Case 36 - Policy Loans – Interest – *in duplum* rule

Background

1. The complaint is expressed as follows by the complainant in his letter, dated 17 July 2018:

> "Summary of complaint:
>
> In 1983 I took out a life policy (no: SX4663919) with the then Southern Life Insurance Company. In 1999 I made a loan of R5000 against the policy. I cannot remember making any arrangements with Southern Life to repay the loan separately as I assumed that my monthly premium would be adjusted to incorporate the monthly loan repayment. At no stage was I informed by Southern Life that I had to make a separate repayment for the loan amount. Although my monthly payment to Southern Life continued I had virtually forgotten about the policy and was not kept abreast of developments regarding additional payments by Southern Life.
>
> Sometime between 1999 and 2017 Southern Life merged with Momentum Life and this state of non-correspondence/notification continued. I must add that during this period I moved home twice, although my employment address stayed the same until December 2012 when I transferred from the Western Cape Education department to the Department of Cultural Affairs and Sport.
>
> On 3 July 2017 I enquired about the status of another life policy (no: SL091673378) taken out with Southern Life in 1997, when I was informed for the very first time that the loan amount on policy no: SX4663919 had not been settled and that it had accrued interest of approximately R48 000 over the years. I immediately wrote to Momentum indicating that I wanted to settle the loan amount, but requesting that the interest be waived, citing as my reason that i had received no correspondence from Southern Life as well as the current holders of the policies (Momentum) in respect of the status of policy no: SX4663919. I am attaching such correspondence.
>
> My appeal to the ombudsman, as has been the case to Momentum, is that in view of the aforementioned insurance companies', failure to inform or notify me about the status of policy SX4663919 after the loan had been granted, to waive such interest."

2. In its response to the complaint the insurer said this:

   2.1 The policy in question commenced on 1 July 1983.

   2.2 During or about 1999 the complainant borrowed R5 000.00 "against the security of the … policy".

2.3 No records exists of the loan, but during 1991 there was a previous loan to the complainant which provides as follows:

- That interest will be paid on the amount of the loan at the rate of 18% per a year “or such other rate as may be determined by the Southern from time to time”.

- That interest is calculated annually in advance “and is payable on granting of the loan and thereafter within 30 days of each anniversary date of the policy”.

- “Should any such interest … be due and payable but unpaid, the amount thereof shall be advanced … as a further loan and all the conditions hereof shall apply to the increased capital.”

- “The capital amount of all loans made under or by virtue of the abovementioned policy (including prior loans), or any balance of the capital amount thereof unpaid at the date hereof – the provision hereof being, to that extent only a variation of the terms of such prior loan(s) – shall not become due and payable until the happening of the earlier of the following events

