Introduction to the Insurance Bill, 2016

Presentation to the Standing Committee on Finance

National Treasury | 24 January 2017

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Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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Structure of presentation

1. Overview of the insurance market in SA
2. Approach to Prudential Regulation in Insurance
3. Overview of Insurance Bill, 2016

Overview of the insurance market in SA

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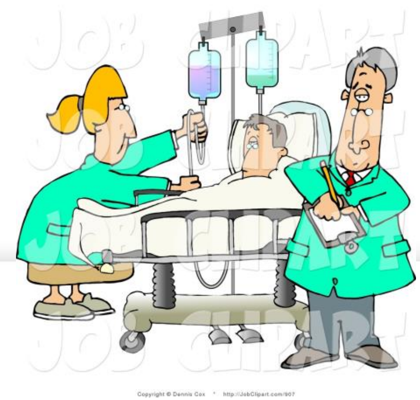
What is Insurance ?

- Insurance entails the pooling of funds and risk from insured persons to pay for losses incurred by others
  - Loss in the form of death, health or disability event – life insurance
  - Loss to property (theft, fire, etc.) – non-life insurance
  - Rating by individual criteria (age, health) or group (gender, community)
- Insurance needs to be regulated prudentially since it promises/guarantees to pay a certain (contracted) amount when risk or commitment materialises
- Key categories are life, non-life (ie short-term), health, medical schemes
- Re-insurers, who insure the insurers, and are primarily multi-national cos
- Insurance also facilitates saving for retirement (e.g. underwritten funds) and enables regular income in retirement (e.g. annuities)



Banking versus insurance

- Insurers and banks have significantly different **business models** and play very different roles in the economy
  - The core activity of insurers and reinsurers is risk pooling and risk transformation
  - Banks’ core activities are the collection of deposits and the issuing of loans, together with the provision of a variety of fee-based services
- **They have different balance sheet structures**
  - As a consequence of their activities, the balance sheet of insurers is economically stable, as fairly long-term policyholder liabilities are matched with assets of corresponding duration
  - Banks engage in maturity transformation assets and liabilities are not matched, and the average duration of most bank assets is generally longer than the average duration of their liabilities

Banking versus insurance contd…

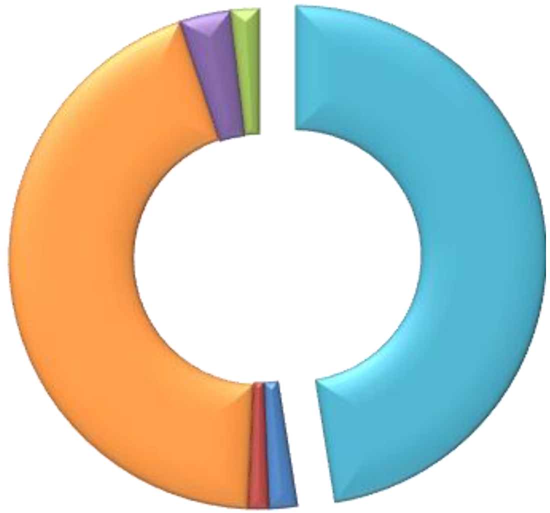
- The risk profiles of insurers and banks are also very different:
  - Insurers are exposed to:
    - Longevity risk
    - Mortality risk
    - Morbidity risk
    - Climate change risk
    - Event risk
    - Catastrophe risk, etc
  - But their investments are also subject to market risk, liquidity risk, credit risk, interest rate risk etc.

Overview of the insurance market

LONG-TERM	
Types	**2015**
Insurers	
Typical insurers	28
Niche insurers	12
Linked insurers	15
Cell captive insurers	5
Assistance insurers	8
Insurers in run-off	7
Reinsurers	
Long-term only	3
Long- and short-term (composite)*	4
Total	**82**
SHORT-TERM	
Insurers	
Typical	31
Niche	35
Cell captive	9
Captive	11
Insurers in run-off	6
Reinsurers	
Short-term only	3
Short- and long-term (composite)*	4
Total	**99**

Overview of life insurance market

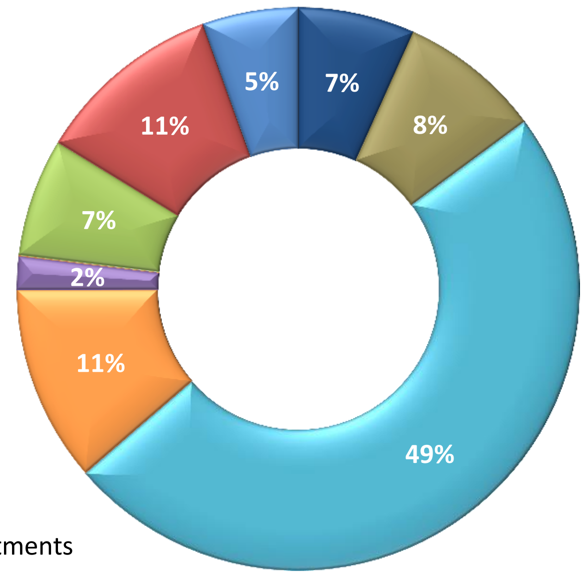
GWP 2015
R468.7 Billion



- Life 47.5%
- Disability 1.9%
- Health 1.3%
- Fund 44.2%
- Sinking Fund 3.3%
- Assistance 1.8%

Number of Policies	44.96 Million
New Policies	12.76 Million
GDP R'm	3.10 Million
Penetration Rate	15.40%

