FSCA POSITION PAPER

PROPOSALS ON THE FUTURE REGULATORY FRAMEWORK FOR THE COLLECTION OF INSURANCE PREMIUMS

[*PUBLICATION DATE: 9 April 2019*]

FSCA

Financial Sector
Conduct Authority

FSCA
Financial Sector Conduct Authority

TABLE OF CONTENTS

1. PURPOSE OF PAPER

1.1. On 14 December 2018, the Financial Sector Conduct Authority (FSCA) published *FSCA Communication 2 of 2018: Update on the future of the premium collection regulatory framework under the Short- and Long-term Insurance Acts* (the Communication). The Communication provided a status update on the technical work underway which is aimed at further refining the premium collection regulatory framework for short and long-term insurers.

1.2. The Communication also highlighted the various regulatory interventions being considered to address specific risks inherent in third party premium collection business models. In this regard the FSCA confirmed that further industry engagements would take place during early 2019 to help inform a broader policy position on the future of the premium collection regulatory framework.

1.3. Subsequent to the publication of the Communication the FSCA engaged with a few industry role-players and considered a high level joint submission provided by the South African Insurance Association (SAIA) and the Financial Intermediaries Association (FIA) on the issues raised in the Communication.

1.4. After considering the various inputs received the FSCA has formulated a number of proposals to address the specific risks identified to date with a view to eliciting more detailed industry inputs in order to confirm its policy position on the future of the premium collection regulatory framework.

1.5. Accordingly the purpose of this Paper is to:

1.5.1. confirm the FSCA's current thinking on a future regulatory model for the collection of insurance premiums in South Africa;

1.5.2. set out specific proposals to give effect to the future regulatory model envisaged in 1.4.1 above; and

1.5.3. elicit detailed industry input on the appropriateness, sustainability, effectiveness and practical implementation of the aforementioned proposals.

2. BACKGROUND

2.1 The Retail Distribution Review

2.1.1. The Retail Distribution Review, 2014[1] (RDR) proposed a set of structural interventions to address a number of key risks inherent in the current landscape for the distribution of financial products in South Africa. These included proposals designed to remediate distribution relationships, intermediary incentive and remuneration structures and business models to

[1] Published by the Financial Services Board (FSB) in November 2014

ensure the consistent delivery of fair outcomes to financial customers.

2.1.2. Proposal F of the RDR (Proposal F) specifically addressed the issue of insurance premium collection by intermediaries as follows:

> ***Proposal F: Insurance premium collection to be limited to qualifying intermediaries***
>
> Collection of insurance premiums will not be permitted to be carried out by intermediaries in the case of any long-term insurance business or in the case of personal lines short-term insurance business, unless the intermediary complies with prescribed conduct standards for this service. Details of these standards will be consulted on but they will include operational capability requirements and standards relating to remuneration for the service and mitigation of conflicts of interest.
>
> A transition period will be granted for intermediaries to become compliant with such standards or for insurers to either take over this function themselves or outsource it to third parties who are not intermediaries or associates of intermediaries.

2.1.3. The RDR also highlighted that the service of collecting premiums presents particular conduct risks and that premium collection by intermediaries tends to exacerbate challenges regarding insurer access to policyholder information and the management of conduct risks.[2]

2.1.4. A range of comments was received in response to the above.

Some commentators proposed that premium collection by financial advisers should be prohibited completely, while others felt that this was a useful service and that sufficient safeguards were in place to mitigate risks of misconduct.

A number of commentators proposed that premium collection should be carved out of the definition of "*services as intermediary*" and instead be regarded as an outsourced activity performed on behalf of the insurer.

Practicality and efficiency concerns were also raised in respect of third party premium collection models that are necessary in the case of non-traditional bundled product offerings such as travel insurance or credit insurance, where the insurance premium is collected together with the payment for the primary transaction.

2.1.5. In a number of subsequent RDR status updates and industry engagements the former FSB and more recently the FSCA confirmed its intention to reclassify premium collection as an outsourced activity through future amendments to the regulatory framework. This reclassification would be subject to further work relating to the development of qualifying criteria for premium collection intermediaries as contemplated in Proposal F. Such work would include consideration of appropriate remuneration arrangements including a potential fee cap for the outsourcing of the activity.

[2] See Proposal E of RDR.

