

FSCA COMMUNICATION 1 OF 2021 (INS)

EXEMPTION FOR DIRECT COLLECTION OF PREMIUMS: SUBSTITUTION OF FSCA INS NOTICES 19 AND 20 OF 2020 (INS)

1 PURPOSE

The purpose of this Communication is to inform stakeholders that the Financial Sector Conduct Authority (FSCA) today published FSCA INS Notice 1 and 2 of 2021 which substitutes FSCA INS Notice 19 of 2020 - Exemption for direct collection of premiums by certain independent intermediaries and short-term insurers, 2020 and FSCA INS Notice 20 of 2020 - Exemption for direct collection of premiums by certain independent intermediaries and long-term insurers, 2020, and the reasons for the substitution.

2 BACKGROUND

- 2.1 On 30 October 2020, the FSCA under section 281 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) published FSCA INS Notice 19 of 2020 in respect of Regulation 5.1(1) and (2) of the Regulations under the Short-term Insurance Act, 1998 (STIA) and FSCA INS Notice 20 of 2020 in respect of Regulation 3.2(1) and (2) of the Regulations under the Long-term Insurance Act, 1998 (LTIA). For purposes of this communication FSCA INS Notice 19 of 2020 and FSCA INS Notice 20 of 2020 are collectively referred to as the 'Exemption Notices'.
- 2.2 Before the granting the Exemption Notices, the FSCA on 17 April 2020 published the draft notices for public comment and had extensive engagement with various industry associations, insurers, and intermediaries regarding the proposed exemptions. The draft notices were published alongside FSCA Communication 22 of 2020¹ which provides detailed information on the intention behind the exemptions as an interim step in transforming the premium collection framework. These documents reaffirmed the FSCA's views as provided comprehensively in the 2019 position paper setting out proposals on the future regulatory framework for the collection of insurance premiums.
- 2.3 The Exemption Notices were aimed at facilitating the payment of remuneration to an independent intermediary where premiums are collected directly into the account of an insurer and the technological systems of the independent intermediary enable the direct collection method. Such an independent intermediary performs certain activities in support of the direct collection, which could be described as accounting for premium. Accordingly, the exemption notices defined accounting for premium in the context of the direct collection of premium and enabled additional remuneration to be allowed, outside of the maximum commission prescribed, for purposes of these activities only, and subject to the conditions as set out in the exemption notices.

¹ Available on the FSCA's website under Regulatory Frameworks < Documents for Consultation < Insurance or by clicking on the following link:
[https://www.fsca.co.za/Regulatory%20Frameworks/Documents%20for%20Consultation/FSCA%20COMMUNICATION%2022%20OF%202020%20\(INS\)%20and%20Draft%20FSCA%20INS%20Notices%20X%20of%202020.zip](https://www.fsca.co.za/Regulatory%20Frameworks/Documents%20for%20Consultation/FSCA%20COMMUNICATION%2022%20OF%202020%20(INS)%20and%20Draft%20FSCA%20INS%20Notices%20X%20of%202020.zip)

3 FURTHER CONTEXT - CLASSIFICATION OF AND CONTRACTUAL NATURE OF PREMIUM COLLECTION IN TERMS OF THE CURRENT REGULATORY FRAMEWORK

3.1 The FSCA received multiple queries requesting clarification in respect of the current nature of premium collection, including how it should be classified and what the nature of the contract should be between the parties entering into an arrangement to collect and or account for premium. From these queries it was clear that there are divergent and inconsistent interpretations that are being applied by industry role-players insofar as it relates to the premium collection regulatory framework. The inconsistent interpretations also have a direct impact on how the Exemption Notices are being applied. For this reason, the FSCA deemed it important to set out its interpretation and understanding of the current requirements relating to premium collection as set out in the STIA and LTIA and the Regulations thereunder, as this interpretation and understanding informed the approach reflected in the Exemption Notices.

3.2 The Regulations under the STIA provides the following definition:

“services as intermediary” means any act performed by a person-

(a) *the result of which is that another person will or does or offers to enter into, vary or renew a policy; or*

(b) *with a view to-*

(i) *maintaining, servicing or otherwise dealing with;*

(ii) *collecting or accounting for premium payable under; or*

(iii) *receiving, submitting or processing claims under.”*

3.3 Correspondingly in the Regulations issued under the LTIA the following definition is provided:

“rendering services as intermediary” means the performance by a person other than a long-term insurer or a policyholder, on behalf of a long-term insurer or a policyholder, of any act directed towards entering into, maintaining or servicing a policy or collecting, accounting for or paying premiums or providing administrative services in relation to a policy, and includes the performance of such an act in relation to a fund, a member of a fund and the agreement between the member and the fund;”

3.4 In both these definitions, it is unambiguous that collecting of and accounting for premium falls within the legal meaning of services as an intermediary.

