.

Upon promulgation of the new legislative changes, any insurance business falling within any one of the elements of the definition of "business as a medical scheme" will be carved out and will constitute business of a medical scheme that may only be rendered by a duly-licensed medical scheme. The Minister of Finance, however, will be granted the authority to reclassify certain products as insurance products to the extent that those products will not be viewed as harmful to the medical schemes environment.

According to the draft regulations non-harmful products include:

- lump sum or income replacement policy benefits payable on a health event, provided the policy benefits do not exceed a maximum amount;
- cover for frail care;
- cover for actual expenses related to HIV/AIDS treatment on an employer-group basis for both employees and their dependants;
- cover for short fall in medical expenses, provided the policy benefits do not exceed a maximum amount;
- motor car third party liability cover and property third party liability cover;
- international and domestic travel insurance (underwritten by short-term insurers in terms of an accident and health policy); and
- emergency evacuation or transport benefits (underwritten by short-term insurers in terms of an "accident and health policy" and long-term insurers under a "health policy").

Conclusion

Significant changes to the insurance landscape will be taking place over the next few years and insurers, brokers and intermediaries will be significantly affected. The interpretation of these interrelating acts will require special attention to avoid transgressions.

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