



**FINANCIAL SERVICES BOARD
REPUBLIC OF SOUTH AFRICA**

**SHORT-TERM INSURANCE ACT, 1998 (ACT 53 OF 1998)
LONG-TERM INSURANCE ACT, 1998 (ACT 52 OF 1998)**

Addressee:	Short-term and Long-term insurers	File:	10.41.1.7.2 and 10.41.2.7.2
Issue date	Reply date	Information Letter	Status
19 July 2012	-	3/2012 (LT&ST)	Issued
-	-	-	-
-	-	-	-
Subject:	Market practices relating to the payment of fees		

1. PURPOSE

The purpose of this information letter is to:

- 1.1 inform short-term insurers¹, intermediaries² and underwriting managers³ that certain market practices relating to the payment of fees may be in contravention of section 48 of the Short-term Insurance Act 53 of 1998 ("the STIA") read with Part 5 of the Regulations under section 70 of the STIA⁴ ("the STIA Regulations"), section 48A of the STIA read with Part 6 of the STIA Regulations and the General Code of Conduct for Authorised Financial Services Providers and Representatives, 2003⁵ ("the FAIS General Code").
- 1.2 inform long-term insurers⁶, intermediaries⁷ and underwriting managers⁸ that

¹ For purposes of this Information Letter, the term "insurer" has the meaning as defined in Part 6 of the STIA Regulations (see footnote 4).

² For purposes of this Information Letter, "intermediary" refers to "independent intermediary" as defined in section 1 of the STIA.

³ As defined in the STIA Regulations (see footnote 4).

⁴ The Regulations made under the Short-term Insurance Act 53 of 1998, as published in GN R1493 of 1998 and amended by GN R462 of 2008 and substituted by GN R1076 of 2011.

⁵ The General Code of Conduct for Authorised Financial Services Providers and Representatives as published in Board Notice 80 of 2003, under section 15 of the Financial Advisory and Intermediary Services Act 37 of 2002.

⁶ For purposes of this Information Letter, the term "insurer" has the meaning as defined in Part 6 of the LTIA Regulations (see footnote 9).

certain market practices relating to the payment of fees may be in contravention of section 49 of the Long-term Insurance Act 52 of 1998 (“the LTIA”) read with Part 3 of the Regulations under the LTIA⁹ (“the LTIA Regulations”), section 49A of the LTIA read with Part 6 of the LTIA Regulations and the FAIS General Code.

2. SHORT-TERM INSURANCE MARKET PRACTICES

2.1. Short-term insurers are reminded that they can only pay the following remuneration to intermediaries or underwriting managers:

2.1.1. Commission as remuneration for rendering services as an intermediary¹⁰, that does not exceed the maximum commission payable in terms of Part 5 of the STIA Regulations;

2.1.2. Fees as remuneration for performing binder functions under a binder agreement in terms of Regulation 6.4 of the STIA Regulations (a “binder holder fee”);

2.1.3. Fees as remuneration for a function or service outsourced in terms of Directive 159.A.i (LT&ST)¹¹, which function or service must not constitute rendering services as an intermediary or binder functions¹².

2.2. Underwriting managers are reminded that they can only pay the following remuneration to intermediaries:

2.2.1. Commission (on behalf of a short-term insurer) as remuneration for rendering services as an intermediary that does not exceed the maximum commission payable in terms of Part 5 of the STIA Regulations;

2.2.2. Fees as remuneration for a function or service outsourced or sub-outsourced in terms of Directive 159.A.i (LT&ST), which function or service must not constitute rendering services as an intermediary or binder functions¹³.

⁷ For purposes of this Information Letter, “intermediary” refers to “independent intermediary” as defined in Part 3 of the LTIA Regulations (see footnote 9).

⁸ As defined in the LTIA Regulations (see footnote 9).

⁹ The Regulations made under the Long-term Insurance Act 52 of 1998, as published in GN R1492 of 1998 and amended by GN R197 of 2000, GN R164 of 2002, GN R1209 of 2003, GNR.1218 of 2006, GN R186 of 2007 and GN R952 of 2008, GN R1493 of 1998, and substituted by GN R1077 of 2011.

¹⁰ As per the definition of “services as intermediary” in section 1 of the STIA.

¹¹ Directive 159.A.i (LT&ST): Compliance with sections 9(3)(b)(i) read with sections 12(1)(c) of the Long-term Insurance Act and Short-term Insurance Act, respectively: Outsourcing, issued on 12 April 2012.

¹² As set out in section 48A(1) of the STIA.

¹³ Section 48A of the STIA prohibits a binder holder from delegating, assigning or subcontracting any binder functions. Accordingly, an underwriting manager cannot pay a binder holder fee to an intermediary.

