Regulatory intelligence

Updating you on current insurance regulatory developments

The FSB issued amended draft regulations dealing with binder agreements in July 2011.

September 2011

On 22 July 2011 the Financial Services Board (FSB) issued draft amendments to the regulations under sections 72 of the Long-term Insurance Act No. 52 of 1998 and section 70 of the Short-term Insurance Act No. 53 of 1998 (binder agreements).

Background to binder agreements

A binder agreement is an agreement between an insurer and a 3rd party (binder holder) whereby the insurer mandates the binder holder to perform certain function for and on behalf of the insurer in connection with the administration of insurance policies.

The Long-term Insurance Act did not previously contain any provisions regarding binder agreements and although the Short-term Insurance Act dealt with arrangements similar to binder agreements, the provisions presented certain interpretation difficulties.

The Insurance Laws Amendment Act of 2008 introduced the concept of binder agreements into the Long-term Insurance Act and together with the draft regulations seeks to address previous difficulties encountered with regards to the interpretation of the provisions in the Short-term Insurance Act.

The initial draft binder regulations were released by the Registrar of the Long-term and Short-term Insurance Act (the Registrar) on 31 August 2010, for comment by the insurance industry by 31 October 2010.

The draft regulations provided clarity with regards to the following:

- The definition of a binder holder;
- The functions a binder holder may perform on behalf on an insurer;
- Matters that should be included in a binder agreement;
- The consideration that a binder holder may receive under a binder agreement;
- Reporting requirements when binder agreements are terminated; and
- Transitional provisions.

The draft regulations were released for comment prior to submitting it to the Minister of Finance and National Treasury for consideration due to the complex nature of the regulations and the fact that the regulations may have significant implications for certain business models in the insurance industry.

The comments received from the insurance industry focussed on the following key issues.

The distinction between intermediary services and binder agreements

"Rendering services as an intermediary" is defined in the Long-term and Short-term Insurance Acts. The draft binder regulations defined "binder functions".

From these definitions it is clear that intermediary services constitute *acts towards or that results in* -

- In respect of short-term insurance, a person entering into, varying or renewing a policy; and
- In respect of long-term insurance, a person entering into, maintaining or providing services in respect of a policy.

Binder functions are the actual entering into, varying or renewing of a policy. The binder holder acts as if it is the insurer and the insurer only becomes aware of the new policyholder liability after the fact. Intermediary services may be rendered on behalf of a policyholder or an insurer but binder functions are rendered only on behalf of an insurer.

Remuneration payable in respect of intermediary services, binder functions and other outsourced services or functions

The overall principle that informs any remuneration payable is that a person should not be compensated twice for performing a service.

Fees and commission

The draft regulations prescribe that:

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- A binder fee is payable in return for the performance of binder functions. The fee must be reasonable to cover the actual costs incurred by the binder holder with an allowance for a reasonable rate of return;

- If a binder holder also renders services as an intermediary, the binder holder may also receive commission subject to the commission regulations in the Insurance Acts;

- If the binder holder also provides services that do not constitute binder functions or intermediary services, an additional fee may possibly be paid subject to the General Code of Conduct for Authorised Financial Services Providers and Representatives.

The Insurance Acts further provide that no person may add an amount to gross premiums or deduct any amount from claims in respect of policies referred to in binder agreements.

Other remuneration

The draft regulations allow an underwriting manager or administrative Financial Services Provider (FSP), in respect of long-term insurance, that is a binder holder to share in the profits of the insurer attributable to the type of kind of policies referred to in the binder agreement.

The following is prohibited in respect of a non -mandated intermediary that is a binder holder:

- Receiving any share in profits; and

- Any fee payable to the non-mandated intermediary that may settle claims or determine the value of policy benefits paid under a binder agreement, may not be determined as a percentage of the difference between the claim originally raised and the claim actually paid.

This is necessary to prevent a non-mandated intermediary from acting in the interest only of the insurer or itself to the detriment of policyholders.

Permissible relationships

The regulations have been amended to allow an underwriting manager to act on behalf of more than one insurer (in respect of the same class of business) if the insurers agree thereto in writing.

Rationale for not permitting underwriting managers to intermediate

The intention of the draft regulations is to make it clear that an underwriting manager acts solely as the agent of the insurer and not on behalf of a policyholder, potential policyholder or an independent intermediary.

The draft regulations have therefore been amended to disallow underwriting managers to directly market, solicit or sell policies to the public but underwriting managers will be able to render other intermediary services, such as premium collection and receipt of claims.

Binder functions of non-mandated intermediaries

The draft regulations limit the binder functions that non-mandated intermediaries may perform in order to manage any potential conflict of interest as non-mandated intermediaries simultaneously act or may act on behalf of an insurer and the policyholder.

Access to policyholder information

The draft binder regulations require a binder holder to make information available and update the insurer with respect to policyholder and policy information. This does not impact on the constitutional rights of intermediaries and underwriting managers to trade and to protect their commercially sensitive information. A policy constitutes a contract between the policyholder and the insurer. An intermediary is not a party to the contract and therefore has no right to withhold information.

Amendments to the draft binder regulations

The amendments informed by the comments from the insurance industry were incorporated into the draft binder regulations issued on 22 July 2011.

The following highlights the amendments made to the definitions in the draft regulations.

"Non-mandated intermediary"

A representative or an independent intermediary, other than a mandated intermediary or an underwriting manager.

"Settle a claim"

Any act that resulting in –

- the acceptance of a claim for policy benefits or a part thereof;
- the determination of the liability of an insurer under a claim for policy benefits; or
- the rejection of or refusal to pay a claim for policy benefits or a part thereof;

where the insurer becomes aware of the acceptance, determination, rejection or refusal only after these acts have been performed.

"Underwriting manager"

Means a person that –

- performs one or more of the binder functions referred to in the binder agreement; and
- if that person renders services as an intermediary, -
  - does not perform any act that result of which is that another person will or does or offers to enter into, vary or renew a policy on behalf of an insurer, a potential policyholder or policyholder; and
  - renders those services to or on behalf of an insurer only; and
- is not an associate of a mandated or non-mandated intermediary.

The following has been added in respect of the requirements, limitations and prohibitions relating to binder agreements:

- A binder agreement must specify if the binder holder is a non-mandated intermediary or an underwriting manager.

- A binder agreement is not prohibited from providing that an insurer may (a) limit or prevent a binder holder from performing certain or all binder functions during the termination period of the binder agreement; or (b) take reasonable measures to limit any risks it may be exposed to resulting or associated with a binder agreement of the termination thereof.

The reporting requirements in terms of which the insurer must inform the Registrar in writing of the termination of a binder agreement has been changed from 30 to 90 days before the expiry of the termination period.

Conclusion

Comments in respect of the draft binder regulations issued in July may be submitted on or before 5 September 2011.

If you wish to discuss how we can help you, please call your regular contact or alternatively:

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