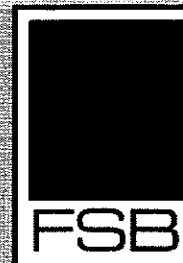


INFORMATION LETTER
FINANCIAL SERVICES BOARD
REPUBLIC OF SOUTH AFRICA



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

SHORT-TERM INSURANCE ACT, 1998 (ACT 53 OF 1998)

Addressee:	Long-term Insurers Short-term Insurers	File:	10/41/2/7/2; 10/41/1/7/2 & 10/13/5
Issue date	Reply date	Info letter	Status
28 July 2008	-	3/2008 (LT & ST)	Issued
Subject:	Prohibition on inducements – Declaratory judgment		

Your attention is invited to the attached declaratory judgment regarding the question of whether a specific product complies with or is an offence against section 45 of the Long-term Insurance Act, 1998.

Insurers must ensure that they attach the correct interpretation to their specific products.

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


pp REGISTRAR OF LONG-TERM INSURANCE
REGISTRAR OF SHORT-TERM INSURANCE

IN THE HIGH COURT OF SOUTH AFRICA

TRANSVAAL PROVINCIAL DIVISION

CASE NUMBER: 38548/2006

In the matter between:

MOMENTUM GROUP LIMITED

And

**THE REGISTRAR OF LONG-TERM
INSURANCE**

DELETE WHICHEVER IS NOT APPLICABLE

(1) REPORTABLE: YES/NO.

(2) OF INTEREST TO OTHER JUDGES: YES/NO.

(3) REVISED.

DATE

SIGNATURE

Respondent

JUDGMENT

THE PARTIES

1. The applicant is **MOMENTUM GROUP LIMITED**, a company with limited liability duly registered and incorporated in accordance with the company laws of the Republic of South Africa. The applicant carries on business *inter alia* as a long-term insurer in term of the Long-Term Insurance Act 52 of 1998. The applicant has its registered office, alternatively its principal place of business is situated at 268 West Avenue, Centurion, Gauteng.

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2. The respondent is **THE REGISTRAR OF LONG-TERM INSURANCE**, an office established by Section 2 of the Long-Term Insurance Act. The respondent is responsible for the administration of the Long-term Insurance Act. The respondent's principal office is Rigel Park, 446 Rigel Avenue, South Erasmus Rand, Pretoria, Gauteng.
3. The applicant is the holding company of the following subsidiaries:
 - a) Momentum Administration Services (Pty) Ltd, a company registered as an administration only financial services provider in terms of the Financial Advisory and Intermediary Services Act 37 of 2002;
 - b) Through the above company the applicant holds Momentum Wealth Nominees (Pty) Ltd, a company registered with the respondent as custodian of the assets of the clients of the Momentum Administration Services (Pty) Ltd, as required by the same Financial Advisory and Intermediary Services Act;
 - c) Momentum Interactive (Pty) Limited, a company incorporated to operate a demand aggregation and loyalty scheme created by the applicant under the name "Save Thru Spend" ("STS").
4. The applicant is also the underwriter of the MM Retirement Annuity Fund, a retirement annuity fund registered in terms of the Pension Funds Act 24 of 1956 and approved as such in terms of the Income Tax Act 72 of 1963.

THE ISSUE

5. Section 45 of the Long-Term insurance Act ("the Act") reads as follows:
"Prohibition on Inducements
No person shall provide, or offer to provide, directly or indirectly, any valuable consideration as an inducement to a person to enter into, continue, vary or cancel a long-term policy, other than a re-insurance policy."