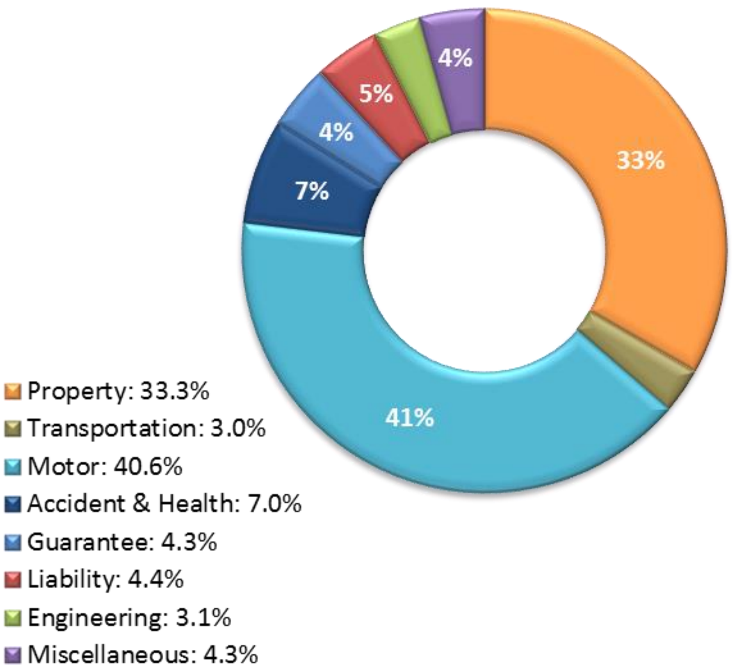
Total Assets 2015
R2.58 Trillion



- Cash and deposits
- Fixed interest investments
- Equities and collective investment schemes
- Debentures and loan stock
- Immovable properties
- Fixed assets
- Current assets
- Foreign (covering domestic liabilities)
- Foreign (covering foreign liabilities)