- 2.3. Intermediaries are reminded that they can only receive fees from a policyholder/s in terms of section 8(5) of the STIA read with section 3A(1)(a)(iii) of the FAIS General Code.
- 2.4. In addition, short-term insurers, intermediaries and underwriting managers who are also financial services providers or representatives are referred to section 3A(1)(a) of the FAIS General Code that prohibits a financial services provider or its representatives from receiving or offering any financial interest from or to a third party other than the financial interests listed in that paragraph.

Fee reasonably commensurate with services actually rendered plus a reasonable rate of return

- 2.5. The Registrar of Short-term Insurance is concerned about the emergence of certain market practices relating to the payment of fees in cases where:
- 2.5.1. the payment of a so-called “binder holder fee” relates to a service or function being provided or performed by the intermediary to the short-term insurer or underwriting manager that is a service or function already remunerated by way of commission; and/or
- 2.5.2. the payment of an additional fee (often referred to as an “administration fee”) relates to a service or function rendered to the short-term insurer or underwriting manager that is a service or function already remunerated by way of commission or, in the case of a short-term insurer, a binder holder fee; and/or
- 2.5.3. the service or function provided or performed constitutes the rendering of services as an intermediary and payment of remuneration for this service or function would result in the total commission payable exceeding thresholds provided for in the STIA Regulations, which provide that the total thresholds cannot be exceeded irrespective of the number of intermediaries involved in the rendering of services as an intermediary in relation to a policy; and/or
- 2.5.4. the fee is for a service or function that is not in fact rendered to the short-term insurer or underwriting manager or the fee is not reasonably commensurate with the service or function rendered. The principle of “reasonably commensurate” fees has been incorporated in Regulation 6.4(1) of the STIA Regulations, Section 3A(1)(a)(iii), (v), (v) and (vii) of the FAIS General Code and Directive 159.A.i (LT&ST).
- 2.6. The Registrar of Short-term Insurance is also concerned about the emergence of certain market practices where intermediaries, other than underwriting managers, are paid binder holder fees that –
- 2.6.1. incorporate a sliding scale based on profits attributable to the type of

policies referred to in a binder agreement; and/or

- 2.6.2. are based on a percentage of the premiums payable or paid in respect of the type of policies referred to in the binder agreement, where this is not commensurate with the services or functions actually rendered plus a reasonable rate of return.
- 2.7. The market practices mentioned in 2.5 and 2.6 above will be in contravention of section 48 of the STIA read with Part 5 of the STIA Regulations or section 48A read with Part 6 of the STIA Regulations or section 3A(1) of the FAIS General Code.

Conflict of interest

- 2.8. An intermediary who is also a financial services provider or representative is further reminded that in terms of sections 2 and 3(1)(b) of the FAIS General Code it must render financial services in the interest of the client and the integrity of the financial services industry and it must avoid any conflict of interest between itself and a client. The transfer of a client from one insurer to another based merely on the fact that the intermediary will earn a higher fee may result in such intermediary not complying with the sections referred to above.
- 2.9. Section 3A(1)(b) of the FAIS General Code of Conduct further prohibits an intermediary who is a financial services provider from offering any financial interest to its representatives for giving preference to the quantity of business secured for the provider to the exclusion of the quality of the services rendered to clients and for giving preference to a specific product supplier or a specific product of a product supplier where such representative may recommend more than one product supplier or more than one product of that product supplier to a client.

3. LONG-TERM INSURANCE MARKET PRACTICES

- 3.1. Long-term insurers are reminded that they can only pay the following remuneration to intermediaries or underwriting managers:
 - 3.1.1. Commission as remuneration for rendering services as an intermediary¹⁴, that does not exceed the maximum commission payable in terms of Part 3 of the LTIA Regulations;
 - 3.1.2. Fees as remuneration for performing binder functions under a binder agreement in terms of Regulation 6.4 of the LTIA Regulations (a "binder holder fee");

¹⁴ As per the definition of "rendering services as intermediary" in Part 3A of the LTIA Regulations.