6. The STS scheme devised by the applicant aims at obtaining benefits for members of the scheme, who are restricted to its own clients and those of the Pension Fund and of the Momentum Administration Services. ("MAS").
7. These clients may apply to become members of the scheme.
8. Momentum Interactive (Pty) Ltd ("Interactive"); the administrator of the scheme, enters into contracts with a variety of retailers, who in turn agree to grant a discount to any member of the scheme who identifies herself or himself and purchases a product from the retailer.
9. Members of the scheme become such upon application to the applicant, to the Fund or to MAS.
10. Interactive then provides the clients with information relating to the participating retailers, a set of rules relating to the scheme, a card with a unique client number through which the member identifies himself or herself to the retailer as a participant in the scheme, and with a copy of the terms and conditions for the usage of the card.
11. Members who purchase a product from a participating retailer may qualify for a discount on the purchase price.
12. This discount is not, however, passed on directly to the member of the scheme. The discount is paid in cash to Interactive, which in turn deducts an administration fee of about 25% of the discount and applies the balance to obtain additional benefits for the member through the product or products the member holds in the applicant, the Fund or MAS.
13. MAS pays the financial benefits directly into the investment contracts of a member, while the Fund accepts the benefits as additional contributions to the Fund that are dealt with in the same way as any asset of the Fund; whereas policies taken out with the applicant by members are enhanced by the benefits obtained through the scheme by purchasing additional units in an asset portfolio or participatory interests in collective investment schemes.

14. The respondent does not object to the scheme in as much as it may relate to retirement annuities (because the benefits do not accrue to long-term insurance policies but to retirement funds); to direct linked investments as they too, do not constitute long-term insurance; to health savers, as these relate to medical schemes and to umbrella retirement funds, called "Funds at Work" by the applicant, which are not long-term policies either.
15. The respondent does, however, hold the view that the scheme contravenes the provisions of section 45 of the Act.
16. The respondent describes the purpose of the prohibition imposed by section 45 of the Act as a measure to protect the consumer from being persuaded by insurers or their agents to bind themselves contractually to the providers of long-term insurance products in respect of products that are beyond their economic capacity, exceed their needs or involve them in premium expenditure that they will not be able to afford throughout the (long-term) contract period.
17. Mr Munyai, the Deputy Executive Officer of the Financial Services Board responsible for the insurance department of the FSB, explains in his answering affidavit what the respondent regards as objectionable in the STS scheme in the following terms:

"9.4 when interpreting section 45 a distinction must be drawn between the benefits that are inextricably linked to the particular insurance product (policy benefits) and other benefits that are extraneous to the particular product that would fall foul of the prohibition in section 45. The very nature of the policy benefits offered by all insurers is designed to 'induce' a consumer to take out a policy. Insurance companies compete with each other in a highly competitive market by offering better or more policy benefits to consumers. These benefits are 'true' policy benefits that are inextricably linked to the policy and the contractual relationship between insurer and insured. The offering of such policy benefits as

the quid pro quo for taking out a policy and the payment of a premium is not the type that section 45 prohibits. These benefits are not extraneous to the policy.

9.5 Where, however, benefits with a valuable consideration are offered by an insurer which stem not from the policy, but from some extraneous source, such benefits will fall foul of the prohibition on inducements in section 45....It matters not that these types of benefits may be described as 'policy benefits' or that they are portrayed as being linked to the policy. Where these benefits originate from some source extraneous to the policy, the offering thereof will amount to inducements in contravention of section 45....It is in this sense that the Applicant's reference to 'illegal' inducements....must be understood....the benefits offered by the Applicant to consumers in terms of the STS scheme have their origin outside the contractual relationship between the Applicant as insurer and its existing or prospective customers. As such it is the Respondent's view that the offering of those benefits contravenes section 45 of the...Act."

18. The respondent concedes that section 46 of the Act allows actuarially calculated rebate of premium and bonuses to be granted by the insurer to the policyholder, but argues that such benefits are not extraneous to the policy and are therefore not affected by the prohibitions of section 45.
19. The respondent finds further support for its stance in the fact that the benefits offered by the scheme are not defined in the insurance contract, but in the rules of the scheme, the benefits are offered by retailers may be variable and not obligatory in each case of a purchase being made, could be cancelled at short notice and are not provided by the applicant as principal.