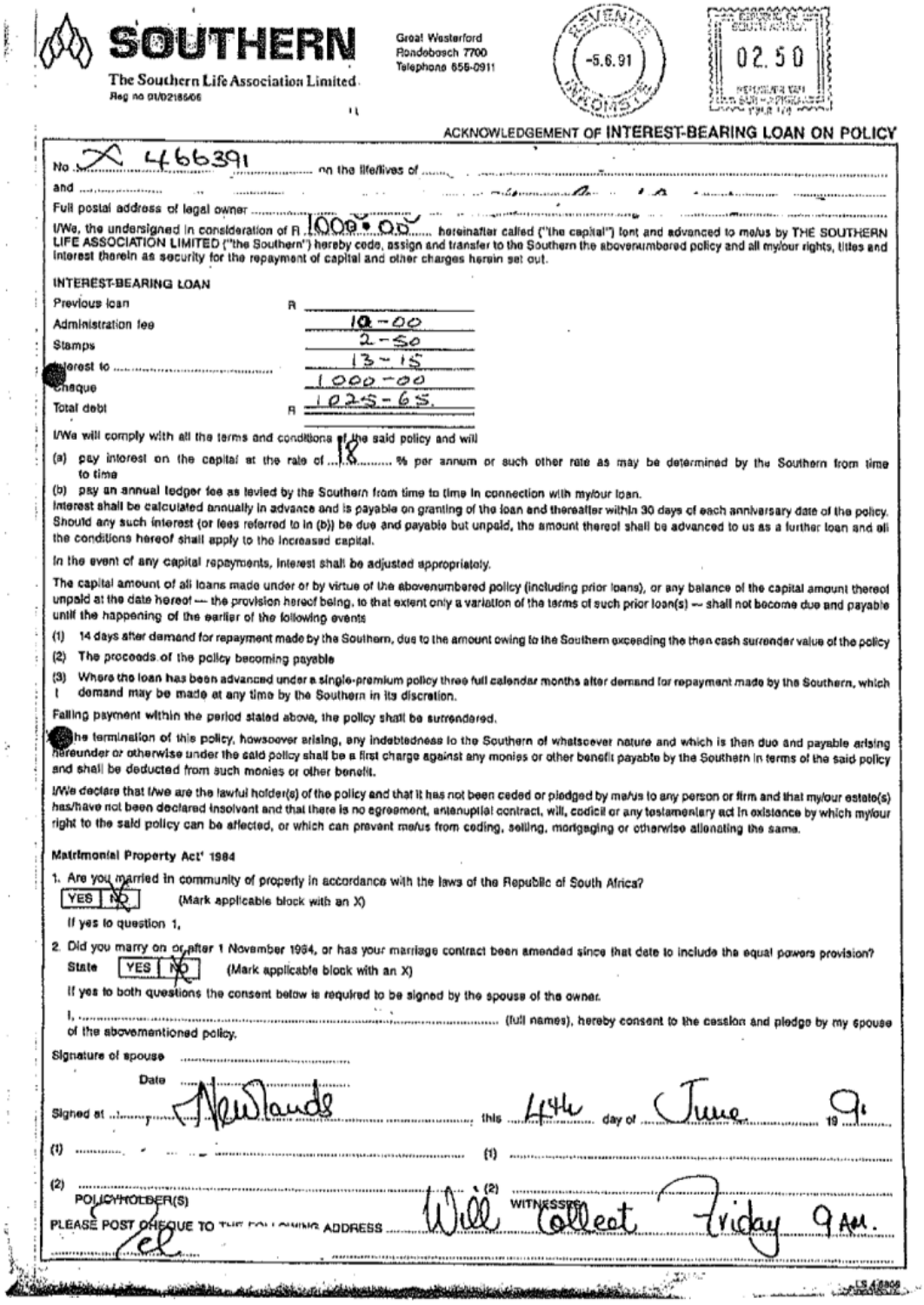
  (1) 14 days after demand for repayment made by the Southern, due to the amount owing to the Southern exceeding the then cash surrender value of the policy.

  (2) The proceeds of the policy becoming payable.

  (3) Where the loan has been advanced under a single-premium policy three full calendar months after demand for repayment made by the Southern, which demand may be made at any time by the Southern in its discretion.

  Failing payment within the period stated above, the policy shall be surrendered.”

2.4 That the 1999 loan “would have been granted on the same basis” as the 1991 loan, which is reproduced here (with the name of the complainant deleted):



SOUTHERN

The Southern Life Association Limited
Reg no 01/02185/06

Great Westerford
Rondebosch 7700
Telephone 655-0911

-5.6.91

02.50

ACKNOWLEDGEMENT OF INTEREST-BEARING LOAN ON POLICY

No X 466391 on the life/lives of

and

Full postal address of legal owner

I/We, the undersigned in consideration of R 1000.00 hereinafter called ("the capital") lent and advanced to me/us by THE SOUTHERN LIFE ASSOCIATION LIMITED ("the Southern") hereby cede, assign and transfer to the Southern the abovenumbered policy and all my/our rights, titles and interest therein as security for the repayment of capital and other charges herein set out.

INTEREST-BEARING LOAN

Previous loan	R	
Administration fee		10-00
Stamps		2-50
Interest to		13-15
Cheque		1000-00
Total debt	R	1025-65

I/We will comply with all the terms and conditions of the said policy and will

(a) pay interest on the capital at the rate of 18 % per annum or such other rate as may be determined by the Southern from time to time

(b) pay an annual ledger fee as levied by the Southern from time to time in connection with my/our loan.