2.2 Amendments to the Regulations under the Short- and Long-term Insurance Acts

2.2.1. On 23 March 2018 National Treasury (NT) published proposed amendments to the Regulations under the Short- and Long-term Insurance Acts[3] (proposed amendments). The proposed amendments contained enhancements to the existing short-term insurance premium collection regulatory framework and, for the first time, introduced equivalent regulatory requirements for the collection of long-term insurance premiums.

2.2.2. The proposed amendments were accompanied by an explanatory statement in the form of *Annexure E* which provided an overview of, and rationale behind, the proposed amendments.

Paragraph 2.3 of *Annexure E* confirmed that the proposed amendments relating to premium collection were intended to:

- align the regulatory frameworks for short- and long-term insurance premium collection;
- address certain premium collection risks and abuses that had been identified through supervisory experiences;
- ensure that the premium collection regulatory framework remains relevant in light of evolving market practices; and
- give partial effect to Proposal F of the RDR.

2.2.3. In *Annexure E* it was acknowledged by NT that the proposed amendments relating to premium collection would potentially have a significant impact on the insurance industry. In particular that implementing the proposed requirements would likely necessitate a restructuring of current premium collection arrangements and that short-term insurers who were not currently exercising adequate oversight over their premium collection intermediaries would need to set up appropriate governance structures in this regard.

2.2.4. On 28 September 2018 NT published the final amended Regulations[4] (final Regulations) following further revisions to the proposed amendments in light of comments received during the consultation process.

2.2.5. The final Regulations were accompanied by a document entitled *High-level Response to Comments Received* (Response Document). Paragraph 2.2 of the Response Document contextualised the principles underpinning the final requirements relating to premium collection and confirmed that insurers, in general, were not significantly opposed to these principles. However some

[3] Published in Government Notices 357 and 358 of *Government Gazette* 41523 on 23 March 2018
[4] Published in Government Notices 1015 and 1018 of *Government Gazettes* 41942 and 41946 on 28 September 2018

concerns were raised regarding the practical implementation of the revised requirements.

2.2.6. Notably the strongest opposition to the proposed amendments came from two large premium collection agencies. Clarity on some of the key drivers underlying this strong opposition came to light as other market events unfolded during the latter part of 2018, as alluded to in 2.3 below.

2.3 Supervisory experience relating to premium collection

Undesirable industry practices

2.3.1. In terms of the current regulatory framework a person who collects premiums on behalf of an insurer must pay over all premiums received to the insurer within 15 days after the end of the month during which such premiums are received[5].

Essentially this means that a person who receives premiums on behalf of an insurer on the first day of the month may lawfully retain such premiums for a maximum period of forty five (45) days. The FSCA's supervisory experiences have shown that this 45 day premium remittance period has directly resulted in the evolution of certain undesirable industry practices that are inconsistent with the delivery of fair outcomes to policyholders and which potentially create stability risks for the insurance sector as a whole.

2.3.2. The FSCA is aware that it has been a long established industry practice for persons collecting premiums to set up payment arrangements in such a way so as to retain such premiums in their bank accounts for the maximum allowable period (45 days) in order to maximise interest earnings on premium monies during this period.

In instances where the person collecting the premium is not the same as the intermediary responsible for selling and servicing the relevant policies it is also common practice for a portion of the interest earnings to be shared between such parties.

The interest earned on premiums is retained by the person collecting the premiums and often a part of the interest is also shared with the relevant intermediary.

2.3.3. Premium collection agencies and intermediaries appear to place great reliance on interest earned on premium monies as additional revenue and expenditure management streams as well as a source of funding for medium to long term investments.

2.3.4. These practices have proven to be key behavioural drivers resulting in

[5] Regulation 4.2(6) of the Regulations under the Short-term Insurance Act, 1998 and Regulation 8.2(4) of the Regulations under the Long-term Insurance Act, 1998

potentially unfair outcomes for policyholders particularly in cases where this additional revenue stream is used to influence the movement of books of policies between insurers and creates the risk of conflicted advice for independent financial advisers.[6]

2.3.5. These risks are further exacerbated by intermediaries who utilise their premium collection mandates to retain exclusive control of policyholder banking information thereby entrenching their ability to direct flows of business in support of their own commercial interests potentially in conflict with the interests of policyholders.

2.3.6. It is also concerning to note that the aforementioned practices appear to have endured in many cases with the explicit or implicit knowledge of insurers who are the rightful owners of the premium monies, including any interest earned on such monies during the remittance period. It is unclear why insurers have been willing to forego their rights to such earnings unless this practice is used as an incentive to secure access to distribution channels.