20. The question whether the STS scheme complies with or offends against section 45 of the Act therefore depends upon the correct interpretation of the section.

THE ARGUMENTS

21. As appears from the wording of section 45 quoted above, the literal interpretation thereof "***No person shall....offer any valuable consideration..***" prohibits even the insurer from granting any benefit to the policyholder.
22. The parties were agreed that the section must therefore be interpreted restrictively in order to avoid the absurd result that the literal interpretation would lead to.
23. When a statutory provision has to be interpreted restrictively, the court must, as a general rule, restrict the words used by the legislature as little as possible to arrive at the true intention of the legislator:
"...a court may depart from the ordinary literal meaning of the words used only where not to do so ..would lead to an absurdity so glaring that it could never have been contemplated by the legislature, or where it would lead to a result contrary to the intention of the legislature, as shown by the context or by such considerations as the court is justified in taking into account." (per Scott JA in *Randburg Town Council v Kersay Investments (Pty) Ltd* 1998 (1) SA 98 (SCA) at 107 B).
The sub-quote in this passage is taken from *Venter v R* 1907 TS 910. A full discussion of this decision is found in Steyn, *Die Uitleg van Wette*, 5th edition, p 31.
24. The applicant has pointed to the forerunners of section 45 in its analysis of the legislative history of the provision. Section 51 (2) of the Insurance Act 27 of 1943 read:

"No person shall pay, allow or give, or offer to pay, allow or give, directly or indirectly to any other person as an inducement to such other person to take out a domestic life policy any valuable consideration and no person shall knowingly receive as such an inducement any such valuable consideration."

This provision was amended in 1993 by the substitution of section 51(2) with section 23D, worded as follows:

"No person shall promise, pay, allow or give, or offer to pay, allow or give, directly or indirectly to any other person, as an inducement to such person to take out a policy or to agree to any alteration of any term of an existing policy, any valuable consideration or benefit and no person shall knowingly receive as such an inducement any valuable consideration or benefit."

25. It is clear – and the parties are agreed – that the legislature intends to, as the Louw Report of 1976 quoted by the applicant in its founding affidavit summed up the position, to protect the consumer against salesmen that seek to persuade them to take out a policy by offering the prospective policyholder money or a similar bait; while the seller is protected against a buyer who insists on receiving a monetary advantage such as a share of the agent's commission.
26. Provisions of this nature have been included in insurance legislation at least since the promulgation of the Insurance Act 37 of 1923. Section of 48 (1) of this act, as quoted in *Rex v Strode* 1927 TPD 281 at p 284, decreed that it was a criminal offence for an agent *"...to pay, allow or give, or offer to pay, allow or give, directly or indirectly, as an inducement to insure, any rebate of premium payable on policy.."*
27. This decision has been referred to in three later decisions, but not one of them deals with the issue at hand.
28. Against this background the applicant argues that the STS scheme does not conflict with the aims of the legislature. While it is common cause that the scheme is an inducement to persuade existing and

prospective policyholders to take out a policy or to maintain the same, it is an instrument that indirectly promotes saving by persuading members of the scheme to make indirect further investments in their policies or the underlying assets that produce the policy benefits in the long run.

29. It is in this fashion that the scheme is linked to the policies and therefore, so the argument runs, it is not in conflict with section 45.
30. The applicant has relied strongly on the existence of so-called linked policies in which the eventual performance of the policy depends upon the financial success or otherwise of the portfolio of shares or immovable properties that form the assets underlying and producing the policy benefit. It argues that the STS scheme falls into the same category in that the scheme is linked to a long-term insurance policy, the benefits of the scheme are only payable upon maturity of the policy, once the benefit has been received from the retailer it becomes the obligation of the applicant as principal to administer the same as part of the policy benefit and to account therefore to the policyholder in the long term.
31. The applicant argues further that the scheme is contracted for as part of the policy.
32. Attractive though these arguments are, and however much the scheme may promote saving and the eventual enhancement of the financial security of the policy holder, I have, not without a great deal of hesitation, come to the conclusion that the applicant's arguments cannot be upheld.
33. If there is a golden thread running through the history of insurance legislation in South Africa it surely is the commitment to consumer protection and to ensure as far as possible that investments with insurance companies are transparent, actuarially assessed, controlled by auditors and protected against undesirable business practices. This

striving for consumer protection is evident from a variety of sections in the Act:

