

Ref: Directive [-].A.i (LT)

DIRECTIVE
FINANCIAL SERVICES BOARD
REPUBLIC OF SOUTH AFRICA



LONG-TERM INSURANCE ACT, 1998 (ACT 52 OF 1998)

Addressee:	Long-term insurers		File:	10/17/1	
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Subject:	Maximum causal event charges that may be deducted under Part 5 (Requirements and limitations regarding the values and benefits of policies) of the Regulations issued under the Long-term Insurance Act				

1. PURPOSE

- 1.1 This directive clarifies the maximum causal event charges that may be deducted under Part 5A or 5B of the Regulations issued under the Long-term Insurance Act ("the Act") in a manner consistent with the purpose thereof.
- 1.2 The directive reflects the manner in which the Registrar will apply Parts 5A and 5B of the Regulations made under section 72 of the Act ("the Regulations") for regulatory purposes.

2. BACKGROUND

The Statement of Intent and the Regulations

- 2.1 The Statement of Intent signed between the Minister of Finance and the long-term insurance industry in December 2005 recognised that in the past the lack of transparency of charge structures resulted in the reasonable expectations of policyholders in respect of net returns from contractual savings products (particularly in the context of early premium reduction and cessation) not being met. As a result, the industry, in the Statement of Intent, committed itself to not deducting charges in excess of agreed maxima for contractual savings products on the occurrence of

certain contractual events prior to the completion of the policy term.

- 2.2 The Regulations were amended in December 2006 and January 2009, respectively, to give effect to the Statement of Intent.
- 2.3 Part 5A of the Regulations provides for maximum causal event charges in respect of policies (other than policies to which Part 5B applies) in respect of which a causal event has occurred on or after 1 January 2001. Part 5B of the Regulations provides for maximum causal event charges in respect of investment policies entered into after 1 January 2009.

The Pension Funds Adjudicator's rulings

- 2.4 A number of rulings issued by the Pension Funds Adjudicator have highlighted the unfair and unreasonable practice by certain insurers, where multiple causal events occur in respect of the same policy, to deduct the *maximum* regulatory causal event charge *for each* causal event.
- 2.5 This practice is inconsistent with the spirit, intent and purpose of the Statement of Intent and the Regulations, as well as fair outcomes for customers in terms of Treating Customers Fairly (TCF) principles, as it results in –
- 2.5.1 the “worst case scenarios” envisaged in the Regulations, namely that policyholders could lose up to 40%, 35%, 30% or 15% (as applicable) of their expected policy values as a result of causal events, potentially being exceeded in the case of multiple causal events; and
- 2.5.2 policyholders who initially reduce and then cease premiums to policies (or where other combinations of causal events occur) being in a poorer position than those policyholders who immediately cease contributions, in effect penalising those policyholders who make an effort to keep their policies in force.

3. PURPOSE AND APPLICATION OF THE REGULATIONS

- 3.1 The purpose of Part 5 of the Regulations is to –
- 3.1.1 rectify past unfair and unreasonable industry practices that necessitated the Statement of Intent and the introduction of the Regulations;
- 3.1.2 promote fair treatment of policyholders; and
- 3.1.3 more particularly, ensure that contractual savings policies are likely to perform as policyholders have been led to expect in respect of the net returns from contractual savings products (particularly in the context of early premium reduction or cessation and other causal events).

3.2 In complying with Part 5 of the Regulations, insurers must give effect to the purpose of the Regulations.

Determining the quantum of “causal event charges” referred to in the Regulations

3.3 Insurers may deduct a causal event charge each time that a causal event takes place. However, to give effect to the purpose of Part 5 of the Regulations, insurers must adhere to the following principles:

3.3.1 When calculating causal event charges, the insurer must take into account the cumulative effect on a policy’s investment value of charges that have already been deducted in respect of previous causal events;

3.3.2 On the occurrence of a second or subsequent causal event on a policy, the causal event charge for that second or subsequent event must therefore be determined taking into account the cumulative effect of that charge and all prior causal event charges on the policy’s investment value;

3.3.3 More particularly, the insurer must ensure that the cumulative effect of multiple causal event charges during the life of a policy does not result in the policy’s investment value at any time being reduced by a greater proportion than would have been the case if, at the time of the first causal event, the maximum causal event charge¹ had been deducted.