2.3.7. As communicated previously[7], it has consistently been the FSCA's view that because premiums paid over to third parties on behalf of insurers are deemed to have been received by such insurers there is no justification for a collecting intermediary to retain interest earned on any premium monies during the 45 day remittance period.

Insure Group Managers Limited (IGM)

2.3.8. A number of the aforementioned concerns and risks, which have been consistently raised by the FSCA and the former FSB over the past few years, materialised in the events leading up to the unfortunate curatorship of IGM during the latter half of 2018.

2.3.9. For a number of years IGM has been one of the largest insurance premium collection agencies in South Africa. As at June 2018 IGM was responsible for collecting an estimated R1.8 billion worth of monthly insurance premiums on behalf of a number of short- and long-term insurers.

2.3.10. During 2017 and 2018 the former FSB and the FSCA began closely monitoring IGM's financial position due to increasing concerns about its ability to meet its liquidity obligations in terms of the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act).

2.3.11. It became clear that IGM's precarious liquidity position arose because of its abuse of the 45 day premium remittance period. It transpired that IGM had been using the 45 day period to "roll premiums" on a monthly basis in order to fund the acquisition of highly illiquid assets and loans to other intermediaries.

[6] Similar to the risk of poor customer outcomes that were sought to be addressed through the introduction of binder fee caps in December 2017
[7] See, for example, the Response Document referred to in paragraph 2.2.5 of this Paper that was published together with the final amendments to the Regulations in September 2018 which sets out NT and the FSCA's responses to comments received on the draft Regulations dealing with this issue.

IGM was able to engage in these practices because the 45 day remittance period allowed it to collect a full month's premium before it was required to pay the previous month's premiums over to insurers. Accordingly IGM, as would be the case with other premium collection agencies, had a permanent cash float at its disposal.

2.3.12. The net industry impact of IGM's premium collection practices were fully realised when it was placed under curatorship during September 2018, during which time it became clear that the absence of urgent intervention would result in IGM failing to meet its obligations to insurers thereby potentially threatening the stability of the entire insurance sector.

2.3.13. It must be emphasised that the undesirable conduct which threatened the collapse of IGM is not, by any measure, unique to IGM. It is very concerning to note that such conduct is prevalent across the insurance sector and continues to be a cause of concern for the sustainability of other intermediaries who are involved in premium collection. Individual regulatory engagements with these entities are ongoing.

2.3.14. The fallout from IGM and the risks associated with the other undesirable industry practices described above provide clear indications as to the unsustainability of certain third party premium collection models. A collective commitment is required to urgently work towards an effective and sustainable overhaul of the premium collection status quo in order to ensure the protection of policyholders and the stability of the insurance sector.

3. REGULATORY PROPOSALS

3.1 Intended outcomes of proposals

3.1.1. The FSCA acknowledges that current insurance premium collection practices have developed over many decades. It is also recognised that in the past, in the absence of sophisticated and convenient payment systems, policyholders had limited options at their disposal for the payment of premiums directly to insurers. Intermediaries therefore played a valuable role in the premium collection process, to the benefit of both insurers and policyholders. For this reason the legislature introduced third party premium collection requirements that were appropriate to prevailing models and practices at that time in order to address potential risks that were then perceived as inherent in such models and practices.

3.1.2. However during the past decade rapid advancements in technology and innovation have significantly changed the banking and payments landscapes. This has resulted in consumers having greater access to more efficient, reliable and suitable payments options.

3.1.3. The payments industry is also undergoing a period of major re-engineering and disruption because of developments in information and communications technology, the impact of globalisation and an increased focus on customer services integration.[8]

3.1.4. Given the aforementioned developments it is difficult to understand the appropriateness and necessity of the traditional intermediary premium collection model in the current era. However, aside from the traditional intermediary premium collection model, the FSCA does recognise that in certain instances appropriately administered and technologically adept third party providers have a critical role to play in promoting innovation, facilitating competition and enabling inclusion in the payments system. It is therefore essential that any regulatory reforms relating to premium collection take cognisance of and accommodate, to the extent reasonably necessary, these types of third party payment models.

3.1.5. The FSCA remains of the view that the payment of premiums directly into insurer bank accounts should be the preferred approach across the sector, especially since this approach to a large extent eliminates the potential liquidity, credit and customer risks that have materialised to date.

3.1.6. However, based on industry feedback, it is apparent that certain legitimate business models cannot, for practical reasons, accommodate direct collections. This, together with the innovation, competition and inclusion benefits associated with certain specialist third party payment models as described above, means that a blanket approach compelling direct collections in all instances would not be appropriate or sustainable.

