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INSURANCE SECTOR EDUCATION AND TRAINING AUTHORITY

# LEARNER GUIDE

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| Unit Standard Title: | **Apply knowledge and insight into the Short Term Insurance Act (no 53 of 1998) and the accompanying regulations** |
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## Apply knowledge and insight into the Short Term Insurance Act (No 53 of 1998) and the accompanying regulations

**Introduction**

Welcome to this module. The typical scope of this module is

- Explain the purpose of the Short Term Insurance Act (53 of 1998) and related concepts
- Explain the basic requirements of the Short Term Insurance Act that apply to insurers
- Explain how the Short Term Insurance Act controls intermediaries
- Explain how the Short Term Insurance Act regulates short term insurance policies and protects individual policy holders

The history of insurance mainly deals with the United Kingdom, simply because most insurance practise developed there. Whenever a need for protection against financial loss has arisen, it has led to the development of some form of insurance. The word "insurance" can be explained as a system where the losses of the few are paid from the premiums of the many.

The main pieces of legislation that govern insurance and related services are:

- The "Long Term Insurance Act (Act 52 of 1998)";
- The "Short Term Insurance Act (Act 53 of 1998)";
- The "Pension Funds Act, 24 (Act 24 of 1956)";
- The "Friendly Societies Act (Act 25 of 1956)"; and
- The "Medical Schemes Act".

Lloyds of London is one of the most famous insurance institutions in the world. Edward Lloyd opened a coffee house in 1688, in Tower Street, in the city of London. He provided dependable shipping news for merchants, which he started as a service to attract more customers to the coffee house. Soon it developed into an association where people, to this day, still carry on business. This fairly simple beginning led to the formation of the first real insurance market, which still survives today as the Corporation of Lloyd's.

Because of the fear of losing their property, people developed a system where they could spread the risk. Different types of insurance developed in response to the needs of people. Insurance companies were there to provide protection against financial loss by people, eliminating worry about losing or damage to their property. Other classes of insurance have developed in a similar manner.

In South Africa, insurance companies must comply with the Short Term Insurance Act No. 53 of 1998. This lays down various regulations, which insurers must comply with specifically. The Short Term Insurance Act contains the legislated requirements of rules and regulations that govern the short-term industry.

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# Module 1

## The purpose of the Short Term Insurance Act (53 of 1998.) and related concepts

This Module deals with:

- The reason for the Short Term Insurance Act in terms of the need for legislation in insurance
- The parties governed by the Short Term Insurance Act and an indication of the role of the Registrar in administering the Short Term Insurance Act
- The consequences of non-compliance with the Short Term Insurance Act for a short term insurance organisation, and an indication of the recourse that a client has to the Registrar in cases of non-compliance
- The concept of short term insurance with reference to the different classes of business defined in the Short Term Insurance Act
- Terminology defined in the Short Term Insurance Act in own words

### 1.1 The reason for the Short Term Insurance Act in terms of the need for legislation in insurance

The Short Term Insurance and Long Term Insurance Acts ensure that insurers remain solvent and are able to discharge their duties to the public, and also ensure that the insured public is protected. It also spells out the legal requirements of brokers and other intermediaries as regards to their conduct and payment of premiums to insurers. Insurers are required to register and strict conditions are imposed on registration. Unregistered persons are forbidden to do insurance business. It is necessary to have short term insurance legislation that regulates the short-term industry. It also enables a policyholder to make informed decisions with regard to short term insurance products, and to ensure that the parties involved conduct business fairly and with due care and diligence.

The reason for the existence of a Short Term Insurance Act lies in the difference in nature between short and long term insurance:

- Short term insurance focuses on the replacement value of objects (e.g., a motor vehicle) in the event of a loss (*indemnity insurance*), with personal accident and sickness also covered, whereas
- Long term insurance focuses on the life events, such as death or retirement of a person (*non-indemnity insurance*),

Each type of insurance business therefore has its own legislation/regulations governing its insurers and the way they conduct, manage, market and maintain their business.

In short, the purpose of the Short Term Insurance Act is:

- to provide for the registration of short-term insurers;

- for the control of certain activities of short-term insurers and intermediaries; and for matters connected therewith

### 1.2 The parties governed by the Short Term Insurance Act and an indication of the role of the Registrar in administering the Short Term Insurance Act

The parties governed by the Short Term Insurance Act are:

- The Registrar
- Insurers
- Intermediaries (e.g. brokers)
- Policyholders (insured)
- Representatives
- Any other entity that may involve himself in the process

Insurance business falls under the control of the Minister of Finance, and the Financial Services Board. All short term insurers must comply with the Short Term Insurance Act (no 53 of 1998). There is a special section of the Act dealing with Lloyd's.

Insurance companies must also conform to the Companies Act, 1973, but because they are under the supervision of the Financial Services Board (FSB), certain exemptions are granted. (Even short term insurers that are not public companies are also subject to certain provisions of the Companies Act.)

The Minister of Finance appoints a Registrar of Insurance to carry out all powers assigned to him by the Act. His duties are wide ranging and insurers must comply with the requirements of the Act, including the following:

- submission of statements and accounts;
- statement of liabilities;
- statement of assets;
- solvency margin regulations;
- commission rates for intermediaries.

The Registrar is the executive officer of the FSB, but his powers and duties may also be exercised by other members or persons appointed by the Board and authorized by the Registrar. Apart from the regular statements and returns required under the Act, the Registrar can:

- Require a short-term insurer, or anyone he believes is contravening the Act, to supply specified information or documents;

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- Direct that any misleading insurance brochure or advertisement is changed, or publication stopped;
- Compel any person carrying on insurance business but not registered under the Act to cease trading, and/or he can apply to the Court for the sequestration or liquidation of the concern
- If the insurer cannot meet the solvency requirements, apply in terms of the Companies Act to have the insurer placed under judicial management, or require steps to put the insurer's business back onto a sound footing, such as restricting the classes of business it may undertake, or limiting the sums insured or exposures.