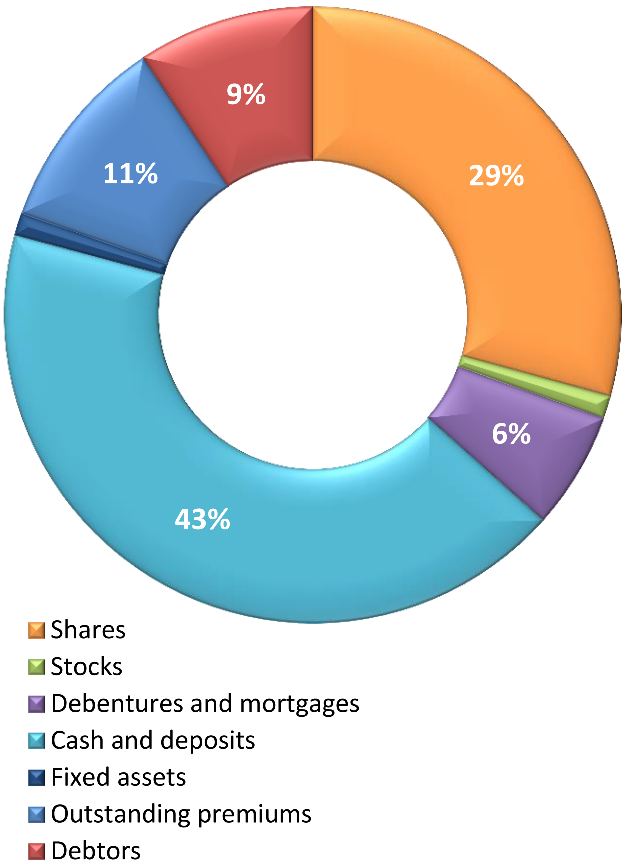
Overview of non life insurance market

GWP 2015
R109.9 Billion



Number of Policies	26.00 Million
GDP R'm	3.10 Million
Penetration Rate	4.00%

Total Assets 2015
R121.9 Billion



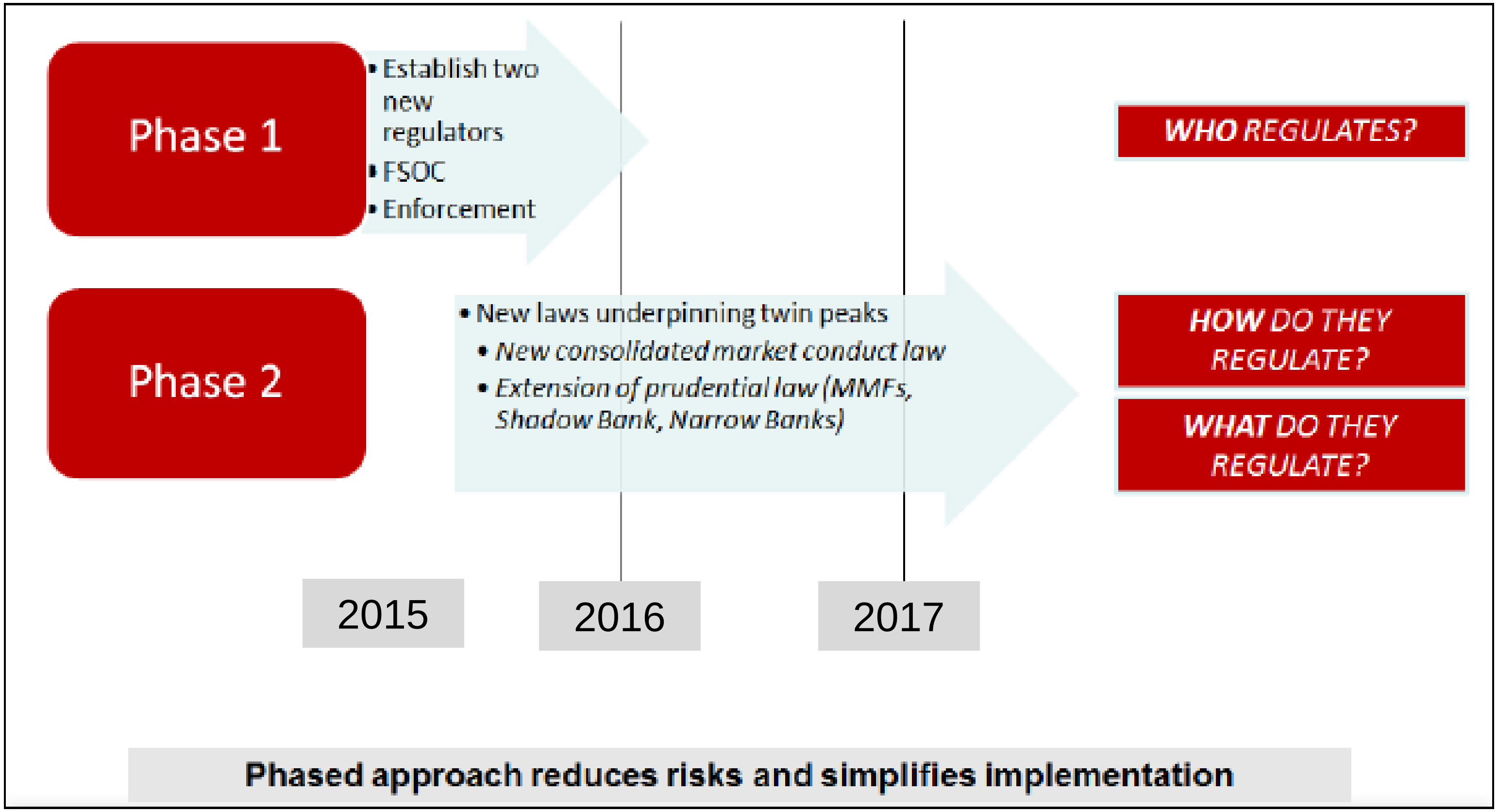
Current Insurance legislative framework

- Under what powers do we regulate in insurance in SA?
  - Long-term Insurance Act, 1998 & Short-term Insurance Act, 1998
    - Board Notices, Regulations & Policyholder Protection Rules
    - Home-host relationships for multi-nationals (eg re-insurers, OM)
  - Acts currently address both prudential and market conduct frameworks
  - Medical Schemes Act, 1998 which falls under the Min of Health and CMS
- Current legislation needs to align with Twin Peaks approach
  - rules-based and primarily relies on historical information
  - does not allow for a proactive & risk-sensitive approach to prudential supervision, and does not adequately deal with market conduct
- New legislation also needs to align to broader national policy objectives – inclusion & transformation
- Other laws applying to insurance: FICA, Co Act, Competition Act, NCA

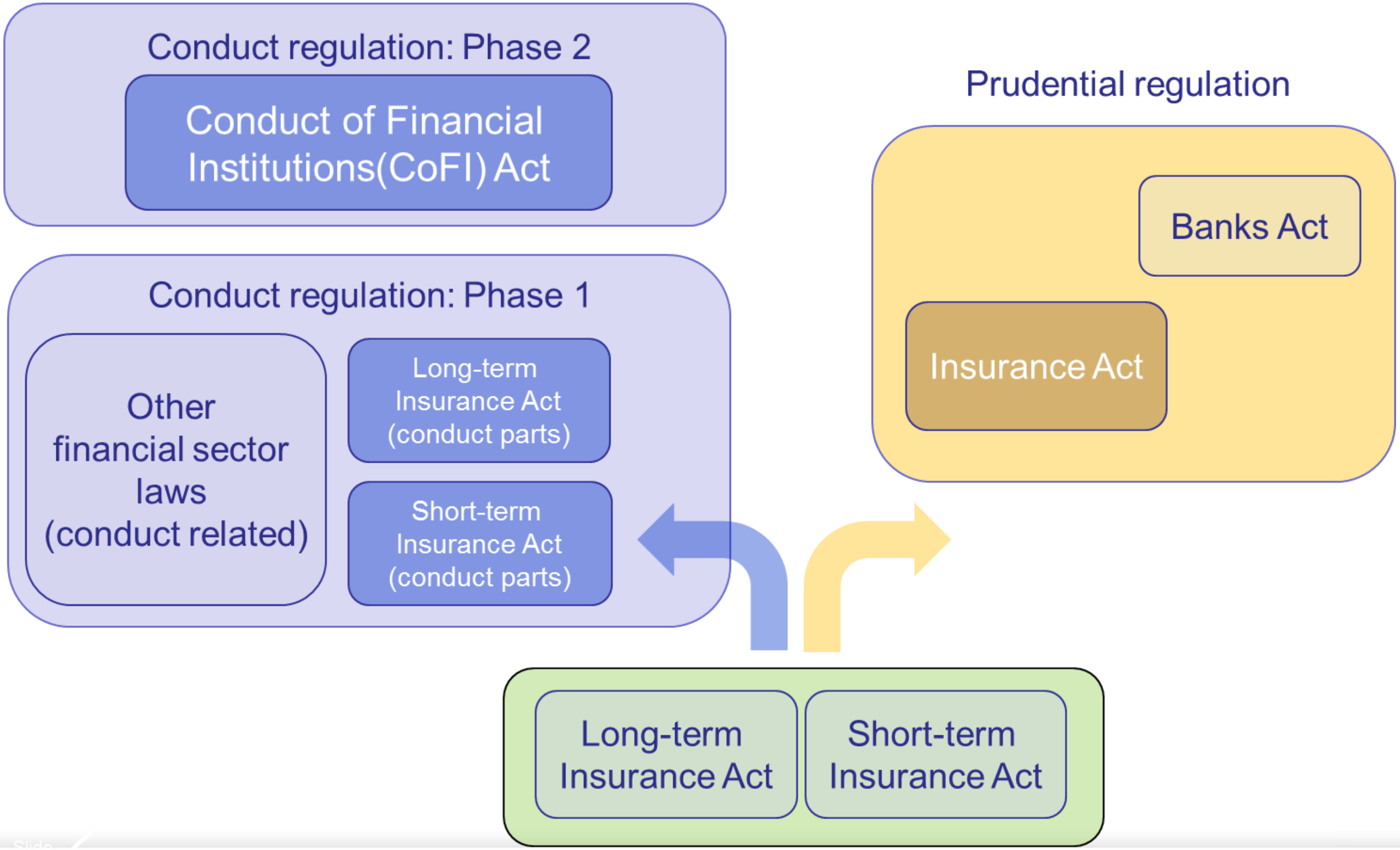
2014 FSAP compliance assessment of Insurance supervision in SA

- **2014 FSAP assessed SA regulatory compliance with International** Association of Insurance Supervisors (IAIS) Insurance Core Principles (ICPs)
- **Number of ICPs 26**
  - Observed 6
  - Largely observed 11
  - Partly observed 9
  - Not observed 0
- **We are addressing most of the concerns as follows:**
  - Corporate governance requirements for insurers
  - Risk management and internal controls requirements for insurers
  - Countering fraud in insurance
  - Public disclosure requirements for insurers
  - Formal framework for group-wide supervision of insurance groups
  - Creditor protection for policyholders in winding-up of insurers

