



DIRECTIVE
FINANCIAL SERVICES BOARD
REPUBLIC OF SOUTH AFRICA

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

Addressee:	Long-term insurers	Reference:	10/17/1
Edition	Date	Directive	Status
1st	12 August 2003	139.A.i	In force
2nd	-	-	-
3rd	-	-	-

AMENDMENTS TO THE LONG-TERM INSURANCE ACT, 1998

1. Purpose of this directive

You are hereby notified that the Insurance Amendment Act, 2003 (Act No. 17 of 2003), which contain the amendments to the Long-term Insurance Act, 1998, was published in Government Gazette No 25230 of 23 July 2003 . The said Amendment Act came into operation on 1 August 2003 in terms of the President's Proclamation No.61, 2003, published in Government Gazette No 25290 of 31 July 2003.

2. The effect of the amendments to the Long-term Insurance Act, 1998 is briefly elucidated hereunder.

2.1 Section 1 – Definitions

2.1.1 The following definitions were inserted as a consequence of the insertion and amendment of certain sections of the Act and the repeal of Schedule 2 of the Act:

"capital adequacy requirement"
"fair value"
"linked liabilities"
"linked policy"
"market-related policy"

2.1.2 The definition of "executive management" is expanded to include not only the chief executive officer but also a manager who reports directly to the chief executive officer. This amendment is necessary since:

- (i) it is desirable, from a regulatory point of view, that the chief executive officer and a manager reporting to the chief executive officer must be fit and proper; and
- (ii) the concept of “fit and proper” must not only apply to a person, but also to the top management of a long-term insurer.

2.2 Section 4 – Misleading advertising material

Consumers need to have confidence that they are dealing with registered entities and therefore Subsection (3) of this section is expanded to ensure that advertising material which relates to a long-term insurance policy must include the name of the long-term insurer who underwrites the policy.

2.3 Section 8(2) – Name of insurer

This subsection is expanded to include the requirement to obtain the Registrar’s approval also if a translation, shortened form or derivative of the long-term insurer’s name is changed.

2.4 Section 10 (h) – Conditions of registration

This amendment is consequential of the amendment to Schedule 3 which in return has been amended to enhance the prudential regulation of insurers by separating the expressions ‘liability’ and ‘capital adequacy requirement’.

2.5 Section 15A – Reinsurance

This section is inserted to allow professional reinsurers to on application in terms of section 11 of the Act also conduct direct insurance business only with “funds” as defined in section 1(1) of the Act.

2.6 Section 18 – Notification of certain appointments, terminations and registration

This section provided that the Registrar has to be notified by the insurer of a director or managing director that resigns or whose appointment has been terminated and the reasons therefore. Section 18 has been extended to allow the Registrar to also request the director or managing director who resigns or whose appointment has been terminated by the insurer to give further information in writing of any matter relating to the affairs of that insurer which that person became aware of, which may prejudice the insurer’s ability to comply with the provisions of the Act. Furthermore that person is indemnified if and when that is done.

Resignations and terminations of appointments may be the result of irregular circumstances in an insurer’s internal affairs and it is necessary that a feasible mechanism be created for information thereon to reach the Registrar as soon as possible as the interests of policyholders and other stakeholders may be at risk.

2.7 Section 24 – Preference shares, debentures, share capital and share warrants

Section 24(a)(vi) is amended as a consequence of the deletions of sections 83 and 84 in the Companies Act.

Sections 24(a)(vii) and (viii) are added. This addition in regard to the issuing of different classes of ordinary shares is necessary to regulate long-term insurers, which conduct their business on a cell basis. The objective of cell business is to differentiate between profits to different shareholders, which is achieved through the issuing of different classes of shares. Other kinds of shares and loan capital are already in terms of section 24, subject to approval by the Registrar.

Section 24(a)(ix) is also added. This addition regulates the acquisition of shares directly or indirectly in a long-term insurer by its subsidiary. The direct or indirect acquisition by a subsidiary of shares in an insurer has an impact on the financial soundness condition of the insurer. It is therefore imperative for the Registrar to approve such transaction subject to conditions prior to it being affected.

2.8 Section 26 – Limitation on control and certain shareholding or other interest in long-term insurers.

The amendment to this section was to replace the expression “associate” with “related party”. This replacement is necessary in order to be more closely in line and to avoid misinterpretation with South African Statements of Generally Accepted Accounting Practice.

2.9 Section 29 – Maintenance of a financially sound condition

This amendment is consequential of the amendment to Schedule 3 to separate the expressions ‘liability’ and ‘capital adequacy requirement’.