3.5 Section 45 of the STIA and the corresponding section 47A in the LTIA states:

“(1) No independent intermediary shall receive, hold or in any other manner deal with premiums payable under a short-term policy (or long-term policy) entered into or to be entered into with a short-term insurer (or long-term insurer) and no such short-term insurer (or long-term insurer) shall permit such independent intermediary to so receive, hold or in any other manner deal with such premiums-

(a) *unless authorised to do so by the short-term insurer (long-term insurer) concerned as prescribed by regulation; and*

(b) *otherwise than in accordance with the regulations.”*

- 3.6 It is important to note in this provision that the wording speaks to hold *or in any other manner deal with premiums payable* (own emphasis), it does not use the word **and** (own emphasis). It is therefore drafted to cast a wide net in respect of activities relating to dealing with premium under a short-or long-term policy.
- 3.7 This view was also set out in detail in the 2019 position paper setting out proposals on the future regulatory framework for the collection of insurance premiums.² One of the proposals in the position paper referred to the potential change in the future framework to clearly delineate certain premium collection activities and to potentially change it to an outsourcing activity. It must be noted that the framework as it currently stands **does not** accommodate any premium collection activities as outsourcing. The FSCA has consistently expressed the view that accounting for premiums on behalf of an insurer includes recording, keeping track of and managing the administration in respect of premiums paid or received, and reporting to the insurer in this regard. The phrase “accounting for” as used in the regulatory definitions set out above must therefore be applied in its widest sense which means that a wide range of premium collection-related activities could possibly fall within this description. As it currently stands these activities are not outsourcing activities but constitute services as intermediary for which commission is payable.
- 3.8 The aim of the Exemption Notices is therefore to accommodate the payment of additional remuneration over and above commission for activities where direct collections are being done. The exemption notices are not intended to support arbitrage or business models that are not compliant with the existing regulatory framework. Premium collection activities currently remain services as intermediary, until such time as the regulatory framework is changed. All that the Exemption Notices do is allow for remuneration for direct collection of premium that is not limited to the maximum commission prescribed. The exemption notices in no way changes or amends the current regulatory framework. The effect of any person not meeting the conditions in the exemption will be that the person does not qualify for being so exempted, and therefore they must comply with the provisions in the law, in this case, the commission regulations.
- 3.9 In the FSCA’s view, therefore, premium collection activities, including activities relating to accounting of premium as defined, constitute services as intermediary which are remunerated by way of commission, save for the relief granted in the Exemption Notices which allows for remuneration outside of the commission regulations.
- 3.10 These services and/or activities, if performed, still require authorisation as set out in section 45 of the STIA and the corresponding section 47A of the LTIA. Furthermore, due to the nature of these services/activities, an intermediary agreement must be entered into between the insurer and the intermediary that will be performing these services/activities.

4 REASONS FOR WITHDRAWAL OF THE EXEMPTION NOTICES AND SUBSTANCE OF THE AMENDED NOTICES

- 4.1 After issuing the Exemption Notices at the end of October 2020, the FSCA received feedback from industry role players operating in the direct collection industry indicating that they are facing a number of practical obstacles to qualify for these exemptions, due to the functioning of their business models and certain system standardisations.

² Available on the FSCA’s website under Regulatory Frameworks > Documents for Consultation > Insurance or by clicking on the following link:
<https://www.fsc.co.za/Regulatory%20Frameworks/Documents%20for%20Consultation/FSCA%20Position%20Paper%20on%20future%20Insurance%20Premiums%20Collection%20Framework.zip>

4.2 The reasons provided included:

- the fact that the current business models were based on percentage-based remuneration (predominantly due to the historic approach by the insurance industry with regards to the “interest sharing” model of third-party premium collection) and the fact that all existing contracts reflect percentage-based remuneration clauses;
- that none of the collection agents that perform direct collection actually carry out all of the activities listed in the definition of ‘accounting for premium’ in the notices (i.e. that some activities are performed by the independent intermediary (broker) on behalf of the collection agency); and
- notwithstanding the fact (as submitted by certain collection agencies) that other independent intermediaries (brokers) perform certain of the functions on behalf of the collection agency, the collection agent may in terms of the existing framework not remunerate such an independent intermediary for activities it performs on behalf of the collection agent due to the limitations around remuneration payable to an independent intermediary.

4.3 It is important to note that the FSCA has been very clear in its view on the inappropriateness of the interest sharing model and the risks that this poses and that it is not in support of the remuneration being based on a percentage of the premium being collected (or accounted for). The reason for the latter is that there is no plausible reason why collecting a higher amount of premium justifies a higher fee, if the activities being performed in essence requires exactly the same amount of work. Reasons for these remuneration practices have been mooted by industry players relate to historical practices that the FSCA does not support. It is the view of the FSCA that if the work in performing these activities are the same regardless of the amount of premium being collected, it should not be remunerated based on a percentage of the total premium received. The remuneration must be reasonable and commensurate to the activities performed and relate to the actual cost pertaining to performing the activities, plus a reasonable margin of return.