Bill is part of Phase 2 of Twin Peaks reforms



Twin Peaks Reforms – how Insurance Act fits in



SIFIs in Insurance Sector

- Systemically Important Financial Institutions (SIFI) classification also applies to insurance sector
- Global Systemic Important Financial Institutions (GSIFIs)
  - 2008 GFC, focus on banks but AIG an exception monoline insurance
  - First list of GSII published by IAIS in 2014
- Do we have Domestically Systemic Important Financial Institutions (DSIFI) or GSIFIs?
- Big domestic insurance groups
  - Sanlam, Old Mutual, Liberty, MMI, Discovery
  - Old Mutual is primary listed in London – lead regulated in London – but significant revenue from South Africa – So host (SA) regulator important

This Bill does not address Market Conduct in Insurance

- Market Conduct Policy Framework for the Financial Services Sector published in December 2014
- CoFI will address market conduct challenges, of which there are many in insurance
- Significant interim reforms already proposed, in demarcation regulations and draft policyholder protection rules and regulations for consultation in December 2016.
- How can more and better ST insurance products be provided to the consumers?
- How can the LT insurance industry serve South Africa better?
  – More affordable and appropriate savings products?
  – How can we get better funeral cover insurance?
- What is the industry doing to meet financial inclusion and empowerment objectives, e.g. procurement practices for panel beaters?
- NT working with insurance sector to develop a road map to address the above.

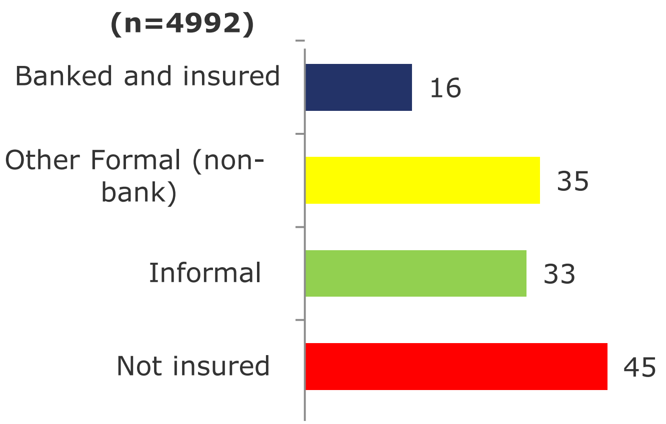
Ownership challenges: Concentration and Transformation

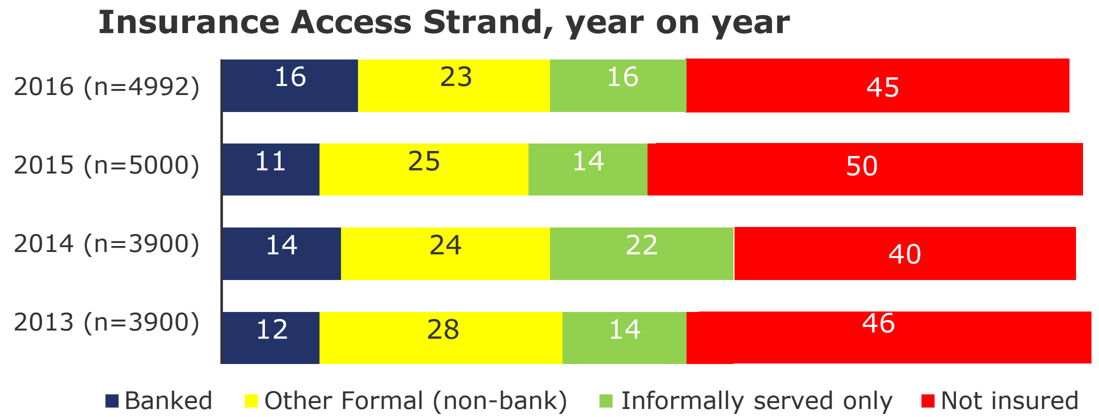
- South African financial sector has a high degree of **concentration and interconnectedness**.
- **The top five insurers account for 74%** of the long-term insurance market,
- **The seven largest fund managers control 60%** of unit trust assets
- **The top five banks hold 90.5%** of banking assets
- No of wholly owned black owned insurer = 13
- 6 State Owned Insurers
- 3 black owned foreign reinsurers
- Number of BEE shareholding in larger insurance e.g African Rainbow Capital stake in Sanlam and the PIC investments in various insurers.

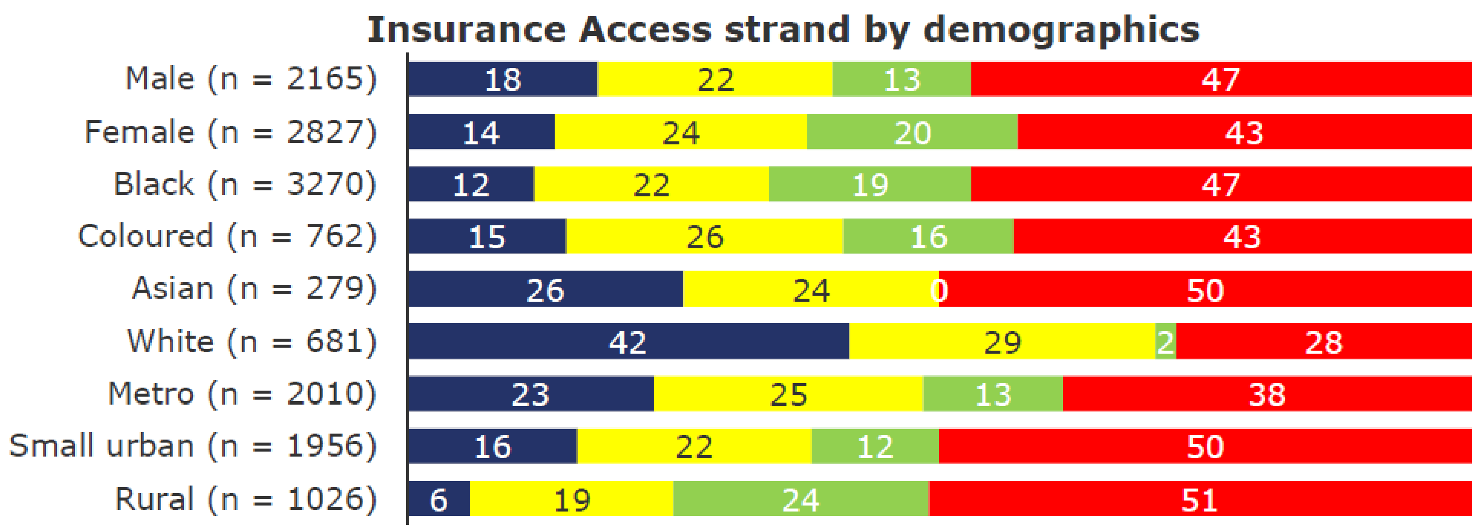
Market share of SA financial institutions (%)