## 1.3 The consequences of non-compliance with the Short Term Insurance Act for a short term insurance organisation, and an indication of the recourse that a client has to the Registrar in cases of non-compliance

Section 64, 65 and 66 of the Short Term Insurance Act outlines the offences and penalties of different parties for non-compliance.

No one may carry on any kind of short-term insurance business unless registered and authorized to do so. Unless they are a registered short-term insurer or a Lloyd's underwriter, they may not use a business name or description that includes words like "insure" "assure" or "underwrite", without the approval of the Registrar.

A person other than an insurer who contravenes or fails to comply with these regulations is guilty of an offence, and liable on conviction to a fine or imprisonment, or both.

Section 64 of the Act highlights the following as consequences of non-compliance by any offender:

- the offender shall be guilty of an offence
- and shall be liable on conviction to a fine of up to R100 000 depending on the category of offence as well as the type of offender
- imprisonment not exceeding one year
- or both such fine and imprisonment
- the non-compliance with the administrative return requirements as they relate to returns shall be to the value of R 1000 per day for every day that a return remains outstanding.

Furthermore, anyone who may lodge a written complaint to the intermediary concerned, if such complaint is not resolved to his satisfaction, to the Registrar of Short Term Insurance.

The Registrar will then order the intermediary to provide a comprehensive report on the complaint within a specified time.

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If the Registrar finds that a breach has taken place, he may, after informing the intermediary concerned of his findings, and giving the intermediary a reasonable opportunity to respond, order corrective steps to be taken within a specified time.

The Registrar may also take any steps in connection with the breach, available in the legislation.

An intermediary who contravenes or fails to comply with the provisions of the Rules will be guilty of an offence and, on conviction, is liable to:

- a fine not exceeding R100 000, or
- to imprisonment for a period not exceeding one year, or
- to both fine and imprisonment,

### 1.4 The concept of short term insurance with reference to the different classes of business defined in the Short Term Insurance Act

Short term insurance is insurance that runs for only short periods of time (or for short terms) - a month or a year, or for any other agreed period, before it needs to be renewed, re-rated, reassessed or reissued. This is unlike a life or pensions policy that is issued and then runs until the insured either dies, or goes on retirement.

Short term insurance also focuses in general on material goods that can be insured – such as buildings, motor vehicles, goods in transit, or to protect the insured against liability that arises as result of his activities, and which cause damage to other parties' property or lives.

When asked by a customer to describe the concept of short term insurance, it is important to know that short-term policies run for specified periods of time. Both the insurance company and the customer decide upon these periods. The insurer decides how long they are prepared to remain as the risk carrier until they wish to check the terms, premiums and risks associated with the customer's assets. The period is also influenced by the need of the customer in seeking to protect his assets through the purchase of insurance cover. The decision regarding the period (or term) of the policy is decided at the start of the period, and is agreed by all parties to the insurance – the customer, the insurer and the intermediary (or broker.)

After an agreed short term, or period expires, the insurer will meet with the customer (or the customer's broker) to discuss the continuation of the policy cover, beyond the original term agreed. In these circumstances there may be new premiums or conditions applied, sums insured may be increased, and some of the cover initially given by the policy may be discontinued. Also, sometimes during the period, or term of the policy there may be changes required to the cover given. The insurer or the customer may even wish to discontinue cover entirely at any stage within the term of the policy

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#### 1.4.1 Classes of Business

The insurer must be registered and authorized to carry on every class of business it conducts.

The Short Term Insurance Act outlines the following classes of business:

- Property (includes fire, theft, all risks and similar cover);
- Transportation, (includes marine);
- Motor;
- Accident/Health (personal accident, stated benefits);
- Fidelity Guarantee;
- Liability;
- Contract/Engineering;
- Miscellaneous (other than those listed above).

The insurer need not be registered for all of the above classes, but it must be registered for every class it conducts.

### 1.5 Terminology defined in the Short Term Insurance Act in own words

The following glossary table can be used to explain the different terminology in the Short Term Insurance Act:

| Terminology | Explanation |
|---|---|
| **Agent** | A person who acts on behalf of another and in the case of insurance is the intermediary between the proposer and the insurer. |
| **Asset** | A property or financial commodity that can, if necessary, be converted into cash. |
| **Attestation** | The signing clause in a contract of insurance. |
| **Broker** | A professional full-time independent agent or intermediary. |
| **Brokerage** | The commission or fee paid to the brokers by the insurers for placing business with them. |
| **Cancellation** | A term appropriately used for policies cancelled on breach of a material term or in terms of a cancellation clause in the policy. |
| **Cancellation Clause** | The clause in a policy which allows one party to cancel the contract following due notice to the other. |
| **Claim** | A demand made by the insured for payment, in terms of the policy contract, after the occurrence of loss or damage covered by the policy. |

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| Terminology | Explanation |
| --- | --- |
| **Claim Form** | A form supplied by an insurer to enable an insured to lodge a claim in terms of the policy. |
| **Commission / brokerage** | The payment made to intermediaries by insurers for placing business with them. |
| **Contract** | An agreement made by two or more parties with the intention of creating a legal obligation between them. |
| **Contract of Insurance** | An agreement between insurer and insured whereby, in return for the payment of a premium, the insurer undertakes to indemnify the insured upon the happening of a specified event. |
| **Cover** | The protection provided by insurance. |
| **Curatorship** | A qualified person who will look after the interest of policyholders and shareholders until a decision is made regarding the future of the company. |
| **Disclosure** | The duty of the parties to a contract of insurance to reveal all material facts to each other before it is concluded and prior to each renewal. |
| **Indemnity cover** | This is a special type of insurance policy, which would cover any compensation the broker would have to pay for wrong advice. |
| **Insurance Policy** | A document that is evidence of a contract of insurance. |
| **Insurance** | A risk transfers arrangement whereby the responsibility for meeting losses passes from one party (the insured) to another (the insurer) on payment of a premium. |
| **Insured** | A person or organisation who takes out insurance. |
| **Insurer** | A company or society transacting insurance business. |
| **Intermediary** | A person who arranges insurance on behalf of another. |
| **Liability** | A claim upon one's assets by another person. |
| **Lloyd's** | The corporation, which organises the market of individual underwriters in London (but accepts business introduced by brokers from all parts of the world) and provides a full range of ancillary. |
| **Policy** | Written evidence of the terms of an insurance contract. |
| **Policyholder** | The insured person. |
| **Premium** | The money paid by the insured to the insurer for |