Interest shall be calculated annually in advance and is payable on granting of the loan and thereafter within 30 days of each anniversary date of the policy. Should any such interest (or fees referred to in (b)) be due and payable but unpaid, the amount thereof shall be advanced to us as a further loan and all the conditions hereof shall apply to the increased capital.

In the event of any capital repayments, interest shall be adjusted appropriately.

The capital amount of all loans made under or by virtue of the abovenumbered policy (including prior loans), or any balance of the capital amount thereof unpaid at the date hereof — the provision hereof being, to that extent only a variation of the terms of such prior loan(s) — shall not become due and payable until the happening of the earlier of the following events

(1) 14 days after demand for repayment made by the Southern, due to the amount owing to the Southern exceeding the then cash surrender value of the policy

(2) The proceeds of the policy becoming payable

(3) Where the loan has been advanced under a single-premium policy three full calendar months after demand for repayment made by the Southern, which demand may be made at any time by the Southern in its discretion.

Failing payment within the period stated above, the policy shall be surrendered.

On the termination of this policy, howsoever arising, any indebtedness to the Southern of whatsoever nature and which is then due and payable arising hereunder or otherwise under the said policy shall be a first charge against any monies or other benefit payable by the Southern in terms of the said policy and shall be deducted from such monies or other benefit.

I/We declare that I/we are the lawful holder(s) of the policy and that it has not been ceded or pledged by me/us to any person or firm and that my/our estate(s) has/have not been declared insolvent and that there is no agreement, antenuptial contract, will, codicil or any testamentary act in existence by which my/our right to the said policy can be affected, or which can prevent me/us from ceding, selling, mortgaging or otherwise alienating the same.

Matrimonial Property Act' 1984

1. Are you married in community of property in accordance with the laws of the Republic of South Africa?

YES [ ] NO [X] (Mark applicable block with an X)

If yes to question 1,

2. Did you marry on or after 1 November 1984, or has your marriage contract been amended since that date to include the equal powers provision?

State YES [ ] NO [X] (Mark applicable block with an X)

If yes to both questions the consent below is required to be signed by the spouse of the owner.

I, (full names), hereby consent to the cession and pledge by my spouse of the abovementioned policy.

Signature of spouse

Date

Signed at New Lands this 4th day of June 19 91

(1) (1)

(2) (2)

POLICYHOLDER(S) WITNESSES

PLEASE POST CHEQUE TO THE FOLLOWING ADDRESS Will Collect Friday 9 AM.

LS 4/806

2.5 "The loan agreement makes no mention of any repayment arrangement or that interest would be added to the premium … Mr White would have noticed that his premium remained the same meaning that no interest was added."

I point out that the insurer's statement that "the loan agreement makes no mention of any repayment arrangement" is irreconcilable with the terms set out in paragraph 2.3, above, and reflected in paragraph 2.4, above.

2.6 During 2007 and 2008 the complainant made enquiries about the loan and he was informed that "no repayment of the loan being made".

2.7 That the insurer sent "quarterly loan statements" to the complainant, as well as annual policy statements on which "the outstanding debt is noted".

2.8 That the insurer was not informed of that the complainant changed his address; that it "cannot be held responsible for the loan status of his policy" and that it "cannot waive such interest as the loan amount was borrowed not from policy funds but from external sources".

3. The insurer furnished to us copies of a number of policy statements of which I only refer to four examples:

3.1 **1 February 2001**
The loan amount is R 5 319,78
"Accumulated interest" is R 1 059.16
The interest rate is 17% per year.

3.2 **1 August 2006**
The loan amount is R 5 319,78
"Accumulated interest" is R 9 508.17
The interest rate is 14.49% per year.

3.3 **1 July 2012**

The loan amount is R 5 319,78
"Accumulated interest" is R26 872.39
The interest rate is 9.9% per year.

3.4 **1 July 2018**
The loan amount is R 5 373,78
"Accumulated interest" is R55 487.16
The interest rate is 11% per year.