Financial Conglomerate	Assets in Life Insurance	Premiums in General	Banking Assets	Assets Under Management
Standard Bank	11.9	-	25.5	31.7
Barclays (ABSA)	0.7	2.8	20.2	21.3
Old Mutual (Nedbanl	22.4	8.6	17.2	11.3
FirstRand Bank	-	-	20.4	0.4
Investec	4.3	-	7.1	11.4
MMI Holdings	15.5	5.6	N/A	0.6
Sanlam Life	14.7	17.2	N/A	1.1
Total share	69.5	34.2	90.5	77.8

Access to Insurance







Source: FinScope SA 2016 Consumer Survey databook September 2016

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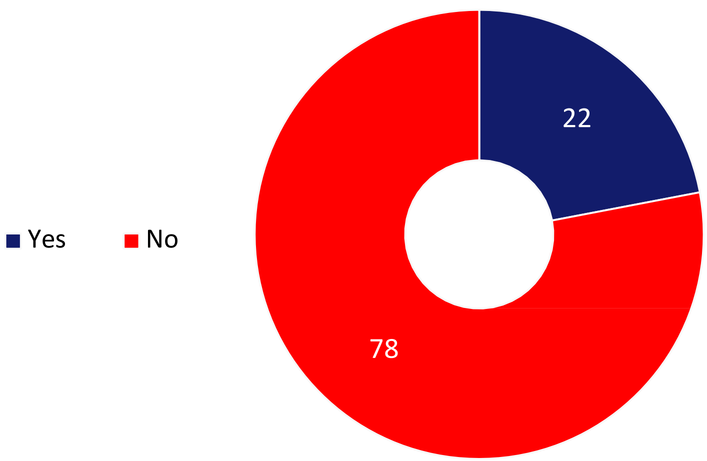
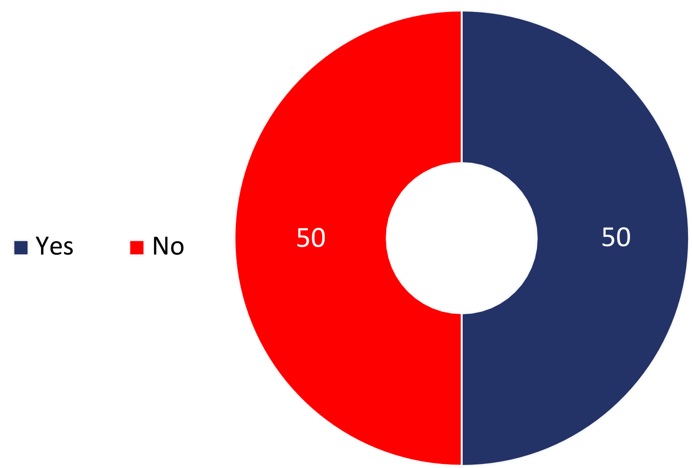
Non-funeral versus Funeral cover landscape

Non-funeral insurance (n =2543)



Have a Funeral Cover product (n =2190)



Those with non-funeral cover = 8.2 million adults

Those with funeral cover = 18.9 million adults

Source: FinScope SA 2016 Consumer Survey databook September 2016

Microinsurance and inclusive financial markets

- Insurance Bill will give effect to the National Treasury's Microinsurance policy document
- FSB in the process of drafting a paper giving an update on the regulation and supervision of an "inclusive insurance market" which will also focus on regulatory options for funeral parlours
  - Informal insurance practices must be encouraged to formalise, to better protect consumers
  - Research underway into options for a proportionate regulatory framework for funeral parlours
  - Rationale
    - Not clear that micro-insurance framework will achieve formalisation objective in respect of funeral industry
    - Need to assess what is realistic from an enforcement perspective

Characteristics of the insurance market

- Long-term insurers (mostly life) hold most of the insurance assets, equal to 64 percent of GDP, with only a small share for short-term insurers (non-life)
- The financial sector has a high degree of concentration and interconnectedness:
  - the top five insurers account for 74 percent of the long-term insurance market
  - all major banks are affiliated with insurers through holding companies or direct ownership. Bank-affiliated insurers underwrite a substantial proportion of private pension assets
  - In addition to cross-ownership and equity investments insurers are a major source of funding for banks

Role of the insurance sector in dealing with climate change

- Insurance directly impacted by climate change - hail damages, excessive flooding, fires, drought…
- Agricultural insurance – support for smallholder farmers and stabilise the commercial farming sector
- NT financial sector sustainability strategy –implications for regulators and financial institutions i.r.o reporting, disclosure and monitoring.
- G20 Green Finance Study Group – seeks to identify barriers to green finance, and based on country experiences, develop options on how to enhance the ability of the financial system to mobilize private capital for green investment.