34. Long-term insurers are controlled by a Registrar and an advisory committee, as determined by Part I of the Act.
35. Long-term insurers must be registered to be able to carry on business – see Part II of the Act.
36. Long-term insurers must comply with a variety of provisions governing the way in which they may conduct their business. One or more auditors must form part of the permanent staff – section 19; as must a statutory actuary – section 20 read with section 21, empowering the Registrar to appoint these professional persons to a long-term insurer if necessary.
37. The assets in which long-term insurers may invest and the structure of their shareholding is circumscribed and controlled by the Registrar – sections 26 to 28 of the Act, read with Part IV of the Act, aimed at ensuring that a long-term insurer always does business while it is in a financially sound condition.
38. Section 46 demands that the premiums, benefits and other values must be actuarially sound and no bonuses may be awarded unless the statutory auditor is satisfied that the money is available for such bonuses to be awarded and that the transaction is actuarially sound.
39. it is against this background that the provisions of section 45 must be considered.
40. It is clear that they are sweeping in their terminology and that the legislature intended to cast the net to capture inducements that might be offered to policyholders, existing and prospective, as wide as possible.
41. Given this clear-cut intention, which is also borne out by the ever-widening terms of successive prohibitions in earlier statutes, the court would not be justified in pruning the excess that would tend to prohibit

- the offering of a long-term policy itself, as little as possible to reach a conclusion that would do justice to the legislator's concerns.
42. This solution can not go beyond the permission of the inducement of the policy and its benefits itself, in other words no inducement that is not part and parcel of the insurance policy is permissible in terms of the section.
43. It is in this respect that the STS scheme must founder. It does not form part of any policy, by definition. The comparison to so-called linked policies is unsound for this very reason. The assets underlying a linked policy are defined. At least by way of category, in the policy contract; the assets themselves are recorded in the long-term insurer's books, they are audited and their performance on the market is recorded and actuarially assessed. The risk to which policyholders are exposed by the assets to which the policies are linked is assessed and considered on an ongoing basis as part of the long-term insurer's day to day activities.
44. The same cannot be said of the STS scheme. In the first instance, it is not assessed as part of the risk and benefits offered to the policyholder. Secondly, the scheme does not form part of the long-term commitment made by the insurer and the policyholder to one another in the insurance contract. While the insurer and its regulators can supervise the risk posed by the assets and investments that underlie the various policy schemes, the participation of retailers in the STS scheme is not assessed by the actuary or the auditor. Participating retailers are not obliged to give a discount for every purchase by every member and the insurer cannot control the formula by which a retailer might grant a discount or not. Long-term participation in the STS scheme is neither guaranteed nor necessarily envisaged.
45. There is obviously no inherent undesirability in the STS scheme – there is in fact nothing on record to indicate that it is not an excellent scheme that is conducted by reputable and successful women and

men of affairs for the indubitable benefit of the participating members. But it operates outside the insurance contract and, in many essential parts, beyond the direct supervision of the regulators of the long-term insurer's business. The mere fact that the major portion of the discount is paid into the assets forming part of the foundations of the particular policy cannot convert the source of the benefit to one that is part of the insurance policy.

46. It is for these reasons that the respondent's views must prevail.
47. It is clear that this matter is a test case in the public interest and for that reason neither party has sought an order of costs in the event of its contentions being upheld.
48. The application is dismissed.

Signed at Pretoria on this 16th day of July 2008.



E Bertelsmann

Judge of the High Court