4. On each of the statements referred to in paragraph 3, above the following is reflected under the rubric, "loans against this policy":

"Protecting your investment is the most important way to manage your future. Repayment of loans against your policy will make ensure (**sic**) that the total debt never exceeds the early cancellation value of your policy. If this happens, we will cancel the policy and it will no longer provide any benefits.

To repay your loan, we need to receive the following monthly payments.

Period	12	Months	24 Months"

Under the two rubrics "12 months" and "24 months" the policy statements set out the amount of the appropriate "monthly payment".

5. It is common cause that no payment was made by the complainant in terms of the 1999 loan agreement.

6. I think the following is demonstrated by the terms of the loan agreement and the growth of the amount of interest which became due in terms thereof:

   6.1 The risk-free nature of the loan – the policy **always** provided sufficient and readily realisable security for the loan and the interest.

   6.2 The appropriateness of Einstein's observations:

   - Compound interest is the eighth wonder of the world. He who understands it, earns it … he who doesn't … pays it.
   - Compound interest is the most powerful force in the universe.
   - Compound interest is the greatest mathematical discovery of all time.

7. On 27 August 2018 this office wrote as follows to the insurer:

   "The **in duplum** rule applies to debt which arises out of a loan or advance granted from 1 January 1999.

   Please advise if the **in duplum** rule has been applied in this instance and if not, why?"

8. On 18 September 2018 the insurer responded as follows to our enquiry about the applicability of the **in duplum** rule:

   "I referred the matter to our product house and legal department, see below their response:

   MMI Group Limited (Momentum) has held a long standing view that the common law doctrine of in duplum applies in respect of interest which is in arrears.

   In Sanlam Life Insurance Limited v SA Breweries Ltd. 2000 (2) SA 647 (W) the judge stated that; '[T]he in duplum rule is confined to arrear interest and to arrear interest alone.'

   We obtained a legal opinion from a reputable law firm which confirmed the view that 'arrears' means interest that is due and payable but not paid.

The National Credit Act effective from 1 June 2007 made the in duplum rule statutory law. It keeps the application of the in duplum rule consistent except that it uses the terms of being 'in default' instead of referring to 'arrear' interest.

An interest bearing loan allows the risk benefits to remain intact while there is a residual value in the policy to fund the loan. The loan debt increases over time as interest accrues to the loan balance.

Policyholder borrowers can repay all or part of the loan debt at any time. When a benefit becomes payable under the policy, the outstanding loan debt is deducted from the benefit amount. If the debt becomes equal to or greater than the cancellation value of the policy at any time, then the policy is cancelled.

With regard to the terms of an interest bearing loan there is no obligation for the client to make repayments towards the loan debt, except for when a benefit becomes payable, or the policy is cancelled.

Policyholder borrowers are only obliged to make repayments at pre-defined times if they specifically choose to do so. From this it should be clear that interest payments in respect of an interest bearing loan only become due and payable when they are paid and therefore repayments are never unpaid and in arrears, and the loan never goes into default.

In a scenario where the in duplum rule applies, it obliges the creditor (the insurer) to claim loan repayments. In the case of a policy loan, this would mean a partial or full cancellation of the policy to redeem the debt. In this specific case, the only option available is to cancel the contract as this product does not offer a partial withdrawal. This is not in the client's interest as a cancellation causes an immediate and substantial reduction in the policy's benefits, and also attracts early termination charges.

This is not consistent with the intent of a product that has a main purpose of providing risk benefits. Amongst other considerations, the client may not be able to obtain alternative cover if he does not meet with the underwriting requirements. Our current practice is therefore also fair from this perspective, and maintains the highest level of risk cover for the longest period of time.

We therefore conclude that in this instance Momentum was entitled to claim interest payable on an unpaid loan granted."

9. In response to the insurer's letter quoted in paragraph 8, above, this office wrote to it as follows on 27 September 2018:

> "Momentum previously advised that it would approach the courts to obtain a declaratory order on this issue.
>
> Please advise what the outcome was of Momentum's action in this regard."