3.1.7. In order to encourage a shift towards direct collections becoming the default rather than the exception, while accommodating specialised third party collections where reasonably necessary and appropriate, the premium collection regulatory framework must:

- impose appropriate operational and system capability requirements on parties who want to perform third party premium collection activities in order to mitigate the relevant risk. We do, however, acknowledge that this will impact the traditional intermediary premium collection models since it is likely, based on current capabilities, that many intermediaries may not be able to meet the proposed operational and system requirements ;
- impose appropriate accountability, governance and oversight requirements on insurers in order to deter insurers from indiscriminately handing out premium collection mandates to non-specialists. This too is envisaged to mitigate the potential risks that

[8] See, for example, paragraph 4 of the South African Reserve Bank's Policy Paper entitled *Review of the National Payment System Act 78 of 1998*

are introduced where traditional intermediaries and financial advisers perform this function; and

- provide for a mechanism that enables insurers to appropriately remunerate and incentivise third parties who perform specified premium collection related activities on their behalf where necessary.

3.2 PROPOSAL 1: Identification of premium collection related activities and principles for remuneration

Premium collection activities in the context of the Short- and Long-term Insurance Acts

3.2.1. In terms of the Regulations under the Short-term Insurance Act, 1998 "*services as intermediary*" is currently defined as, amongst other things, "*any act performed by a person with a view to collecting or accounting for premium payable under a policy*".

Similarly, in terms of the Regulations under the Long-term Insurance Act, 1998 "*rendering services as intermediary*" is currently defined as, amongst other things, "*the performance by a person other than a long-term insurer or a policyholder, on behalf of a long-term insurer or a policyholder, of any act directed towards collecting, accounting for or paying premiums*".

3.2.2. The ordinary grammatical meaning of the term "*accounting*" includes[9], amongst other things, the following:

- the system of recording and summarising business and financial transactions and analysing, verifying, and reporting the results;
- a systematic process of identifying, recording, measuring, classifying, verifying, summarizing, interpreting and communicating financial information; and
- the systematic and comprehensive recording [and summarizing, analysing and reporting] of financial transactions pertaining to a business.

3.2.3. Based on the above, it is the FSCA's view that *accounting for premiums* on behalf of an insurer includes recording, keeping track of and managing the administration in respect of premiums paid or received, and reporting to the insurer in this regard. The term "*accounting for*" as used in the regulatory definitions set out in 3.2.1 must therefore be applied in its widest sense which means that a wide range of premium collection related activities could possibly fall within this description. The FSCA does, however, acknowledge that there

[9] Based on various sources.

are instances in which it could be quite ambiguous as to whether certain activities would be captured within the above definitions.

3.2.4. Notwithstanding the wide definitions and the potential for ambiguity, a critical feature in framing the future premium collection regulatory framework is to appropriately delineate the various activities associated with premium collection.

3.2.5. As mentioned earlier the FSCA has previously signalled its intention to re-classify the actual physical collection of premiums as an outsourced activity. It is therefore proposed that the activity of physically collecting premiums be carved out from the definitions of "*services as intermediary"* as described in 3.2.1 above.

3.2.6. Where premiums are collected directly into the insurer's bank account, the actual premiums are received by the insurer itself (direct collection model). Therefore no physical collection of premiums by a third party takes place. However certain other activities related to the direct collection might still be performed by the intermediary concerned.

Similarly, where premiums are physically collected by the third party (third party collection model), certain other activities might be performed by that third party, or another party, aside from and in relation to the actual physical collection of premiums.

3.2.7. The FSCA proposes that specific activities related to premium collection (both in the direct and third party collection models) should be classified as outsourced activities. However the FSCA is still in the process of defining these activities and therefore requires specific inputs on the different types of activities that should potentially be covered by the definition of premium collection aside from the actual physical collection itself.

3.2.8. The joint submission recently provided by SAIA and the FIA proposed that the following premium collection related activities be considered:

- premium collection processes and systems required for the enablement of the collection from policyholders comprising mainly the premium notification and collection functions;
- reconciliation of monies received, preparation of premium collection bordereaux and on-payment to insurers; and
- administration functions related to the reconciliation of debit orders, providing reports on unpaid items, disputed items and the payment of commission to intermediaries and so forth.