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| Terminology | Explanation |
|---|---|
| | cover as provided in the policy. |
| Rejection | Is the suggested term for the rejection of a claim to an indemnity under a valid policy. |
| **Short Term Insurance** | Insurance that operates on a year-to-year basis and which the insurer or the insured may terminate. |
| **Solvency Margin** | Solvency margin is equal to Surplus Assets divided by Net Premium Income. |
| **Syndicates** | The meaning is similar to “group”. |
| **Third Party** | A person who is not a party to a contract. |
| **Underwriter** | An insurer; a person who makes decisions on whether or not to accept insurance business. |
| **Underwriting** | The process of assessing a proposal for insurance to decide on its acceptability and if so, on what terms. |
| **Void** | Refers to a policy that never existed as a lawful contract so that no rights and obligations came into being. |
| **Voidable** | Refers to a policy that either party may elect, on good grounds, to declare to be of no effect from its inception. |
| **Void Contract** | A contract that cannot be enforced by either party. |
| **Write**<br>**(Insurance Business)** | Provide insurance cover. |
| **Types of Policies** | |
| **Accident and health policy** | Means a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits if a –<br>• Disability event;<br>• Health event; or<br>• Death event<br>**Disability event** means the event of the functional ability of the mind or body of a person becoming impaired, as a result of an accident.<br>**Health event means** an event relating to the health of the mind or body of a person by accident.<br>**Death event**, in short-term insurance, means when a person dies as a result of an accidental, external, visible event. |
| **Engineering policy** | Means a contract in terms of which a person, in return for a premium, undertakes to provide policy |

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| Terminology | Explanation |
| --- | --- |
| | benefits if an event contemplated in the contract as a risk relating to – <br>• The possession, use or ownership of machinery or equipment, other than a motor vehicle, in the carrying on of a business; (in case of a breakdown or collapse of machinery)<br>The erection and installation of machinery or other structures or the undertaking of other works |
| **Guarantee policy** | Means a contract in terms of which a person or company in return for a premium receives policy benefits if an event contemplated in the policy as a risk relating to the failure of a person to discharge an obligation, occurs; and includes a reinsurance policy in respect of such a policy.<br>(This is the only manner in which a short-term insurer can provide security) |
| **Motor policy** | Means a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits if an event, contemplated in the contract as a risk relating to the possession, use or ownership of a motor vehicle, occurs; and includes a reinsurance policy in respect of such a risk |
| **Property policy** | Relates to the use, ownership, loss or damage to movable or immovable property |
| **Transportation policy** | Something which is in the course of a journey. Whether it is a parcel, object, etc. Means a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits if an event, contemplated in the contract as a risk relating to the possession, use or ownership of a vessel, aircraft or other craft or for the conveyance of persons or goods by air, space, land or water, or to the storage, treatment or handling of goods so conveyed or to be so conveyed, occurs; and includes a reinsurance policy in respect of such a risk |
| **Miscellaneous policy** | Means a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits if an event, contemplated in the contract as a risk relating to any matter not otherwise defined in this section, occurs; and includes a reinsurance policy in respect of such a policy.<br>An example of this could be Pluvial Insurance, which is insurance against rain. Organisers of open-air |

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| Terminology | Explanation |
|---|---|
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## Module 2

## The basic requirements of the Short Term Insurance Act as they apply to insurers

This Module deals with:

- The requirements for registration as an insurer as prescribed in the Short Term Insurance Act
- Returns that an insurer is required to submit to the Registrar and an indication of the consequences of non-compliance
- The concept of a solvency margin in terms of approved assets over liabilities
- The requirements imposed on Lloyd's compared to those that apply to any other insurance organisation in terms of registration and operations

### 2.1 The requirements for registration as an insurer as prescribed in the Short Term Insurance Act

In order to market short term insurance products, the insurer:

- has to be registered or deemed to be registered as a short term insurer;
- has to be authorised to carry on that kind of business and;
- has to carry on business in accordance with the Short Term Insurance Act.

#### 2.1.1 Requirements for registration

Part II, Section 7 of the Short Term Insurance Act prescribes the following as requirements for registration as an insurer:

- Applicants for registration must be:
  1. A public company incorporated in South Africa, and registered under the Company's act or
     - 1.1. Incorporated without a share capital under a Law providing specifically for the constitution of a person to carry on short term insurance business as its main object.
  2. May not be a branch office of a company incorporated outside of South Africa,

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3. The Head office of the company must be in SA and the Registrar must be notified of the address within 30 days.

The insurer must have its head office in the Republic, and appoint a natural person permanently resident in the Republic, as its public officer, whose responsibility it is to ensure that the insurer complies with the Act.

Although currently registered insurers must convert to registration under the Act by applying within six months (Section 67), the Registrars have wide powers regarding the conditions of registration conditions for registered insurers (Section 10 and 11).

The Registrar also has wide powers to prohibit insurers from continuing to carry on business where there is a failure to furnish information called for, misrepresentations of information provided and a failure to comply with conditions imposed on the insurer (Section 12).