10. On 10 October 2018 the insurer responded as follows to the letter referred to in paragraph 9, above:

> "Momentum has not approached the court for a declaratory order at this stage but opted for an alternative strategy instead.
>
> Momentum decided to engage the services of a respected academic specializing in the field of consumer credit law to write an article to be published in a widely read publication such as the South African Law Journal on the in duplum rule relating to lump sum payments as it is applied in the common law as well as in the National Credit Act. The writer is Doctor Monica Vessio a practicing attorney who has contributed to a number of articles and journals relating to credit law and was cited in at least three High Court matters dealing with the in duplum doctrine.
>
> It must be stressed that the writer agreed to write the article for publication on condition that she formulate her own conclusions on the in duplum doctrine independent from Momentum's views.
>
> Depending on the outcome of the article which is due in October 2018 Momentum will finally formulate its view on the application of in the duplum doctrine."

11. On 18 October 2018 the matter was discussed at a meeting of the Adjudicators in this office, at which my Deputy and I were present.

12. On 23 November 2018 a provisional ruling, with which this final determination should be read, was made in the following terms:

> "12. This matter was discussed at a meeting of the adjudicative staff on 18 October 2018 under the chairmanship of the Ombudsman, Judge RP McLaren. The meeting:
>
> · Held that the *in duplum* rule was applicable and that it was applicable to any debt which arises out of a loan or advance granted after 1 January 1999;

- Held that the rule was not limited to 'interest which is in arrear' as argued by Momentum;

- Noted that the applicability and application of the *in duplum* rule was accepted and supported by the Financial Sector Conduct Authority (previously the Financial Services Board);

- Noted that the rule was accepted and applied by other members of the industry.

13. The meeting unanimously agreed that for the reasons set out above, the *in duplum* rule was to be applied by Momentum to Mr White's policy and his loan balance adjusted accordingly.

14. The ruling set out above is of a provisional nature. In accordance with our usual practice each party is given an opportunity until 24 December 2018 to place new information before us and to make new representations to us before we proceed further with the complaints handling process. Any response received from a party will be regarded as that party's only response, unless otherwise indicated.

15. If we do not hear from any party by 24 December 2018 we will assume that neither party challenges the provisional ruling and we will then close our file."

13. On 20 December 2018 the insurer wrote to us as follows, referring to an enclosed article ("the article"):

"I refer to my telephone conversation with Mrs Preiss.

The article will be published in the South African Law Journal soon but the exact date is currently unknown to us.

Momentum have permission from the author and the publisher (SALJ) to release this article to your office only on condition that the Ombudsman may until date of publication not release this article to any third party and to treat the contents as confidential."

14. The article was circulated amongst the Adjudicators in this office for the purpose of their meeting which was held on 11 January 2019, at which my Deputy and I were present. If the article had any impact on the deliberations at this meeting no decision would have been taken thereat, but we would have waited for the publication of the article before submitting a copy thereof to the complainant for his comment.

15. At the meeting referred to in paragraph 14, above, it was unanimously resolved that the provisional ruling referred to in paragraph 12, above, be confirmed as the final determination.

16. **Reasons for the final determination**

16.1 In terms of section 68A(1) of the Insurance Act, 37 of 1943, a loan or an advance made by a registered insurer "on the sole security of a policy under which the insurer is liable" is exempted from the **in duplum** rule.

16.2 Act 37 of 1943 was repealed by the Long-term Insurance Act, 52 of 1998, which came into operation on 1 January 1999.

16.3 Act 52 of 1998 was in force when the loan was made to the complainant.

16.4 The exemption referred to in paragraph 16.1, above, was omitted from Act 52 of 1998. This omission reflects the intention of the Legislature and is in line with the following statements in:

16.4.1 **Verulam Medicentre (Pty) Ltd v Ethekweni Municipality** 2005 (2) SA 451 (D + CLD):

454E: "Joubert JA … emphasised … that it is not limited to money-lending transactions but applies to all contracts under which a debt is subject to interest at a fixed rate. He also stressed … that its purpose was to protect debtors."

454F: "… Zulman JA added … that the rule is based on public policy and cannot be waived by a debtor. It is therefore clear that there are no exceptions to the rule, the only question in a given case being whether the rule applies at all."