3.2.9. The joint submission proposed that the first two activities mentioned above

should be classified as outsourced activities, and that the third activity should remain an activity falling within the definitions of "*services as intermediary"* as described in 3.2.1 above. Further industry input is required to provide clarity regarding these activities as well as to highlight whether any other activities in addition to those proposed above should be considered in respect of direct collections.

3.2.10. If premium collection and premium collection related activities are classified as outsourced activities, insurers would be able to remunerate persons performing these activities by means of an outsourcing fee. Specific inputs are required in respect of the principles to be applied for determining such remuneration, per the options set out in the box below.

3.2.11. Commentators are reminded that the potential reclassification of certain premium collection activities as outsourced activities for which additional remuneration may be paid is, to a certain extent, a regulatory concession as these activities currently fall within the definition of "*services as intermediary"*, and are subject to regulated commission caps. Any commentator who recommends that a specific premium collection related activity should be reclassified as an outsourced activity is therefore expected to provide substantive and well-motivated reasons as to why such a concession should be granted in respect of that activity.

Premium collection activities in the context of the FAIS Act

3.2.12. The FSCA acknowledges that, separately and distinctly from the insurance regulatory framework, the FAIS Act also imposes specific requirements in respect of premium collection activities. In light of this, and to address potential inconsistencies and regulatory uncertainty, it is important to consider the potential impact of any future premium collection regulatory reforms in the context of both the insurance and FAIS regulatory frameworks.

3.2.13. In terms of section 1 of the FAIS Act "*intermediary services*" is currently defined as, amongst other things, **"***any act other than the furnishing of advice, performed by a person for or on behalf of a client or product supplier with a view to collecting or accounting for premiums or other moneys payable by the client to a product supplier in respect of a financial product*".

3.2.14. As mentioned in 3.2.12 the FAIS regulatory framework is separate and distinct from the insurance regulatory framework. Therefore the definition of "*intermediary services*" contained in the FAIS Act must be applied separately and distinctly from the definition of "*services as intermediary*" contained in the Regulations made under the Short- and Long-term Insurance Acts. While the existence of a dual regulatory framework for the same activity is not ideal, and notwithstanding future activity segmentation initiatives envisaged under the RDR and more broadly through the activity based Conduct of Financial Institutions Bill (COFI Bill), the impact of the proposals set out in this Paper

must be considered in line with the current sectoral based regulatory landscape.

3.2.15. The current regulatory framework governing payment services activities does not have a dedicated conduct of business focus. It is the FSCA's view that in the absence of an appropriate conduct of business regulatory framework for payment services activities, premium collection activities must remain within the ambit of the FAIS Act.

3.2.16. For purposes of the FAIS Act, "*collecting"* or "*accounting for"* premiums will therefore remain an "*intermediary service"* and any person performing these activities must either be an authorised Financial Services Provider (FSP), or a representative of an FSP, and must comply with the relevant requirements of the FAIS Act.

3.2.17. Developments relating to the strengthening of the regulatory framework governing payment services activities are currently underway.[10] This work will include consideration of how premium collection activities should ultimately be transitioned into the conduct of business framework governing payment services activities.

PROPOSAL 1: Identification of premium collection related activities and principles for remuneration

(a) It is proposed that the physical collection of premiums is carved out from the definition of "services as intermediary" and re-classified as an outsourced activity for which an outsourcing fee may be paid.
(b) It is proposed that in addition to the physical collection of premiums various other activities related to premium collection will be classified as outsourcing activities for which outsourcing fees can be paid.
(c) It is proposed that specific remuneration principles or requirements be imposed that will apply to remuneration for the activities referred to in paragraphs (a) and (b) above.

As part of developing the above proposals, input is specifically requested on:

(i) What types of activities, in addition to the physical collection of premiums, are being performed in relation to premium collection?
(ii) How should the above activities be classified, e.g. as services as intermediary or outsourcing, and why?
(iii) What remuneration principles or requirements should apply to the activity of the physical collection of premiums, and why?
(iv) What remuneration principles or requirements should apply to the activities referred to in (i) above, and why?

Options currently being considered in respect of remuneration include that remuneration for physical premium collection and premium related activities be:

(A) subject to the general remuneration principle of being reasonable and commensurate; or

[10] See for example the South African Reserve Bank's Policy Paper titled *Review of the National Payment System Act 78 of 1998* published in September 2018 and the draft Conduct of Financial Institutions Bill that was published by National Treasury for public comment in December 2018

(B) limited to the actual cost of collecting the premium plus a reasonable rate of return (only in respect of the physical collection of premiums); or
(C) capped at a specific level (Rand amount or percentage based). The caps can either apply to any person performing the relevant activities or potentially only apply to financial advisers in order to mitigate the risk of the additional remuneration resulting in biased advice. Inputs are requested on what would be considered an appropriate approach to a fee cap. It is preferred that commentators provide alternative costing methodology options to the traditional volume (premium) based percentage.