In drastic cases, registration can be terminated (Section 13).

### 2.2 Returns that an insurer is required to submit to the Registrar and an indication of the consequences of non-compliance

Short-term insurers must submit the following to the Registrar:

- Within one month after the expiry of each quarter of the financial year, a spreadsheet return of the amount of **current assets and liabilities**, and the gross and net underwriting results for each class of business listed above.
- Within four months after the expiry of each financial year, **an audited annual return**, with full details as required by the regulations to the Act.
- Within six months after the expiry of each financial year, a copy of **any audited account or balance sheet** required to be submitted to shareholders in terms of the Companies Act, or other legislation by which the insurer is incorporated.

#### 2.2.1 Statement of Assets

The information required is very detailed, but some points are:

- No amount may be included for goodwill (goodwill is the value of the business as a popular, going concern);
- The regulations limit the percentage of assets that may be invested in any one body, council, or institution;
- Premiums that are outstanding may be included as assets, but only if outstanding for 60 days or less.

#### 2.2.2 Statement of Liabilities

This includes:

- The Rand value of claims outstanding;
- An estimate of claims incurred but not yet reported (claims that have happened, but of which the insurer has not yet been advised);

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- Provision for unearned premium;
- Provision for taxation.

The amount of claims is net of reinsurance recoveries.

### 2.2.3 Details of the Insurer

- Name of Public Officer;
- Name of Chairman;
- Name of Chief Executive Officer;
- Details of the auditors;
- Any change in the shareholders;
- Any major non-insurance business;
- Number of persons employed;
- Physical and postal address of the insurer, also fax number and e-mail address.

In section 64 of the Act the consequences of non-compliance by any offender are defined as follows:

- the offender shall be guilty of an offence and
- shall be liable on conviction to a fine of up to R1 00 000 depending on the category of offence as well as the type of offender
- imprisonment not exceeding one year
- or both such fine and imprisonment
- the non-compliance with the administrative return requirements as they relate to returns shall be to the value of R 1 000 per day for every day that a return remains outstanding.

## 2.3 The concept of a solvency margin in terms of approved assets over liabilities

The solvency margin of a company is the difference between its assets and its liabilities, expressed as a percentage.

Solvency margin is equal to Surplus Assets divided by Net Premium Income.

An asset is any item, tangible or intangible, excluding goodwill, which belongs to the organisation.

A liability shows the financing or capital structure of the enterprise as at a specific date. Liabilities are usually divided into two criteria namely, the term for which the funds have been made available and secondly the source of the funds.

In addition to liabilities (debts), liabilities for solvency margin include:

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- the Rand value amount of claims outstanding; (less recoveries from approved reinsurance policies)
- an estimate of the claims incurred but not reported (in short-term insurance provision must be made for claims which have happened, but of which the company has not been advised);
- the estimated liability for taxation.

A local insurer must hold assets with an aggregate value of not less than its liabilities, plus the greater of:

- R3 000 000; or
- 15% of **the greater** of
  - its premium income in the previous financial year, **or**
  - its premium income in the 12 months previous to the calculation.

If the insurer is unable to comply with the solvency requirements, the Registrar may:

- direct action to put things back on the correct basis, e.g. the insurer might be made to cease writing some classes of business, or reduce the size of the risks it can accept;
- in extreme cases, make applications to the Court for the company to be placed under judicial management, or even be wound up.

Therefore, maintenance of the solvency margin is of the utmost importance.

If the Registrar feels a company's solvency margin is too low, he can put the company under curatorship. (A qualified person who will look after the interest of policyholders and shareholders until a decision is made regarding the future of the company.)

## 2.4 The requirements imposed on Lloyd's compared to those that apply to any other insurance organisation in terms of registration and operations

Lloyds of London is one of the world`s best known financial brands and perhaps the world`s leading insurance company, and Lloyds South Africa is the local division of this more than 300 year old company. The original company is known for taking on virtually anything that can be insured, often insuring items that other companies will not.

Section 56 of the Act, prescribes the provisions relating to Lloyd's underwriters. Lloyd's brokers act like normal brokers but they are also able to place insurance at Lloyd's of London. To become a Lloyd's broker, it is necessary for the broker to display his experience, integrity and financial standing within the market place to the satisfaction of the Committee of Lloyd's. Only Lloyd's brokers are able to place business with Lloyd's underwriters.

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# Module 3

## How the Short Term Insurance Act controls intermediaries

This Module deals with:

- The way in which commission and certain fees are regulated with reference to the Short Term Insurance Act
- Limitations on business practices in terms of placing business with insurers with reference to case studies and the Short Term Insurance Act
- The concept of a Lloyd's binder and the criteria used by Lloyd's to enter into an underwriting relationship with an intermediary with reference to specialist classes of business
- The way in which Lloyd's binders are regulated with reference to case studies and the Short Term Insurance Act
- The rights and responsibilities of an intermediary in accounting to the insurer with reference to the collection and payment of premiums

### 3.1 The way in which commission and certain fees are regulated with reference to the Short Term Insurance Act

#### 3.1.1 Commission

Commission in the Short Term Insurance industry means the money, which is paid to representatives and intermediaries in respect of the business that is generated by the representative/intermediary. Commission is therefore the representative's and intermediaries earnings for the insurance business that he generates for the insurer. Brokers refer to commission as "brokerage".

The Short Term Insurance Act stipulates the maximum commission payable to intermediaries. These are as follows:

- Motor policy, maximum commission – 12,5% of the premium payable under the policy
- Non-motor maximum commission – 20%
- Collective policies written through Lloyd's – 20%
- Any other policy written through Lloyd's – 25%

These rates are payable only when the premium has been paid to the insurer. Also note that in terms of the new Short Term Act, the intermediary may also deduct any refunds due to policyholders, when determining the net amount due to the Insurer.