16.4.2 **Ethekweni Municipality v Verulam Verulam Medicentre (Pty) Ltd** [2006] All SA 325 (SCA) 331d – g:

"[21] The correct quotation is, however, the one contained in the other report, [2002] 2 All SA 199 (SCA) [**Commissioner, South African Revenue Services v Woulidge**] and it reads as follows at paragraph 12:

> 'It is clear that the **in duplum** rule can **only** be applied in the real world of commerce and economic activity where it serves considerations of public policy in the protection of borrowers against exploitation by lenders …' (My emphasis).
> …

[23] Furthermore, whilst it may be so that the **in duplum** rule is founded on public policy considerations, it now forms part of positive law."

16.5 It is important to have regard to the following observation by Madlanga J in **Paulsen and Another v Slip Knot Investments 777 (Pty) Ltd** 2015 (3) SA 479 (CC):

> [81]: "Thus the broad basis for the existence of the rule – protecting debtors from being buried under a mountain of debt – applies with at least equal force in today's modern world of finance, …"

16.6 The facts of this complaint demonstrate that the unchecked accumulation of interest resulted therein that the complainant is "buried under a mountain of debt" – his loan debt of R5 319.00 has grown more than ten fold to a policy debt of R55 487,00.

16.7 In the judgment of Madlanga J in **Paulsen** there is a reference to another judgment which, in my view, also applies to the facts of this complaint:

> [53]: "… the rule is concerned with public interest and protects borrowers from exploitation by lenders who permit interest to accumulate."

On the facts of this matter there appears to be little doubt that the insurer allowed the interest to accumulate, secure in the knowledge that its investment was safe.

16.8 It is also apposite to refer to the concurring judgment in **Paulsen** which was delivered by Moseneke DCJ:

> [107]: "In this dispute there is no grumbling about what the **in duplum** rule lays down or its longstanding pedigree as part of our law... The plain policy consideration underlying the rule is to prevent a broken debtor from being pounded by the ever-growing interest burden. The purpose of the rule is dual. It permits a creditor to recover double the capital advanced to the debtor whilst it seeks to alleviate the plight of debtors in financial distress."
>
> [114]: "The main judgment has not merely corrected a little error of assaying public policy made in **Oneanate** ... Its reasoning has rightly recognised the financial and often class inequality between lenders and borrowers. It points to the financial injustice of an uncapped and mounting interest yoke where the lender is rewarded well beyond a fair return on money advanced... It gives a constitutional nod in favour of sanctity of contract, but holds that the value of that principle alone is not sufficient to permit an onerous and crushing debt burden on the debtor. A burden of that kind cannot properly be imposed, not even under the guise of free will, particularly in a society where equal worth is an ideal that is prized perhaps more than financial gain."

16.9 Our Rules are compatible with the views expressed by Moseneke ACJ in paragraph [114] of the concurring judgment, quoted in paragraph 16.8, above.

"The Ombudsman shall seek to ensure that:

- **Rule 1.2.3**
  he or she keeps in balance the scale between complainants and subscribing members;

- **Rule 1.2.4**
  he or she accords due weight to considerations of equity;

- **Rule 1.2.7**
  subscribing members act with fairness and with due regard to both the letter and the spirit of the contract between the parties and render an efficient service to those with whom they contract."

16.10 It appears to me that the insurer's submission that the **in duplum** rule does not apply in this matter is principally based on the judgment of Blieden J in **Sanlam Life Insurance v South African Breweries Ltd** 2000 (2) SA 647 (W), more particularly his statement (at 655D) that "the **in duplum** rule is confined to arrear interest and to arrear interest alone". In **Bellingan v Clive Ferreira & Associates CC and Others** 1998 (4) SA 382 (W) 401C it was also said that "the prohibition of interest **in duplum** was by 1613 limited to unpaid arrear interest". I accept the correctness of these judicial pronouncements. In paragraph 12 of the provisional ruling, quoted in paragraph 12, above, it was said that the **in duplum** rule was "not limited to 'interest which is in arrear' **as argued by Momentum**" (my emphasis). The insurer's submissions are quoted in paragraph 8, above.