3.3 PROPOSAL 2: Criteria for "qualifying intermediaries"

3.3.1. Where non-direct collections take place, the actual premiums are still being received and held by one or more third party. As discussed earlier, technological developments and evolutions in the payments landscape make it difficult to support a continuation of third party premium collection by traditional intermediaries who are not payments specialists.

3.3.2. It is therefore proposed that third party premium collection should only be performed in very limited instances by certain types of third parties, namely "qualifying intermediaries" as proposed in the RDR, who meet specific operational and systems requirements in order to promote innovation, fair competition and financial inclusion.

3.3.3. Considering the context provided in paragraph 2 above, there is a case to be made for prohibiting the collection of premiums by independent intermediaries[11] altogether. However, the impact of such a blanket prohibition is unclear at this stage and requires further exploration and input. An alternative to a blanket prohibition would be to require insurers to obtain approval from the FSCA on a case by case basis before they outsource premium collection to independent intermediaries.

PROPOSAL 2: Criteria for "qualifying intermediaries"

(a) It is proposed that a third party that collects premiums must comply with the relevant requirements applicable to Third Party Payment Providers (TPPP)[12] as set out in the South African Reserve Bank's Directive No. 1 of 2007[13], including notification of its status as a TPPP to the Payments Association of South Africa (PASA).
(b) It is proposed that a third party that collects premiums must at all times have the following in place:
- **appropriate systems capability to ensure payment of all premiums to the insurer within three (3) working days of collection;**
- **requisite systems and data integration capability to ensure that the insurer is readily able to access any relevant data in respect of premium monies owed to the insurer at any given time;**
- **appropriate and regularly tested business continuity and disaster recovery plans to mitigate risks arising from potential failures in its payments and administration infrastructure;**

[11] As defined in the Regulations under the Short- and Long-term Insurance Acts
[12] TPPP includes beneficiary services providers and payer service providers
[13] Directive for conduct within the National Payment System: In respect of Payments to Third Persons: Directive No. 1 of 2007 published in Government Notice 1110 of *Government Gazette* Number 30261 on 6 September 2007

- **clearly defined segregation and access controls between functions related to the provision of third party payment services for multiple insurers/ beneficiaries; and**
- **proper record keeping procedures to document and retain details of every payment processed for a period of five (5) years.**

(c) It is proposed that if the party that is to collect premiums is an independent intermediary[14], an insurer must first obtain approval from the FSCA before it outsources premium collection to such independent intermediary. Inputs are requested on the viability of this approach as opposed to an outright prohibition of premium collection by independent intermediaries altogether.

3.4 PROPOSAL 3: Treatment of premiums as trust monies

3.4.1. The Regulations under the Short- and Long-term Insurance Acts currently provide that:[15]

(a) An independent intermediary who receives premiums must account for such premiums properly and promptly and open and maintain one or more separate bank account into which premiums are to be received; and

(b) A separate bank account referred to above may only contain monies collected from policyholders and may not contain any monies or funds of the independent intermediary.

3.4.2. During recent industry engagements it was proposed that the separate bank account requirement above should be replaced with a requirement that premium monies be held in a statutory trust account. However details as to the specific mechanics of what this solution would entail have been vague. While the FSCA supports the proposal that premiums should be treated as trust monies, additional input from commentators is required on the practical implications of this solution.

3.4.3. If premium monies are treated as trust monies, the existing requirement referred to in paragraph 3.4.1(b) will potentially become redundant, but the requirement in paragraph 3.4.1(a) will still be relevant.

3.4.4. To ensure transparency and to help the relevant insurer exercise its oversight responsibilities, a third party that collects premiums should keep adequate accounting records in relation to the premiums collected.

3.4.5. The FSCA acknowledges that section 19(1) of the FAIS Act requires that an FSP must maintain full and proper accounting records on a continual basis, brought up to date monthly. However, these requirements apply in respect of the whole of the business of the FSP. The FSCA is of the view that the accounting records relating to the premium collection portion of the FSP's business should be appropriately ring-fenced from the rest of its business, and the regulatory framework should reflect this.