- 3.1.3. Fees as remuneration for a function or service outsourced in terms of Directive 159.A.i (LT&ST)¹⁵, which function must not constitute rendering services as an intermediary or binder functions¹⁶.
- 3.2. Underwriting managers are reminded that they can only pay the following remuneration to intermediaries:
- 3.2.1. Commission (on behalf of a long-term insurer) as remuneration for rendering services as an intermediary that does not exceed the maximum commission payable in terms of Part 3 of the LTIA Regulations;
- 3.2.2. Fees as remuneration for a function or service outsourced or sub-outsourced in terms of Directive 159.A.i (LT&ST), which function or service must not constitute rendering services as an intermediary or binder functions¹⁷.
- 3.3. Long-term insurers, intermediaries and underwriting managers who are also financial services providers or representatives are referred to section 3A(1)(a) of the FAIS General Code that prohibits a financial services provider or its representatives from receiving or offering any financial interest from or to a third party other than the financial interests listed in that paragraph.
- Fee reasonably commensurate with services actually rendered plus a reasonable rate of return**
- 3.4. The concerns referred to under paragraphs 2.5 to 2.7 above apply with the necessary changes to the long-term insurance sector.
- 3.5. The Registrar of Long-term Insurance is concerned about the emergence of certain distribution arrangements between long-term insurers, intermediaries, or associates of intermediaries, whereby such persons may be negotiating an additional fee (often referred to as a "netco fee"¹⁸) for rendering certain distribution-related services or functions, such as administration of new business, marketing campaigns, sales management and commission management systems.
- 3.6. This results in the following concerns:
- 3.6.1. the service or function being provided or performed by the intermediary to the long-term insurer is a service or function already remunerated by way of either one of the means outlined in 3.1.1 and 3.1.2 above; and/or

¹⁵ See footnote 11.

¹⁶ As set out in section 49A(1) of the LTIA.

¹⁷ Section 49A of the LTIA prohibits a binder holder from delegating, assigning or subcontracting any binder functions. Accordingly, an underwriting manager cannot pay a binder holder fee to an intermediary.

¹⁸ The consideration is often calculated on the basis of the commission generated in respect of the sales of a particular long-term insurer's products.

- 3.6.2. the service or function being provided or performed constitutes the rendering of services as an intermediary and payment of remuneration for this service or function will result in the total commission payable exceeding thresholds provided for in the LTIA Regulations, which provides that the total thresholds cannot be exceeded irrespective of the number of intermediaries involved in rendering services as an intermediary in relation to a policy; and/or
- 3.6.3. the fee is for a service or function that is not in fact provided or performed by the intermediary to the long-term insurer or the fee is not reasonably commensurate with the service or function provided or performed. The principle of “reasonably commensurate” fees has been incorporated in Regulation 6.4(1) of the LTIA Regulations, section 3A(1)(a)(iii), (iv) and (vii) of the FAIS General Code and Directive 159.A.i (LT&ST).
- 3.7. The market practices mentioned in 3.5 above will be in contravention of section 49 of the LTIA read with Part 3 of the LTIA Regulations or section 49A read with Part 6 of the LTIA Regulations or section 3A(1) of the FAIS General Code.

Conflict of interest

- 3.8. Paragraphs 2.8 and 2.9 above apply with the necessary changes to a long-term insurer and intermediary.

4. BROADER REGULATORY INITIATIVES IN THE INSURANCE SECTOR

Definition of intermediary services and related remuneration

- 4.1. On 11 November 2011 the Registrar of Long-term and Short-term Insurance addressed a letter to various insurance industry associations (“associations”) to solicit contributions on possible refinements to the definition of intermediary services in the current insurance laws and reforms to related remuneration structures.

One of the objectives of clarifying the definition of intermediary services is to help identify those outsourced insurer functions for which a fee over and above commission and/or a binder fee may be legitimately paid. In the short-term insurance sector, clarifying the definition of intermediary services will also help identify those types of additional services provided to a policyholder/s that may legitimately justify the payment of a fee from the policyholder/s over and above the payment of commission. However, the current definitions of services as an intermediary in the insurance laws are broad and encompass all services rendered by an intermediary during the life cycle of a policy (advice, intermediation and administration).

Given the broad and all-encompassing scope of the current definition of intermediary services, this leaves limited services for which an additional fee may be charged. Insurers should be mindful of this when considering whether it is legitimate to remunerate intermediaries in the form of an additional fee for services or functions rendered to the insurer.

Outsourcing

- 4.2. Directive 159.A.i (LT&ST)¹⁹ outlines requirements that insurers need to meet when outsourcing any aspect of their long-term or short-term insurance business. Specifically, insurers entering into arrangements with intermediaries to render services and functions to the insurer (other than intermediary services) will be required to ensure that such agreements comply with the requirements of Directive 159.A.i. Existing outsourcing arrangements must be brought in line with the requirements of Directive 159.A.i by 1 January 2013.

5. REGULATORY ACTION

While recognising the need for adequate remuneration to support a sustainable business model for financial advice, the Registrar of Long-term and Short-term Insurance will take decisive regulatory action against those insurers or intermediaries found to be acting outside of the regulatory requirements, given the potential to not only create unlevel playing fields between insurance providers but also the potential for such practices to seriously undermine appropriate, affordable and fair advice and services to potential and existing policyholders.

6. INFORMATION SHARING

This information letter is available on the website (www.fsb.co.za) of the FSB. Insurers must bring this Information Letter to the attention of their appointed auditors and statutory actuaries where applicable.



REGISTRAR OF LONG-TERM AND SHORT-TERM INSURANCE

¹⁹ See footnote 11.