#### 3.1.2 Collection of Premiums

The intermediary must:

- be authorised by the Insurer in writing; and
- furnish a guarantee representing 30% of the estimated annual premiums handled, with a minimum of R100 000 and maximum of R50 000 000.

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## 3.2 Limitations on business practices in terms of placing business with insurers with reference to case studies and the Short Term Insurance Act

There are cumbersome provisions regarding the free choice given to a person who is required to provide insurance in connection with money loaned, goods leased or credit granted (Section 43). Such a customer is entitled to prior written notification of the free choice of insurer, whether to use a new policy or an existing policy or both, and the intermediary who is to render services in connection with the transaction.

The customer must be told whether the value of the policy benefits will exceed the interests of the creditor. Where such a customer chooses to have two policies involving two intermediaries, there is going to be considerable complications in regard to the servicing of the policy, the collecting of premiums and the handling of claims. Consent of the insured is required to insure against risks other than mortgage insurance (e.g. home loan insurance – fire, etc. cover on the building of the house).

Insurers handling this type of credit insurance will have to draw up a standard document advising the customer of the free choice.

The details are to be found in Section 43 of the Act. Below is an extract from the Short Term Insurance Act, Section 43:

**43. Free choice in certain circumstances**

1) Subject to subsection (5), if a party to a contract in terms of which money is loaned, goods are leased or credit is granted, requires, whether as a condition thereof or otherwise, that a short-term policy or its policy benefits be made available and used for the purpose of protecting the interests of a creditor, the person who is so required to, make that policy or those policy benefits available shall be entitled, and shall be given prior written notification of that entitlement to a free choice—

a) as to whether he or she wishes to enter into a new policy and make it available for that purpose, or wishes to make available an existing policy of the appropriate value for that purpose, or wishes to utilise a combination of those options; and

b) if a new policy is to be entered into—

i) as to the short-term insurer with which the policy is entered into and as to the person (if any) who is to render services as intermediary in connection with the transaction; and

ii) as to whether or not the value of the policy benefits to be provided thereunder, when taken in the aggregate with the value of the policy benefits provided under any other policy which is also to be made available and used for that purpose, shall exceed the value of the interest of the creditor; and

c) if an existing policy is to be made available—

i) as to the person (if any) who is to render services as intermediary in connection with the transaction; and

ii) as to whether or not a variation of the policy required for that purpose shall be such as to cause the value of the policy benefits to be provided thereunder, when taken in the aggregate with the value of the policy benefits provided

under any other policy which is also to be made available and used for that purpose, to exceed the value of the interests of the creditor.

2) The provisions of subsection (1) shall be deemed not to have been complied with unless the policyholder whose policy is to be made available has confirmed in writing, before the policy is used for the purpose of protecting the interests of the creditor concerned, that he or she—

a) was given prior written notification of his or her entitlement to the freedom of choice referred to in that subsection;

b) exercised that freedom of choice;

c) was not subject to any coercion or inducement as to the manner in which he or she exercised that freedom of choice.

3) Any policy benefits that may be provided under a policy referred to in subsection (1) shall accrue and be paid to a creditor only to the value of the interests of the creditor in the subject-matter of the policy, and any surplus shall accrue and be paid to the policyholder whose policy is used for the protection of the interests of the creditor concerned.

4) If the provisions of subsections (1) and (3) are not complied with, the security provided by the policy made available and used for the purpose shall be void and the policy benefits shall be provided to the person who made it available.

5) a) Subsection (1) shall not apply in the case of a short-term policy which is required to be made available in relation to a contract in terms of which money is loaned upon the security of the mortgage of immovable property.

b) In a case where a new policy is to be entered into, the premiums payable under that policy shall be reasonable in relation to the premiums generally charged by insurers under similar policies.

c) A certificate by the Registrar that he or she is satisfied that the premiums concerned are reasonable, shall for the purposes of this subsection be sufficient proof of the reasonableness of such premiums.

The handling of the insurance and claims and the collection of premiums will become complicated where there are two policies covering the debt or where the insured insists on their own intermediary.

The following case studies illustrate the example of limitations on business practices in terms of placing business with insurers:

**Case Study 1:**

Summary:

Mr. Naidoo (the insured) filed a complaint with the Ombudsman concerning the rejection of a claim for theft of a TLB (tractor loader backhoe) machine. ABC Insurance Brokers (the insurer) declined liability for the claim on the grounds that there was no insurable interest as this item belonged to the bank and that the insured could never have acquired beneficial ownership. ABC Insurance Brokers further rejected the claim on the grounds of Mr. Naidoo not having taken due care and precaution in minimizing the loss.

The Complaint:

Mr. Naidoo purchased a TLB machine from a company. After taking delivery of the machine, the insured contacted ABC Insurance Brokers and requested that the machine be added to his policy.

A new client had approached Mr. Naidoo to hire the TLB machine for a day. A deposit was paid to Mr. Naidoo to cover the hiring cost. Mr. Naidoo delivered the machine as requested. At the close of business that day the operator called Mr. Naidoo requesting that the machine be left on site as the hirer had requested that they continue to use the machine on the following Monday. Mr. Naidoo communicated with the new client who confirmed the request and who informed Mr. Naidoo that over the weekend the machine would be kept under lock and key at the local councillor's house. The machine was locked by the operator who departed with the key.

On the morning of that Monday Mr. Naidoo's operator informed him that the machine had been stolen. The matter was reported to the police immediately and a claim was intimated with ABC Insurance Brokers. Mr. Naidoo was subsequently requested to submit a copy of the contract entered into with the hirer as well as a quotation for the replacement of the machine. A loss adjustor was appointed by ABC Insurance Brokers' underwriting managers to investigate the matter. Mr. Naidoo was later informed by ABC Insurance Brokers' investigator that it had been discovered that the machine in question was owned by the bank and that the previous seller still owed monies on the machine and that they would have to settle the bank first. Mr. Naidoo later learned that the seller had been placed in liquidation.