2.10 Section 30 – Assets & Dividends

This amendment is consequential of the amendment to Schedule 3 to separate the expressions ‘liability’ and ‘capital adequacy requirement’.

Section 30(2) is expanded to clarify the restrictions placed on dividend payments by long-term insurers.

2.11 Section 31 – Kinds and spread of assets

As a consequence of the deletion of Schedule 2 the liabilities mentioned in subparagraph (i) will now be calculated on the method of valuation prescribed in Schedule 3.

This section is further amended to make a distinction between “liabilities” and “minimum capital adequacy requirement” also as a result of amendments to Schedule 3 but also to set a minimum level at which an insurers must spread their assets.

Furthermore the expression “market value” in this section is replaced with term “fair value”.

2.12 Section 33 – Liabilities

Section 33(2) is deleted as the meaning therein is given to the expression “linked liabilities” which is now been inserted in section 1.

2.13 Section 34 – Prohibitions concerning assets and certain liabilities

Paragraph (e) to subsection 1 of this section is inserted. The purpose of this addition is to enable an insurer to apply for approval to include shares held directly or indirectly in its holding company in its assets, i.e. shareholders’ funds. Shares held in this manner may have an impact on the financial soundness condition of the insurer due to exposure in the group. It is therefore imperative for the Registrar to approve of such a holding. In this regard also refer to Directive 141 issued by this Office dated 1 August 2003.

2.14 Section 44 – Free choice in certain circumstances

This section was amended to exclude “policy loans” from the said requirements. The exclusion will only apply in the case where a long-term insurer lends money to the holder of and upon the security of, a long-term policy taken out with that insurer. The giving of policy loans is a long-standing practice and has become a standard commercial feature and facility of long-term policies.

2.15 Section 47(2) – Cash premiums

The current banking systems do not make provision for a bank to state the names of the insurance company and of the policyholder in receipts. The result was that banks were continuously breaching the provisions of section 47(1). This section envisages to particularly protecting a particular segment of the market, and most specifically the less sophisticated part of the market where premiums are paid in cash to a person collecting it on a frequent basis. It was argued that enough protection is built into the current banking system to safeguard a policyholder paying the premium in cash to a bank and therefore banks are now excluded from the said requirement to issue receipts.

2.16 Section 59 – Materiality of misrepresentation

The intention in the newly worded section 59(1) is to clearly broaden the scope of the expression “representation”. In strict law this expression in this context basically and in the first place refers to representations by means of positive acts (“misrepresentations *per commissionem*”) committed by a policyholder, but can according to legal dogmatics also be interpreted as covering (negative) cases of *omissions* (“misrepresentations *per omissionem*”), such as failures to disclose certain information. The intention behind the new section 59(1) is to make this legal position clear in order to promote the extension of the relative protection granted in the section to policyholders who are guilty of non-material inaccuracies. In conjunction with this aim, the new paragraph (b) of section 59(1) intends to legally clarify the concept of “materiality” of representations.

The new wording should clearly promote legal certainty as regards the exact intention behind section 59(1)(a), and also clarifies the legal position following conflicting views expressed in two judgments of the Supreme Court of Appeal. The Ombudsman for Long-term Insurance, the Honourable Judge J. H. Steyn has recommended the amendment. As regards the new section 59(1)(b), this summarises views on the relevant “materiality” as enunciated by the Courts.

2.17 Schedule 1 – Kinds of assets

- a) The previous concluding words “and other financial instruments of whatever nature” of the definition of “securities” affected a virtual unlimited extension of the definition. The wide effect of that wording had to be limited for the sake of legal certainty. The Registrar is now empowered to prescribe the other new kinds of financial instruments that are continuously being developed.
- b) Paragraph 2(b)(i) of Schedule 1 made that a requirement for the Registrar to approve a counterparty to an over-the-counter instrument. It was practically not possible for the Registrar to approve each and every counterparty. Instead of approving the counterparty the Registrar will now approve the relevant conditional criteria for a counterparty.
- c) Item 16(1) of the Table to Schedule 1 referred to “debentures” which were already included in the definition of “securities” in paragraph 1 of the Schedule.
- d) Item 16(5) in the Table to Schedule 1 previously determined that listed securities and shares issued by a foreign government or institution would have been regarded as an asset in the Republic, which long-term insurers must hold, if the Registrar had recognised the stock exchange or the country in which a regulated market existed.

Essentially the effect of these amendments to paragraph 16(5) are that the relevant assets still are regarded as assets in the Republic, but the stock exchange or the country within which a regulated market exists, shall no longer be subject to the recognition of the Registrar. These assets however remain subject to the spreading limitations required in terms of section 31 of the Long-term Insurance Act.