Approach to prudential regulation

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International Context following 2008 Global Financial Crisis

- International focus has been on strengthening macro-prudential and micro-prudential measures
  - Focus on systemically important financial institutions (SIFIs), both global and domestic
  - Focus on banks and insurance sector
- G20 has also adopted principles on consumer protection and on innovative financial inclusion
  - Three pillars of protection, access and education
- Strong recognition of the linkages between equally good consumer protection and prudential measures
- Need to empower regulators to be more intrusive and tougher but also accountable

Different regulatory approaches

- Both risk-based
- Similar pillars
  - Capital Requirements (Pillar 1)
  - Systems of Governance (Pillar 2)
  - Reporting Requirements (Pillar 3)
- Capital requirements primary difference
  - Insurance: Principle based. Total Balance Sheet approach incorporating both assets and liabilities and covers all risk areas but mainly insurance, operational and market risk
  - Banking: Prescriptive. Focus on assets and risks concentrates on Credit, Market and Operational risk

Overview of the Insurance Bill

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Background to the Bill

- Builds on the Twin Peaks model of financial regulation envisaged in the FSRB in respect of prudential supervision

- Provides a consolidated legal framework for the prudential supervision of insurers as envisaged in the FSRB

- Gives effect to the mandate & functions of the PA as articulated in the FSRB

Background to the Bill

- Builds on objectives of FSRB
- Insurance Bill will:
  - Promote financial inclusion & financial transformation through the introduction of a microinsurance regulatory framework
  - Enhance safety and soundness of insurers through introducing a new Solvency Assessment and Management (SAM) regime
  - Help maintain financial stability through introducing a framework for insurance group supervision
  - Facilitate alignment with international standards (adapted to South African circumstances) in accordance with South Africa's G20 commitments

Background to the Bill

- Proportionality
  - The Bill entrenches the principle of proportionality - regulatory requirements will be applied in a manner which is proportionate to the nature, scale and complexity of the risks inherent in the business of an insurer (and reinsurer), so that requirements imposed on small and medium- size insurers are not too onerous
  - Proportionality will be applied coherently across all aspects of the Bill
- Framework legislation
  - It is enabling or empowering (and should be in respect of the new solvency regime)
  - It contains the fundamental policy or underlying principles of legislation that are unlikely to change over time

Background to the Bill

- It provides for the basic or minimum issues and powers necessary to regulate insurers, and delegates the power to make secondary legislation and other authority to implement and enforce the Bill to the PA

- The delegation of the power to make secondary legislation and other authority to implement and enforce the Bill is important to allow for or facilitate—

  — expert input into its design and technical language to be used in its wording

  — flexibility in responding to events, emergencies and industry developments

- Oversight by Parliament of secondary legislation

Financial Inclusion & Financial Transformation

- Promote financial inclusion & transformation through introduction of a microinsurance regulatory framework
  - Gives effect to the National Treasury's Microinsurance Policy Document released in July 2011
  - Facilitates formalisation of currently informal providers
  - Lowers barriers to entry, to encourage broader participation in the market
  - Allows for lower minimum regulatory capital requirements for microinsurers, while introducing proportionate conduct standards to adequately protect policyholders

Safety & soundness of insurers

- Enhance safety and soundness of insurers through introducing a new Solvency Assessment and Management (SAM) regime
  - SAM introduces a forward-looking risk-based approach to solvency, by aligning the capital requirements with the underlying risks of an insurer
  - SAM is principles-based regulation based on an economic balance sheet, and utilises a three pillar structure of capital adequacy (Pillar 1), systems of governance (Pillar 2) & reporting requirements (Pillar 3)
  - Encourages insurers to adopt more sophisticated risk monitoring and risk management tools

Financial stability

- Help maintain financial stability through introducing a framework for insurance group supervision

— Consolidated group supervision allows for identification of risks across groups (such as an insurer's exposure to other group entities through intra-group loans), which can pose risks to policyholders as well as overall financial stability

— A significant number of SA licensed insurers are currently operating within a group structure, reflective of concentrated and highly-interconnected nature of SA financial system

— SAM will apply requirements (capital adequacy, governance & reporting) at both individual insurer level and at insurance group level

International standards

- Facilitate alignment with international standards (adapted to South African circumstances) in accordance with South Africa's G20 commitments
  - The international standard-setting body for insurance supervision is the International Association of Insurance Supervisors (IAIS), which issues Insurance Core Principles (ICPs) with which all jurisdictions must comply
  - The 2014 IMF/World Bank Financial Sector Assessment Program (FSAP) identified areas where SA insurance regulation needed to be aligned with the ICPs
  - The implementation of SAM and insurance group supervision will largely address these gaps, but there are other provisions in the Bill that also help align to the ICPs

Alignment of Bill with FSRB

- Bill is aligned to the FSRB as tabled
- A few additional amendments will be proposed to the Committee –
  - ensure alignment with the FSRB as adopted by the NA
  - clarify potential ambiguities identified post tabling of the Bill
  - further enhance requirements relating to branches and Lloyd’s

Prudential Standards: Overview

- Technical requirements are addressed in Prudential Standards
- **Financial Soundness Standards (FS)**
  - FSI: Insurers
  - FSG: Insurance groups
  - FSM: Microinsurers
  - FSL: Lloyd's
  - FSB: Branches of foreign reinsurers
- **Governance Standards (GR) Replaces BN 158 of 2014 & Outsourcing Directive**
  - Same split as for Financial Soundness Standards
- **Auditing Standards (AU)**
  - Not required at commencement of Bill
- **Reporting Standards (R)**
  - Same split as for Financial Soundness Standards

Prudential Standards: Consultation

- Informal consultation of draft Financial Soundness Standards have commenced
- Informal consultation on Governance and General Standards to commence shortly

•**Round 1**

— FSI (Insurers)	– Dec2015
— FSG (Insurance Groups)	– May 2016
— FSM (Microinsurers)	– July 2016
— GS4 (Reinsurance arrangements)	– September 2016
— FSB (Branches)	– October 2016
— FSL (Lloyd's)	– October 2016

Prudential Standards: Consultation

Round 2 – November 2016

- FSI, FSG, FSM, FSB and FSL

Round 2 – end Q 1 2017

- Governance Standards
- General Standards

Round 3 – final formal consultation

- After enactment of Insurance Bill, but before commencement
- In accordance with FSR Bill process

Structure of the Bill

- Chapter 1: Interpretation & objective of Bill
- Chapter 2: Overarching framework for conducting insurance business & insurance group business
- Chapter 3: Key persons & significant owners
- Chapter 4: Licensing
- Chapter 5: Governance
- Chapter 6: Financial soundness
- Chapter 7: Reporting & public disclosure requirements
- Chapter 8: Transfer of business & significant transactions
- Chapter 9: Resolution
- Chapter 10: Administration of the Bill
- Chapter 11: General provisions