Mr. Naidoo then received a letter of rejection from ABC Insurance Brokers' underwriting managers, declining liability for the claim on the grounds that there was no insurable interest as this item of plant actually belonged to the bank and Mr. Naidoo could never have acquired beneficial ownership.

It was further contended in the letter of rejection that it was also the responsibility of Mr. Naidoo to ensure that all the information provided at the time of insuring the item of plant was true and correct and that failing to disclose that there was a problem in obtaining the logbook as proper proof of ownership amounted to non-disclosure. The third ground advanced for the rejection of liability was that Mr. Naidoo was negligent in the manner in which he had hired out this item.

Mr. Naidoo's complaint was submitted to ABC Insurance Brokers for formal response.

**Case Study 2:**

Mr. Banks could not believe his good fortune as the numbers appeared on the late night show and he realised that he has won the lottery for that week. He immediately decided that he would revive his short-term loan business that he had managed from his room at the university where he had studied. He also decided that he would use the money to set up a short term insurance company. He knew immediately that he would name it maximum risk. His lottery winnings would only just cover the establishment of an office and the recruitment of some clerks to run the business. Mr. Banks contacted his long lost friend, James Steward, who immediately agreed that for a small fee he would cover all the business that Mr. Banks could not cover as some sort of reinsurance.

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Mr. Banks calculated that if he could find about 100 people that would pay him about R 500 per month he could quite easily cover any claim that they would submit to him. He also calculated that he could quite easily draw a salary from these premiums that he was receiving.

Mr. Banks actually managed to find the 100 people that he had set an objective for. However upon arriving at the office two months after setting up business he found a very important looking person waiting for him. He was surprised to learn that this person was an inspector from the Registrar's office. The inspector advised Mr. Banks that he was there to do an audit.

The inspector upon realising that Mr. Banks did not appear to be above board, preceded to lock Mr. Bank's offices prohibiting him from entering the premises.

### 3.3 The concept of a Lloyd's binder and the criteria used by Lloyd's to enter into an underwriting relationship with an intermediary with reference to specialist classes of business

Binder agreements are an established feature of the Short Term insurance industry. A binder agreement is simply an outsourcing agreement between an insurer (principal) and a third party (broker, administrator or underwriting manager). The insurer mandates the binder holder to perform certain functions for and on behalf of the insurer in connection with administration of insurance policies and claims.
The proposed new section 48A of the Short Term Insurance Act and section 49A of the Long Term Insurance Act are aimed primarily at tidying up the regulatory regime applicable to binder agreements between insurers and other parties who act on behalf of the insurer.

There is a clear distinction between binder holders (tied agents) and independent intermediaries. Independent intermediaries should ideally charge a fee to the client, and not receive commission or any other remuneration from the insurer. Their sole role should be to advise and educate consumers regarding financial services and products. Binder holders may take the form of intermediaries performing administration services for one or more insurers while also acting as a sales or distribution channel. Alternatively, binder holders may act solely in an underwriting or administration capacity where sales and distribution is via independent intermediaries or tied agents. As this can be confusing to consumers, it is essential that clear and meaningful disclosure is made to the consumer regarding roles, responsibilities and any real or potential conflicts of interest.

Some intermediaries can be authorised to issue policies and settle claims on behalf of the insurer, subject to a written agreement that sets out:

- the kinds of policy, the rates to be used, and the maximum sum insured;
- the scope of the claim settling authority;
- in addition to normal commission, how the intermediary is to be paid for these services.

The name of the insurer must be disclosed to the policyholder, and the fact that the intermediary is acting in terms of the binder agreement.

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### 3.3.1 Lloyd’s of London:

- Lloyd’s of London is not an insurance company, but an association of underwriting syndicates.
- Lloyd’s brokers negotiate cover with underwriters who accept business on behalf of their underwriting syndicate.
- The members of the syndicate are fully liable for losses.
- The syndicate members must satisfy the Committee of Lloyd’s that they have sufficient assets to meet all losses that might incur.

Members of Lloyd’s of London provide the supporting capital on which the market is built. Corporate members include investment institutions and international insurance companies. Individual members are known as “Names”.

Capital provided by members of Lloyd’s is used to underwrite insurance risks.

Criterion that should be used by Lloyd’s to enter into an underwriting relationship with an intermediary as stipulated in Section 57 of the Short Term Insurance Act:

- Lloyds are required to appoint, and at all times have a natural person who is a permanent resident of South Africa as its representative. This person should also have a deputy appointed on the same basis as the representative. The deputy assumes all the responsibilities as required in the absence of the representative.
- The Registrar must approve these appointments before they are effective. These persons must be fit and proper to hold office. It is their duty to ensure that:
    - Lloyds complies with the Act
    - Lloyds complies with the requirements of the board of trustees of Lloyds themselves.

Means a person who is approved by Lloyd’s and authorised by a Lloyd’s broker or Lloyd’s underwriter to act in the Republic as an agent for or on behalf of such broker or underwriter.

## 3.4 The way in which Lloyd's binders are regulated with reference to case studies and the Short Term Insurance Act

No independent intermediary or Lloyd’s binder shall be allowed to accept any consideration for the rendering of services as an intermediary from any short-term insurer unless an agreement to this effect is in place.

Section 48(2) of the Short Term Insurance Act describes in full the terms and conditions that in addition to any other term or condition should be included in an agreement for remuneration between the short term insurer and such Lloyd’s binder or independent intermediary.

The following compulsory important terms are to be included in such an agreement:

- the kinds of short-term policies which may so be entered into;
- the premiums or the basis for the calculation of premiums to be charged set out;
- the wording of the policies clearly defined;
- the maximum value of the policy benefits clearly stated;

If the intermediary is empowered to settle or pay claims, such powers must be clearly stipulated in the agreement as well as the circumstances under which it may be done.