[14] As defined in the Regulations under the Short- and Long-term Insurance Acts.
[15] See Regulation 4.2(2) and (3) of the Regulations under the Short-term Insurance Act, 1998 and Regulation 8.2(1) and (2) of the Regulations under the Long-term Insurance Act, 1998

3.4.6. In addition, section 19(3) of the FAIS Act sets certain auditing requirements applicable to FSP's that hold money on behalf of clients. However, certain FSP's that collect premiums are currently exempted from the requirements of section 19(3).[16]

3.4.7. It is the FSCA's view that in order to provide an additional level of assurance in respect of whether, amongst other things, premiums are indeed treated as trust monies, the separate bank account into which premiums are received should be audited. This could potentially be achieved by withdrawing the exemption referred to above.

PROPOSAL 3: Treatment of premiums as trust monies

(a) It is proposed that the existing requirement contained in Regulation 4.2(3) of the Regulations under the Short-term Insurance Act and Regulation 8.2(2) of the Regulations under the Long-term Insurance Act be replaced with a requirement that premiums received into the separate bank account must be treated as trust monies.

(b) It is proposed that an obligation be introduced requiring the person collecting premiums to, in relation to its premium collection business, maintain accounting records on a continual basis and prepare annual financial statements that conform with generally accepted accounting practice.

(c) It is proposed that the separate bank account into which premiums are received must be audited on an annual basis, potentially through the application of section 19(3) of the FAIS Act.

3.5 PROPOSAL 4: Reduction of premium remittance period

3.5.1. As highlighted earlier the current requirement that premiums received must be remitted 15 days after the end of the month during which such premiums are collected has contributed significantly to the undesirable premium collection practices prevalent across the insurance industry and poses significant risks to the stability of the sector and the delivery of fair outcomes to policyholders.

3.5.2. Furthermore it unclear as to why a 45 day premium remittance period is still appropriate considering the technological developments within the payments landscape during the last decade. The FSCA has engaged specifically with specialist TPPP's who perform high volume bulk collections from multiple payees to multiple beneficiaries and involving many transaction types. Even in such complex value chains it was demonstrated that a maximum of three (3) working days, calculated from the day on which the policyholder pays the premium, is sufficient for premiums to be paid over to the insurer.

3.5.3. Based on current payment system capabilities and market expectations it is therefore proposed that the current premium remittance period be significantly shortened.

[16] See FAIS Notice 123 of 2017 *Exemption of Particular FSP's from Section 19(3) Audit Report and Liquidity Requirements* that was published on 21 September 2017

PROPOSAL 4: Reduction of premium remittance period

(a) It is proposed that the time period within which premiums must be paid over to the insurer should be reduced from fifteen (15) days after the end of the month within which premiums are collected to three (3) working days from the date on which such premiums are collected.

3.6 PROPOSAL 5: Interim approach to remuneration for direct collections

3.6.1. During recent engagements the FSCA has encouraged industry players to begin, where possible, fast-tracking steps towards adopting direct premium collection models. However, questions have been raised relating to the application of the current remuneration framework to certain premium collection activities (aside from the physical collection of premiums) that potentially fall within the definition of "*services as intermediary*" but which are still required to be performed by third parties in the direct collection model.

3.6.2. The FSCA acknowledges that because the current regulatory framework does not provide for the payment of additional remuneration other than commission for premium collection related activities that fall within the definition of "services as intermediary", it is likely that industry players may be reluctant to move towards a direct collection model pending the finalisation of the future regulatory framework which would allow for the payment of additional remuneration in the form of an outsourcing fee.

3.6.3. In order to encourage an immediate shift to direct collections it is proposed that, as an interim measure, a general exemption be granted for certain premium collection related activities that potentially fall within the definition of "services as intermediary" and which are performed by third parties in direct collection models. This would enable the payment of additional remuneration over and above commission for such activities where direct collections are being done. As mentioned previously, specific industry input is requested from commentators regarding the types of premium collection related activities that should be subject to such an exemption.

PROPOSAL 5: Interim approach to remuneration for direct collections

(a) It is proposed that the FSCA grants a general exemption to insurers exempting them from having to comply with Commission Regulations when remunerating intermediaries for performing certain stipulated premium collection related activities in instances where premium is collected directly into the insurer's bank account.
(b) It is proposed that the above exemption should be subject to specific conditions, including principles (such as commensuration with the activities being performed) or limits (fee caps or fee ranges) for determining the appropriateness of remuneration to be paid for performing these activities.