In my view **Sanlam** is distinguishable from the facts of this complaint. Blieden J said (at 655B) that the interest referred to in the relevant agreement "is not 'interest' in the sense referred to in the **in duplum** rule …" The insurer places emphasis on the statement that "the **in duplum** rule is confined to arrear interest and to arrear interest alone". Those words must not be read in isolation, but in their proper contextual setting, including the facts of the case and the statement by Blieden J (at 655F) that "interest was at no time in arrear, but was to be calculated as future interest in the relevant time period involved". In the present complaint the loan agreement provided for the payment of interest as set out in paragraphs 2.3 and 2.4, above. The complainant failed to pay any amount of interest, which, in the words of the 1999 loan agreement, became "payable on the granting of the loan agreement and thereafter within 30 days of each anniversary date of the policy". Each amount of such accrued and unpaid interest is "arrear interest". The insurer did not take any steps to recover such interest which, in terms of the 1999 loan agreement, was "due and payable but unpaid". Instead, the amount of that interest the insurer "advanced to (the complainant) as a further loan…" In this way the original loan grew exponentially (or "sky-rocketed", **per** Madlanga J in paragraph [63] of **Paulsen**) from R5319,00 in 1999 to R55 487,00 in 2018. It was the unanimous view of the meeting that the insurer cannot escape the consequences of the **in duplum** rule

by its reliance on the addition of the arrear interest to the capital amount of the loan.

16.11 In the light of the aforegoing, I think the matter can be summarised as follows:

16.11.1 In its submission, quoted in paragraph 8, above, the insurer said this:

> *"With regard to the terms of an interest bearing loan there is no obligation for the client to make repayments towards the loan debt, except for when a benefit becomes payable, or the policy is cancelled.*
>
> *Policyholder borrowers are only obliged to make repayments at pre-defined times if they specifically choose to do so. From this it should be clear that interest payments in respect of an interest bearing loan only become due and payable when they are paid and therefore repayments are never unpaid and in arrears, and the loan never goes into default."*

16.11.2 It appears to me that this submission flies in the face of the following express provisions in the 1999 loan agreement:

- That the complainant "will … pay interest on the capital …"
- "Interest shall be calculated annually in advance and is payable on granting of the loan and thereafter within 30 days of each anniversary date of the policy."

16.11.3 If the complainant does not pay the interest which, in the words of the 1999 loan agreement, is then "due and payable but unpaid" such interest is, in law, in arrears and, in relation thereto, the complainant would have been entitled to the protection of the **in duplum** rule.

16.11.4 Instead of collecting that arrear interest the insurer, since the inception of the policy, advanced it (and, presumably, the unpaid arrear annual ledger fees) to the complainant.

16.11.5 It was the unanimous view of the meeting that such an accumulation of interest offends against the **in duplum** rule.

16.12 This final determination does not decide any principle of general application – it relates only to the complaint under consideration. We carefully considered the matter and came to the unanimous conclusion that, on the facts of this matter, fairness demands that the protection of the **in duplum** rule should be extended to the complainant. The printed form which was used for the 1991 loan agreement may have been suitable

for policy loans before 1 January 1999, but the law changed on that date. See paragraphs 16.1 to 16.4, above.

16.13 With regard to the complainant's request that the insurer should waive all the interest charged on the 1999 loan we point out the following:

16.13.1 The complainant had a duty to inform the insurer of any change of his address and, according to the insurer, this did not happen.

16.13.2 We do not think that it will be fair if the insurer is deprived of all interest on the loan and we are only prepared to confirm paragraph 13 of the provisional ruling, as quoted in paragraph 12, above.

16.14 The considerations mentioned in the last two bullet points in paragraph 12 of the provisional ruling (quoted in paragraph 12, above) are indicative that, in the long-term insurance industry, the application of the **in duplum** rule to policy loans "serves considerations of public policy in the protection of borrowers against exploitation by lenders".

17. It was the unanimous view of the meeting referred to in paragraph 14, above, that, for the reasons set out in paragraph 16, above, the insurer is bound by the **in duplum** rule in relation to the complainant's policy loan.

18. For the above reasons the provisional ruling is confirmed as the final determination.

Outcome

Momentum adjusted the loan accordingly.