If additional remuneration other than commission is to be received by the intermediary, it should also be clearly set out in the agreement.

An independent intermediary, acting on behalf of a specific short-term insurer and in terms of an agreement, must always disclose this to a prospective policyholder.

If the short-term insurer offers any other remuneration than commission, such agreement cannot be entered into with more than one intermediary for any particular kind of policy.

An independent intermediary who is entitled to remuneration other than commission only, is prohibited from:

- entering into any other short-term policy than the kind to which the agreement relates;
- enter into any short-term policy to which another independent intermediary
    a. holds shares or any interest in the former;
    b. if the former holds shares in the latter's business;
    c. who is a debtor or creditor of the former;
    d. who is related within the second degree of consanguinity or affinity to the former;

Even if an intermediary failed to act in accordance with the agreement entered into, the short-term insurer shall still be liable for any such policy issued. The short-term insurer therefore has to be very careful in selecting an intermediary who in the end could cause a lot of problems for it.

### 3.5 The rights and responsibilities of an intermediary in accounting to the insurer with reference to the collection and payment of premiums

The Short Term Insurance Act stipulates that no person shall render services as an intermediary for a short-term policy, unless short-term insurers and/or Lloyd's underwriters are the only underwriters of the policy concerned. The only exception to this rule is when it has specifically been approved by the Registrar.

No bribes are allowed – no person shall offer any valuable consideration as an inducement to enter into or cancel a short-term policy.

Intermediaries are not to receive, hold, or deal with premiums in any manner, unless authorised in writing by the insurer, and in accordance with the regulations forming part of the Act.

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As soon as the policy has been accepted, the policyholder needs to pay the premium. The Insurance Act, which governs the operation of insurance companies, lays down certain rules that must be followed. This includes important issues such as:

- that intermediaries have a set amount of time to pay to companies the premiums that they have received.
- That not every broker is allowed to collect premium. (There are credit brokers and non-credit brokers.)

In terms of Section 45 and Regulation 4 of the Short Term Insurance Act, any person who collects premiums on behalf of an insurer must have a guarantee issued to cover the premiums he has received from clients. The insurer can lodge a claim against the guarantee, if the broker fraudulently misappropriates premiums paid by the insured's. This protects the client.

Furthermore, clients should pay over premiums to the insurer within 15 days after the end of the month in which they were received from the insured, but commission and refunds due to policyholders may be deducted.

### 3.5.1 Collection of premiums

The Short Term Insurance Act deals with the collection of premiums by intermediaries in Section 45. This section highlights that no intermediary shall *"receive, hold or in any other manner deal with premiums payable under a short term policy"* (not including short term reinsurance policies) and short term insurers may not permit such dealing in premiums, unless the intermediary is authorised to do so by the short term insurer in accordance with the Regulations.

Short-term insurers must authorise independent intermediaries in writing to receive, hold and deal with premiums under their policies and the intermediary must provide a guarantee (which will be a Regulation 4 guarantee).

The terms are similar to those in the Act, though in clearer language. The guarantee will be a guarantee policy or a bank guarantee in similar form to a guarantee policy, in the form prescribed by the Registrar.

Premiums for a policy can be paid in different ways: e.g.

- The premium can be paid annually (less popular).
- Monthly payments made by debit order (more popular-more convenient).
- Some insurers have a quarterly or half-yearly payment method.

The undertaking by the insurer to provide policy benefits shall be suspended until the insurer has received the first (or only) premium, or until arrangements to its satisfaction have been made for the provision of the premium by debit order, stop order, credit card or other instrument approved by the Registrar.

If a premium has not been paid on its due date, the insurer shall notify the policyholder of the non-payment, and the policy shall remain in force for a prescribed grace period (maximum of one month), or for such longer period as may be agreed

between the parties. If the overdue premium is not paid by the end of any such period, the policy shall, provided there is sufficient value, be made paid-up (continue without further premium payments). If there is not a sufficient value, the policy shall be surrendered / lapsed. The insurer must inform the policyholder of these events in writing.

Policy wordings, as well as the debit order form which must be completed by the insured, have a clause which details when the premium is payable. It will also state what will happen if the insured fails to pay the premium.

It is normal practice for insurers to represent debit orders that have been returned. However, if the debit order is returned with "payment stopped" the contract is immediately cancelled.

If two or more orders are returned, the policy is cancelled from the due date of the first returned debit order.

Where premiums are paid in cash, the recipient must be given a written receipt stating the name, address and telephone number of the recipient, the policy number and the name of the short term insurer.

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## Module 4

## How the Short Term Insurance Act regulates short term insurance policies and protects individual policy holders

This Module deals with:

- The standard duration of a policy with reference to the Short Term Insurance Act
- Rules governing policies issued to minors with reference to the Short Term Insurance Act
- Reasons why a personal lines policy must be issued within a prescribed period with reference to the rights and responsibilities of both parties to the contract
- The way in which the Short Term Insurance Act protects individual policyholders with reference to Section 55 of the Act and the Policyholder Protection rules

### 4.1 The standard duration of a policy with reference to the Short Term Insurance Act

The standard duration for Short term insurance contracts are normally one year and are then reviewed by insurers. The contract can then be renewed or declined or terms and conditions altered.

Personal lines and small retail policies can be issued for a monthly period and a monthly premium.

In many of the cases the onus is on the insurer to justify cancelling or rejecting a policy after reviewing it.  Avoidance or a cancellation of a policy or the rejection of a claim should be based on facts that the insurer is able to prove in court.

The decision to avoid/cancel/reject is so important that it should be discussed with management within the company on every occasion that it is contemplated. No decision should be taken without full consideration of the claim file and the underwriting file.