As part of developing the above proposal, input is specifically requested on:
(i) What premium collection related activities should be subject to the proposed exemption, and why?
(ii) What remuneration principles or requirements should apply to the activities that will be subject to the proposed exemption, and why?

3.7 Other practical considerations in respect of specific business models and payment arrangements

Specific business models

3.7.1. The FSCA acknowledges that there are specific business models where premium collection is necessary, but in respect of which the above proposals would pose practical implementation challenges. This is largely the case in models where the insurance premium is a small component of, and ancillary to, a composite payment made by a customer to a specific provider.

3.7.2. Examples of such models include:

- the retail credit industry where the credit instalment includes a nominal insurance premium component (e.g. consumer credit or credit life);
- digital broadcasting subscription services where insurance cover for damage to broadcasting hardware forms a small part of the overall subscription payment (e.g. DSTV subscriptions); and
- marine cargo industry where marine cargo insurance is one of the components of the entire service offering provided by freight forwarders. In such cases it has also been highlighted that applying the premium collection regulatory requirements to South African freight forwarders places them at a significant disadvantage to international freight forwarders as it appears that these entities are, to a large extent, excluded from the ambit of financial services regulation internationally.

Other areas of concern

3.7.3. Industry role-players have also raised concerns about the practical challenges of complying with existing and proposed premium collection regulatory requirements in the following scenarios:

- collection of premiums related to multi-insurer policies;
- collection of invoiced premiums; and
- collection of premiums relating to foreign insurer/currency policies (including Lloyd's business).

3.7.4. Further input is requested from commentators in order to gain a better understanding of the concerns raised in this regard.

Proposed approach

3.7.5. Notwithstanding the above, it will not be appropriate or practically possible for the future regulatory framework to be designed in such a way so as to accommodate each one of these individual models.

3.7.6. The FSCA's current position is that these types of models will need to be dealt

with on a case by case basis possibly through an exemption process. Entities that are able to provide cogent justification for their inability to align with existing and proposed regulatory requirements related to premium collection are encouraged to approach the FSCA directly in order to explore the possibility of an exemption from the relevant requirements.

3.7.7. Inputs are, however, specifically requested on other types of business models or areas of concern that may face similar practical challenges in complying with the regulatory proposals outlined in this Paper.

3.8 Interest earned on premiums collected

3.8.1. This Paper does not put forward any regulatory proposals regarding the treatment of interest earned on premiums that have been collected by third parties.

3.8.2. The FSCA remains of the view that any interest earned on premium monies belongs to the insurer and there is no justification for a collecting intermediary to retain interest earned on any premium monies that are held on behalf of the insurer.

3.8.3. Nevertheless it is envisaged that if the proposals outlined in this Paper are implemented, specifically the proposal relating to the reduction of the premium remittance period to three (3) working days, the issue of interest will become academic.

3.9 Further areas for potential alignment between the FAIS and insurance regulatory frameworks

3.9.1 Section 10 of the *General Code of Conduct for Authorised Financial Services Providers and Representatives* under the FAIS Act (General Code) sets out various requirements pertaining to the custody of financial products and funds.

3.9.2 Similar to the issues raised under 3.2 above, this also essentially results in a dual regulatory framework governing aspects of premium collection.[17]

3.9.3 In addition there is an inconsistency within the FAIS framework itself in respect of the application of section 10 of the General Code to the collection of long-term insurance premiums as opposed to short-term insurance premiums.[18]

3.9.4 The FSCA is currently considering the extent to which further alignment and consolidation between section 10 of the General Code and the premium collection requirements contained in the Regulations under the Short- and Long-term Insurance Acts is necessary in order to avoid potential regulatory

[17] Section 10 of the General Code as well as the Regulations under the Short- and Long-term Insurance Acts
[18] FSP's that collect short-term insurance premiums (including short-term reinsurance premiums) have always been excluded, by virtue of section 10(3) of the General Code, from the requirements contained in section 10(1)(d) of the General Code

arbitrage and to ensure harmonisation between the requirements applicable to the collection of long-term and short-term insurance premiums. Specific inputs are requested from industry in this regard.

4. WAY FORWARD

4.1. Interested parties are requested to submit written comments on the proposals outlined in this Paper by **10 May 2019** to the following email address: FSCA.RFDPremiumCollectionPaper@fsca.co.za.

4.2. For further information or clarity regarding the contents of this Paper please contact the Regulatory Framework Department of the FSCA by emailing Eugene du Toit at eugene.dutoit@fsca.co.za.