3.4 There are different ways in which the insurer may apply these principles. The insurer, however, must apply the same method of calculation to all policies of the same type.

Maximum charges

3.5 The Regulations determine the *maximum charges* that may be charged on the occurrence of causal events. Insurers are reminded that they –

3.5.1 are not obliged to charge the maximum charges;

3.5.2 must, where their actuarial basis² provides for a charge percentage that is less than the maximum prescribed charges in the Regulations, apply the lesser percentage in calculating causal event charges and in determining their cumulative effect; and

3.5.3 must, prior to effecting any amendment to the actuarial basis of a policy that

¹ The “maximum causal event charge” here refers to the lower of the highest charge the insurer applies to any one causal event for the type of policy concerned according to the policy’s actuarial basis, and the highest causal event charge envisaged in the Regulations for the type of policy concerned. The “highest causal event charge” will typically be the charge deductible on surrender of the policy as contemplated in paragraphs (f) or (g) of the definition of “causal event” in Part 5A of the Regulations (which definition also applies in respect of Part 5B of the Regulations as per regulation 5.10), unless the insurer’s actuarial basis determines a lower charge.

² As defined in Part 5A of the Regulations. Note that Regulation 5.10 provides that any word or expression to which a meaning has been assigned in Part 5A has the same meaning for purposes of Part 5B of the Regulations.

will have the effect of reducing the values or benefits of a policy, inform the Registrar of the proposed amendment and the reasons therefore.

3.6 Insurers should consider adjusting the actuarial bases for products to ensure that these bases are not inconsistent with the minimum principles embedded in Part 5 of the Regulations and this directive.

4. COMPLIANCE WITH REGULATIONS AND THIS DIRECTIVE

4.1 Insurers must ensure that they adhere to the principles set out above.

4.2 Insurers that have previously applied Part 5 of the Regulations in a manner inconsistent with the Regulations *and* this directive must –

4.2.1 for every policy that has not come to an end subsequent to the happening of a causal event, adjust the investment value of the policy in accordance with the principles. The adjustment must be made no later than the earliest of the following events in relation to the policy concerned:

- the next regular communication of the policy's investment value to the policyholder;
- any further causal event;
- the payment of the policy's investment value or any part thereof; or
- receipt of any request by the policyholder to be provided with the policy's investment value, or any query or complaint regarding the policy's investment value, from the policyholder irrespective of the query or complaint being received via the financial services provider of the policyholder, the Pension Funds Adjudicator, the Ombud for Financial Services Providers³, the statutory ombud⁴ or any other ombud⁵;

4.2.2 where a policy has come to an end and a query or complaint regarding the investment value as at the date the policy came to an end is received from the former policyholder irrespective of the query or complaint being received via the financial services provider of the policyholder, the Pension Funds Adjudicator, the Ombud for Financial Services Providers, the statutory ombud or any other ombud, determine the amount that would have been payable if the investment value had been determined in accordance with the above principles, and pay the policyholder any resultant shortfall.

4.3 Improved monitoring and oversight controls must be implemented immediately to ensure, pending the rectification of operating systems (where necessary), that the

³ As defined in section 1 of the Financial Services Ombud Schemes Act No. 37 of 2004 ("the FSOS Act").

⁴ As defined in section 1 of the FSOS Act.

⁵ As defined in section 1 of the FSOS Act.

insurer adheres to the Regulations *and* this directive.

4.5 The Registrar, to facilitate compliance with the Regulations or this directive, may direct an insurer –

4.5.1 under section 4(2) of the Act, to provide information on policies referred to under paragraph 4.2; and / or

4.5.2 under section 4(3) of the Act, to take such measures as may be necessary to rectify any non-compliance with the Regulations.

5. FAILURE TO COMPLY WITH REGULATIONS OR DIRECTIVE

A failure to comply with the Regulations or this directive may be referred to the Enforcement Committee of the Financial Services Board, in accordance with the Financial Institutions (Protection of Funds) Act No. 28 of 2001.

6. AVAILABILITY OF DIRECTIVE

6.1 This directive is available on the website (www.fsb.co.za) of the Financial Services Board.

6.2 Insurers must bring this directive to the attention of their appointed auditors, appointed statutory actuary and Board of Directors.

REGISTRAR OF LONG-TERM INSURANCE