Where there are co-insurers, it is desirable to ensure that every co-insurer agrees to the avoidance/cancellation/rejection. The extent to which the co-insurers' consent is necessary and the extent to which they are bound by the decision of the lead insurer depend on the terms of the policy.

### 4.2 Rules governing policies issued to minors with reference to the Short Term Insurance Act

Section 52 of the Short Term Insurance Act highlights the rules regarding polies issued to minors.  According to this section of the Act, a minor is a person who is younger than 18 years.

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A minor who has attained the age of 18 years may, without the consent of his or her guardian, enter into or deal with a short term insurance contract and pay the premium due under the policy with money which he or she has earned or which is at his or her disposal, and a policy benefit under the policy shall be provided to the minor who may deal with it as he or she thinks fit without the consent of his or her guardian.

In short - minors over 18 years of age may enter into and deal with policies without the consent of the guardian.

### 4.3 Reasons why a personal lines policy must be issued within a prescribed period with reference to the rights and responsibilities of both parties to the contract

Personal lines insurance policies are standard, general policies bought by individuals to cover their personal assets.

These policies cover:

- house owners insurance (buildings)
- householders insurance (contents)
- personal motor
- all risks insurance
- personal computers
- small craft
- personal accident insurance
- personal liability insurance

It is usual for these policies to provide different types of cover under a single policy, usually with a single combined premium for all of the sections (payable annually or monthly). This is known as a personal lines "multi-peril" policy.

The private individual in insurance is the "man in the street". The individual often comes into contact with insurance when he buys a house or a motorcar.

The supplier of finance will usually insist that the buyer proves valid insurance, not necessarily via the supplier. Therefore this is often the first point of contact with insurance.

Natural persons who are insured under short term policies (personal line business) must be provided with a copy of the document embodying the contract within 30 days being entered into or varied (section 47 of the Act).

A policyholder and anyone else who entered into a short term policy, shall be entitled, against payment of a fee, which will be prescribed by the Registrar, to be provided upon request, with a copy of the policy.

Reasons why a personal lines policy must be issued within a prescribed period:

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- The person insured must be certain the policy is what he or she wants
- When a loss happens, is there enough cover or not?
- Is the policy by the insurer the policy the insured chose?
- Excess
- Scope of
- Cover conditions
- Exclusions

As with any other contract, an insurance contract or policy is concluded when the parties (the proposer or client, and the insurer) agree to be bound by certain terms and conditions. There must be an offer (proposal) by the prospective policyholder on the one hand and acceptance on the other hand by the insurer. The issue of a policy indicates the insurer's acceptance.

The terms by which the parties agree to be bound, basically resolve around:

- The person insured
- The risk insured against
- The amount payable by the insurer on the happening of the event insured against
- The amount of premium payable by the insured, and
- The period of insurance.

The terms of an insurance contract can be classified into:

- Terms required for **the contract to come effect**

  E.g. Untrue statements by the policyholder which result in a material alteration in the risk
- Terms required for **the contract to remain valid**

  E.g. that the policyholder remains a South African resident and pay premiums on every due date, and
- Terms required **at claim stage**

  E.g. that a claim must be submitted in writing on the insurer's prescribed form.

## 4.4 The way in which the Short Term Insurance Act protects individual policyholders with reference to Section 55 of the Act and the Policyholder Protection rules

Section 55 of the Short Term Insurance Act, determines that the Advisory Committee or the Registrar, after consultation with the Advisory committee, may determine rules that ensure that all policies are enforced and managed in terms of sound insurance

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practices. They may also vary or recall any such rule. The time frames that relate to the lapsing of any rule are part and parcel of their powers.

These rules may provide that:

- Particular imports may not appear
- Information must be made known
- Policyholders may cancel policies under certain conditions and within specified periods, and the legal consequences of such
- The different arrangements applicable to the various policies
- Determine and implement fines and the circumstances of such
- Publish rules and variations in the *Gazette* relating to variations and rescission requirements inviting all interested persons to make written representations in relation to any matter within a specified period of 21 days in this regard.

### 4.4.1 The Advisory Committee on Short Term Insurance

- The Committee consists of a chairperson and other members appointed by the Minister after consultation with the board, and includes insurance experts and consumer representatives.
- The Committee will investigate and report on any matter connected with short-term insurance.
- This might be on its own initiative, or at the request of the Minister or the Registrar.

### 4.4.2 The Policyholder Protection Rules

These apply only to policies issued to natural persons acting otherwise than for the purposes of his or her business.  A statutory notice must be given to policyholders and prospective policyholders, informing them that they have the right to the following information:

About the intermediary

- Name, physical and postal address, and telephone number.
- Legal status and any interest in the insurer.
- Whether or not in possession of professional indemnity insurance.
- Details of how to institute a claim.
- Rand amount of fees and commission payable.
- Written mandate to act on behalf of the insurer

About the Insurer

- Name, physical and postal address, and telephone numbers.
- Telephone number of compliance department of the insurer.

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- Details of how to institute a claim and/or complaint.
- Type of policy involved.
- Extent of the premium obligations of the policyholder.
- Manner of payment of premium, due date of premiums and consequences of non-payment.

Other important things to take note of:

- You must be informed of any material changes to the information above.
- If the information was given orally, it must be confirmed in writing within 30 days.
- If complaints to the intermediary or insurer are not resolved to your satisfaction, you may complain to the Registrar.
- Polygraph or lie detector tests are not obligatory in the event of a claim. Failure of the test is not to be the **sole** reason for repudiating a claim.
- If the premium is paid by debit order this is to be in favour of one person only, and may not be transferred without your approval, and the insurer must give you at least 30 days' written notice of its intention to cancel the debit order.
- The insurer, **not the intermediary**, must give the reason(s) for repudiating your claim.
- Your insurer may not cancel your insurance simply by informing the intermediary. Notice must be sent to you.
- You are entitled to a copy of the policy, free of charge.

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