4.4. Industry participants should apply the principles of fair remuneration that entails that remuneration should be reasonable and commensurate with the services being performed, meaning that there has to be some cost-based analysis underpinning remuneration structures. In the absence of considering the cost and the details of the activities being performed, there may well be instances where excessive fees are being paid which are not commensurate with activities being performed, in order to ‘lure’ independent intermediaries to place business with a specific entity. It may also result in the independent intermediary being remunerated for the same function as is already being remunerated by way of commission.

4.5 Feedback from industry participants also brought to light that independent intermediaries (mostly collection agents) were entering into remuneration arrangements with other independent intermediaries to perform activities that fall within the definition of services as intermediary in the STI Regulations (or rendering services as intermediary in the LTIA regulations), and were paying remuneration outside of commission to such independent intermediaries. The arguments raised by the industry in an attempt to justify these business models were that the FSCA has mooted the change to the regulatory framework on premium collection and that these approaches align to these regulatory proposals.

4.6 In the FSCA’s view, in many instances these practices in their current form amount to duplication of remuneration in that the intermediary authorised to account for premium pays another independent intermediary for performing some of the administrative activities that fall within the definition of services as intermediary. These activities are integral to the nature of what a typical intermediary does. In addition, it must be noted that future

legislation proposed cannot be taken as the actual law before it has been given effect to. The reality is that business practices, whether or not aligned to future legislative proposals, can only be implemented to the extent that the current law allows or accommodates such a practice. Adapting business practices based on draft regulatory proposals without the changes being formally introduced in the legislation is unlawful, and such behaviour increases the risk of arbitrage purely because of the competitive drive from some industry players. Regulatory changes are extensively consulted on to ensure that an orderly and balanced approach is adopted when transitioning into the new regulatory regime, in order to avoid unintended consequences. The fact that some entities undertook practices that were based on the proposals for the future regulatory framework has resulted in many industry players factually not complying with the existing regulatory framework.

- 4.7 Notwithstanding the above, after careful consideration of the potential impact and the extent of the current practices, the decision was taken to allow for a period of 12 (twelve) months for industry participants to change the current undesirable practices to ensure that practice aligns with the prescripts of the law.
- 4.8 This was achieved by amending the current Exemption Notices to temporarily accommodate existing business practices in order to provide industry participants an opportunity to affect the necessary system and contractual changes to align their business practices with the regulatory framework. In order to facilitate an orderly transition, the FSCA hereby confirms that both FSCA INS Notice 19 and 20 of 2020 have been withdrawn and replaced by FSCA INS Notice 1 and 2 of 2021 (replacement Notices).
- 4.9 The main changes contained in the replacement Notices compared to the previous Exemption Notices are as follows:
- The limitation in the previous Exemption Notices which prescribed that the consideration may not be based on a percentage of the total premium amount received by or payable to the short-and long-term insurers has been removed. A period of twelve months from publication of the Notices is provided for entities to make the necessary system and contractual changes. After the expiry of this 12-month period the intention is to reintroduce this limitation through changes to subordinate legislation; and
 - the replacement Notices have been extended to also exempt other independent intermediaries (brokers) who perform some of the direct collection related activities.
- 4.10 The intention is, however, to accommodate the above practices for a limited time only in order to facilitate the orderly dissolution of, or changes to, the undesirable business arrangements described in this communication to comply with the existing regulatory framework. For this reason, the exemption is only valid for a period of approximately 12 months from publication of the Notices. After the expiry of this 12-month period the intention is to reintroduce the relevant limitations through changes to subordinate legislation.
- 4.11 Although the FSCA has decided to allow these practices for a limited time to ensure stability in the market, it wishes to reiterate that is not in support of an arrangement where the independent intermediary is already earning commission from the insurer for performing services as intermediary and is also earning a fee from another independent intermediary (collection agent) authorised to collect or account for premium for performing exactly the same activity. It goes against the principle of fair remuneration and impacts the fees related to the insurance product, and ultimately the cost of insurance to the policyholder.
- 4.12 Lastly, it should be noted that any agreements related to collecting of, or accounting for, premium structured as outsourcing agreements, are not in line with the existing regulatory

framework applicable to insurance. As explained in detail above, any activities related to collecting or accounting for premium payable under a policy falls within the definition of “services as intermediary” and must be structured as an intermediary agreement.

- 4.13 Industry is reminded that these exemptions are temporary in nature aimed to encourage an immediate shift to direct collections. It does not constitute a change in the overall regulatory framework. The FSCA will in due course submit proposed draft amendments to the Regulations under the STIA and LTIA to the Minister of Finance, and if accepted it is envisaged that such proposed amendments will be consulted on during the course of 2021.

5 ENQUIRIES

For more information regarding this Communication contact the Regulatory Framework Department of the Authority at FSCA.RFDRegulatorySupport@fsca.co.za



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