Chapter 1: Interpretation & Objective

- Definitions
- General interpretation
- Objective
  - — to promote the maintenance of a fair, safe and stable insurance market for the benefit and protection of policyholders, by establishing a legal framework for insurers and insurance groups that—
    - — facilitates the monitoring and the preservation of the safety and soundness of insurers
    - — enhances the protection of policyholders and potential policyholders
    - — increases access to insurance for all South Africans
    - — contributes to the stability of the financial system in general

Chapter 2: Insurance business

- **PART 1: General principles**
- **PART 2: Insurance business and other business of insurers**
  - A licence is required to conduct insurance business in SA
  - States what constitutes conducting insurance business in SA
  - Places limitations on insurance business outside SA and other business in SA or outside SA without PA's approval
  - State-owned insurers may be exempted from Act by Minister
  - Registrar may include or exclude specific types of business from Act, subject to certain considerations

Chapter 2: Insurance business

- **PART 3: Branches of foreign reinsurers and Lloyd's**
  - Foreign reinsurer may establish a branch if licensed
  - Lloyd's may conduct business – deemed to be licensed
  - Subject to requirements:
    - Trusts
    - Representative offices
    - All requirements of Bill apply, unless specifically stated otherwise
  - Specific provisions regarding claims against branches & Lloyd's underwriters

Chapter 2: Insurance business

- **PART 4: Insurance Groups**
  - PA must determine, per group, the scope of the group that is subject to group supervision
  - Controlling company responsible for meeting regulatory requirements in respect of group (similar to those that apply to insurers)
  - PA may amend scope of the group that is subject to group supervision, under certain circumstances

Chapter 3: Key persons & significant owners

- **PART 1 & 4: Fit & proper requirements**
  - PA may prescribe fit and proper requirements for key persons and significant owners
  - Key persons: PA may direct insurer or controlling company to take certain actions, including termination of appointment
    - [Key persons are defined as a director, senior manager, head of a control function, auditor, representative & trustee of Lloyd's / foreign reinsurer branch]
  - Significant owners: If found not to be fit & proper, PA may direct significant owner to take certain actions, including disposal of part or full shareholding in certain circumstances

Chapter 3: Key persons & significant owners

- **PART 2: Appointments and terminations of key persons**
  - — Appointment of directors, auditor, representatives and trustees must be approved
  - — Appointment of senior manager and head of a control function must be notified
  - — Termination of appointments must be notified & must provide information

Chapter 3: Key persons & significant owners

- **PART 3: Changes in control of insurer / insurance group**
  - Builds on requirements of the FSRB
  - Changes in control require PA's approval & all significant owners to be approved
  - If control by significant owner is found to be prejudicial to insurer/ controlling company / policyholders, PA may direct significant owner to take certain actions, including disposal of part or full shareholding in certain circumstances
  - If approvals not secured, transaction and any dividends paid are void
  - CC & Tribunal may not approve merger without Registrar's agreement
  - PA may oust jurisdiction of CC & Tribunal if in the public interest
  - Approval required for shares to be registered in name of a person other than beneficial owner – may prescribe circumstances under which approval is not required

Chapter 4: Licensing

- Micro-insurers: profit or non-profit company (i.e. public or private company), cooperative or established under dedicated Act
- Branches: External company
- Lloyd's: deemed to be licensed
- Other insurers: public company*
- No composite insurers – except for microinsurers
- Licensed for specific classes & sub-classes
- May provide rider benefits as prescribed
- Requirements for licensing stated & additional requirements may be prescribed

Chapter 4: Licensing

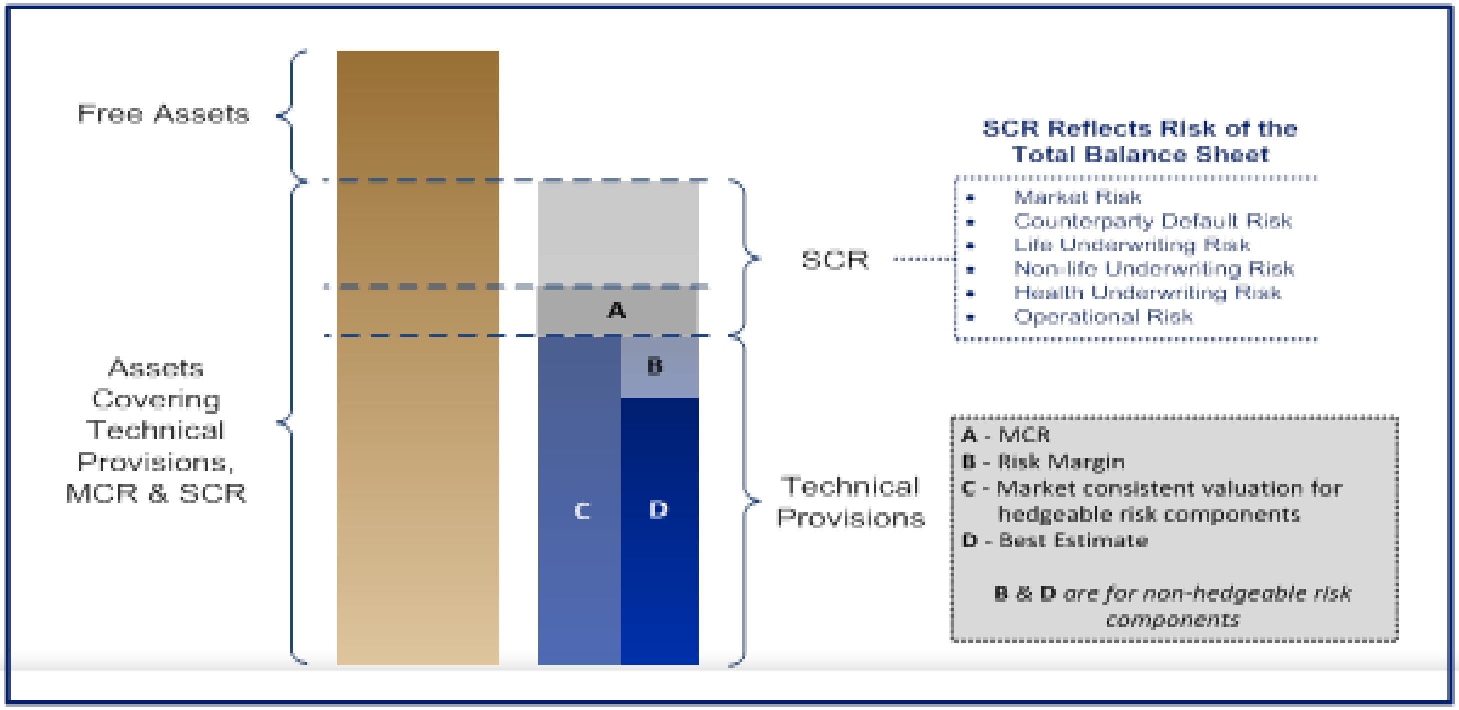
- Consultation with other financial sector regulators required
- Application to be dealt with within 120 days or longer agreed period
- Conditions may be imposed
  - Cell captive insurance may only be conducted through a separate licensed legal entity
- Conditions may be varied
- Licence may be suspended
- Licence may be withdrawn