Investing on a recognised stock exchange or in a country within which a regulated market exists is not necessarily a guarantee that it will be a good investment. The amendments have the effect that greater responsibility are placed on the directors of long-term insurance companies to assess the risks in investing on foreign stock exchanges and regulated markets. Furthermore, this will facilitate investments in e.g. SADC and other developing countries without having to wait for the Registrar’s recognition.

- e) Item 20 in the Table to Schedule 1 was amended to allow also for claims against, and for stocks and shares in, a body corporate which is not incorporated and registered in the Republic, but which in the opinion of the Registrar carries on business in the Republic.

The amendment was necessary since -

- unintended consequences resulted from the previous wording, such as a claim against a stock or share of a body corporate;
- only claims are allowed as an asset in terms of the previous wording; and
- claims against, and stocks and shares in, a body corporate should be allowed as an asset as they were allowed in the Insurance Act, 1943.

2.18 Repeal of Schedule 2

Schedule 2 of the Long-term Insurance Act was repealed. It regulated the method of calculation of the value of a long-term insurer's assets and liabilities for the purposes of section 30 of the Act (maintenance of a financially sound condition), on what was commonly known as the "prescribed valuation method". Part I of the Schedule dealt with the valuation of assets and Part II dealt with the valuation of liabilities. The valuation of liabilities (Part II) was also used for purposes of section 31 of the Act (spreading requirements).

The prescribed valuation method was a prescriptive basis. It became increasingly outdated because of the following reasons:

- The basis was a static basis, which had little or no resemblance to the market conditions consequently the results were artificial or unrealistic;
- the method did not distinguish between different risk profiles of different insurers, and therefore the method was inflexible and often inappropriate;
- for most modern new long-term insurance products the method was not relevant and therefore no prescriptions exist; and
- the method required different approaches to the valuation of the assets and the liabilities of a long-term insurer, thereby it had the effect that the values were inconsistent with each other.

In future the method of valuation in Schedule 3 will be the only method of valuation to be used for purposes of section 30 of the Act (maintenance of a financially sound position).

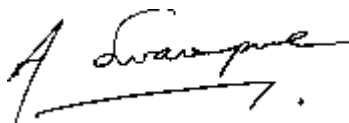
2.19 Schedule 3

Schedule 3 of the Act was replaced by a new Schedule. In future the method of valuation in Schedule 3 (which includes the Prescribed requirements for the calculation of the value of assets, liabilities and capital adequacy requirements of long-term insurers as per Notice No 1877 published in Government Gazette No. 25189 of 18 July 2003.

The following aspects are now addressed in the new Schedule 3:

- a) Par 1: the definition of 'approved reinsurance policy' is introduced in this Schedule, which was formerly addressed in Schedule 2 that was repealed. Such a policy is important as it may be deducted from the amount of the liability of an insurer. Subparagraph (a)(i)(bb) of the definition is dealing with an approved reinsurance policy issued by a foreign insurer. It provides that if reinsurance is placed with another insurer approved by the Registrar, such reinsurance will be approved reinsurance. The new approach is also that the Registrar may grant approval subject to certain conditions, The rationale for this approach is that –
 - (i) in certain circumstances the Registrar needs to restrict the percentage of business placed with a particular foreign insurer;
 - (ii) the Registrar needs to approve the kind of risks that may be reinsured with a particular foreign insurer; and
 - (iii) it is necessary to require the foreign insurer to provide the local insurer with the necessary security.
- b) Par 2: the Registrar is now empowered to prescribe the basis of the calculation of values of assets, liabilities and capital adequacy requirement. This is done by way of a notice that is published in the Government Gazette.

- c) Par 3: the treatment of an approved reinsurance policies for the calculation of contingent liabilities remained the same as was previously addressed in par 6 of the old Schedule 3;
 - d) Par 4: the provisions relating to amounts that must be disregarded have been streamlined and, inter alia, it is made clear that negative reserves will not be allowed as assets although they may be deducted from liabilities;
 - e) Par 5: the manner in which outstanding premiums and potential profits should be calculated was retained and was taken over from the old Schedule 3.
 - f) Par 6: It is important to note that the Registrar is now empowered to take action where the valuation of the assets, contingent liabilities or capital adequacy requirement by means of the method of valuation in Schedule 3 does not result in acceptable and proper values; and
 - g) Par 7: similar provisions with regard to the valuation of other liabilities than contingent liabilities and subordinate liabilities have been taken over from the old Schedule 2.
3. This directive is available on the website of the FSB (www.fsb.co.za) and the insurer must bring it to the attention of its auditor (appointed under section 19 of the Act) and the statutory actuary and/or alternate statutory actuary (appointed under section 20 of the Act).



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