Chapter 5: Governance framework

- Must have & maintain governance framework
- Sets out matters that may be prescribed in respect of framework
- PA may require compliance to be demonstrated
- Sets out processes and plans required when insurer or controlling company fails to maintain framework
- Empowers PA to direct insurer or controlling company to to effet improvements to governance framework
- Sets out requirements for auditors
- Sets out requirements for audit committee
- Imposes additional governance requirements on branches & Lloyd's – representatives and representative offices

Chapter 6: Financial Soundness

- Must maintain financially sound condition
- What constitutes a financially sound condition specified
- Sets out matters that may be prescribed in respect of framework



Chapter 6: Financial Soundness

- Sets out circumstances under which capital add-on may be imposed
- Requires approval in respect of certain matters relating to capital and securities
- Registrar may require compliance to be demonstrated
- Sets out processes and plans required when insurer fails to maintain framework
- Imposes additional requirements on branches & Lloyd's – trust and trustees

Chapter 7: Reporting & public disclosures

- Requires disclosures on beneficial interests (insurer and holder of interest)
- Requires returns
- Requires annual disclosures to the public
- Requires submission of annual financial statements and accounting requirements
- Imposes auditing requirements
- Requires branches and Lloyd's to report changes in home jurisdiction legislation
- PA may require additional information or direct independent verification

Chapter 8: Transfers & other transactions

- Approval of transfers and other fundamental transactions required (mergers, reorganisations, take-overs)
- Approval of significant acquisitions and disposals required
- Notification of all other acquisitions and disposals required

Chapter 9: Resolution

- Refers to statutory manager & curatorship under existing legislation
- States powers of curator (still Court approved)
- Specifies requirements relating to business rescue and winding-up - Registrar must be aware & may intervene; may initiate

[Broader resolution framework reform will require alignment. Alignment to be achieved through consequential amendments under the proposed Resolution Bill]

[Chapter somewhat longer as it impacts on other Acts]

Chapter 10: Administration

- PART 1: Applications & notifications
- PART 2: Powers and functions of the PA
  - Aligned to FSRB
  - Additional requirements
  - Prudential Standards
  - Publications by Registrar
  - Equivalence in relation to branches
  - Unlicensed insurance business
  - Penalties for late submission of information
  - Offences – limited to situations where other remedies are limited relating to group supervision

Chapter 11: General provisions

- Regulations – demarcation
- Special exemptions for certain insurers not to be public company
- Consequential amendments to LTIA and STIA
- Transitional provisions to facilitate implementation
  - Re-licensing – 2 years
- Temporary delays and exemptions to facilitate implementation
- Short title and commencement

Schedules

- SCHEDULE 1: Consequential amendments
- SCHEDULE 2: Classes and sub-classes
  - More granular authorisation classes and sub-classes
  - Specific authorisation for inward reinsurance
  - Consequences for group policies
- SCHEDULE 3: Transitional provisions

Consultation process

- Cabinet first approved the release of the Bill for comment 15 April 2015
- NT releases Bill for comment 17 April 2015
- Public comment allowed until 29 May 2015 with 34 comments received
  - Comments received from insurers, reinsurers, industry bodies, law firms, NGOs
- Cabinet approved the Bill at its meeting of 4 November 2015
- Minister of Finance tabled the Bill in Parliament 28 January 2016

Consultation process contd..

- Bill has been in development for a 7 year period, through a consultative approach
  - SAM consultation structures set-up in late 2009 - SAM Steering Committee & Sub-committees and Working Groups
  - Includes FSB, SARB, NT, SARS, industry associations (ASISA, SAIA), professional bodies (ASSA) and industry experts
  - Since 2009, more than 117 discussion documents & position papers published on various components of the framework
  - 3 Quantitative Impact Studies (QISs) to test Pillar I proposals
  - A Pillar II (governance) readiness review plus a follow-up study
  - A Socio Economic Impact Study done in consultation with & in accordance with guidance by Presidency

Consultation process contd..

- An Economic Impact Study also done
  - Designed to evaluate the costs and benefits of the SAM on the behaviour of insurers and the potential impact on key financial regulatory objectives, and the broader SA economy
  - The SAM EIS study found that the implementation of SAM is likely to lead to better risk management and also contribute to a more sustainable and stable financial sector
  - Report made available to Committee on tabling

Implementation readiness

- Pilot testing of SAM commenced in July 2014, to test insurers' readiness for implementation and to smooth transition
  - July 2014: "Light parallel run" – initial testing of SAM preparedness
  - January 2015 to present: "Comprehensive parallel run" (CPR)
  - CPR reporting on a SAM basis is done quarterly (unaudited) and annually (audited since beginning of 2016) for solo insurers
  - CPR reporting on a SAM basis is done bi-annually (larger insurance groups) (unaudited) and annually for all insurance groups (unaudited)
  - CPR reporting in parallel to reporting on current statutory basis
  - Insurers now well-prepared and eager to move to SAM basis

Documents Available to the Committee

- Insurance Bill 2016 – tabled version
- Response to public comments
- Summary of significant changes to the Bill
- Summary of SAM Economic Impact Study
- Media statements

QUESTIONS