Monarch
Insurance Company Ltd.

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Parliament's Standing Committee on Finance
Attention: Mr Allen Wicomb
Per email: awicomb@parliament.gov.za

3 February 2017

Dear Sir

RE: SUBMISSIONS ON THE INSURANCE BILL [B1 – 2016]

Background

1. Monarch Insurance Company Limited ("**Monarch**") is a short-term insurer which offers a range of optional short-term credit insurance products for customers of Lewis Stores, Beares, and Best Home & Electric when purchasing merchandise on credit. Insurance cover is offered for the settlement of a customer's outstanding debt in the event of death, permanent disability, or loss of employment (i.e. credit life insurance), and for the replacement of goods as a result of accidental loss, such as fire, theft or natural disaster (i.e. property insurance). Monarch is registered with the Financial Services Board and operates under a short-term insurance licence.

2. The Insurance Bill [B1-2016] that was published for public comment on 15 December 2016 ("**the Bill**") therefore directly affects us and our business operations going forward. We support the Twin Peaks regime and more specifically, the aims and objectives of the Bill, but we have a fundamental objection to the Bill's proposed treatment of credit life insurance. An executive summary of our submissions appears directly below, with our detailed submissions following.

Executive Summary of submissions

3. **Life vs Non-life insurance business**:

   3.1. Objection: We respectfully submit it is not in line with international practice, unfair, unconstitutional and uncompetitive to force insurers who currently sell short-term credit life insurance under short-term insurance licences, to apply for life licences in order to continue offering credit life insurance products, and to have to compete in the life insurance market with long-established major life insurance players.

   Furthermore in our respectful view Credit life insurance relates to the contractual risk event of failing to pay a liability or discharge an obligation weighing more than what caused or brought about the contractual risk event (e.g. death, disability, loss of employment or other).

3.2. <u>Solution</u>: Amend Table B of Schedule 2 to permit Credit Life Insurance as a class of **non-life** insurance.

4. **Microinsurance**:

4.1. <u>Objection</u>: Despite the Bill being in almost-final form, it is still wholly unclear as to what the requirements, thresholds, limits and conditions applicable to microinsurers will be. This makes it impossible for stakeholders to properly assess their position and rights under the Bill.

4.2. <u>Solution</u>: Publish the draft prudential standards for microinsurance for public comment as a matter of urgency and before the coming into force of the Bill, so that stakeholders can assess their position and rights under the Bill, and begin preparing their corporate structures and business offerings to comply with either the microinsurance, life and/or non-life insurance regimes.

<u>Submissions</u>

a) Life vs Non-life insurance business

What the Bill says

5. In terms of the Bill, short-term insurance will be referred to as "non-life insurance" and long-term insurance will be referred to as "life insurance". Separate licences will be required in order to offer non-life insurance and life insurance. A single entity will not be permitted to hold both a non-life insurance licence and a life insurance licence.

6. As an existing short-term insurer offering credit life insurance, we would thus have expected, on the enactment of the Bill, to have been required to apply for a non-life insurance licence to replace our existing short-term insurance licence. However, it appears from Schedule 2 to the Bill (which sets out the classes of insurance that may be licensed under a life and a non-life insurance licence), that this will not be possible. Instead, it appears that the Bill will require us to apply for a non-life insurance licence for our short-term insurance product (property insurance), **<u>and</u>** to establish a new, separate entity that will have to apply for a life licence in order to offer the short-term credit life insurance products that we have, up until now, been permitted to sell under our short-term insurance licence.

7. During the public consultation period on the 2015 Bill, a large number of commentators, including our industry representative, the South African Insurance Association ("**SAIA**"), and Sigma Risk Solutions obo Shoprite Insurance Company Limited, made submissions objecting to the exclusion of death and disability from the definition of non-life insurance policies as this would, among other things, negatively impact credit life insurance.

8. The objections were only partially addressed by amending the definition of non-life insurance to include cover for a death event or disability event resulting from an **accident**. This allows non-life insurers to underwrite death and disability events in the case of an accident (e.g. short-term cover for death and disability while travelling), but it still does not appear to allow for short-term Credit life insurance cover.

9. The response to comment 631 in the Response to Public Comments on the Insurance Bill, 2016 document ("**Response Document**") which states that "*going forward only a life insurer will be able to underwrite credit life insurance, in line with the principles for authorisation outlined in SAM DD29, version 9*" ("**SAM DD29 Document**") was brief and did not properly explain or sufficiently address concerns raised by industry.

10. We strongly object to this for all the reasons listed below, and believe that the correct and fair course of action would be to allow providers of credit life insurance products to continue providing them under a non-life licence.

Reasons for objection

11. The response to comment 631 in the Response Document states that allowing only a life insurer to underwrite credit life insurance is in line with the principles for authorisation outlined in the SAM DD29 Document ("**the Authorisation Principles**").

12. Paragraph 6.3 of the SAM DD29 Document sets out the Authorisation Principles. On proper consideration of each of the Authorisation Principles, we fail to see how the conclusion can be reached that credit life insurance should be housed under life insurance, and we respectfully request that this position be reconsidered by the Committee. We deal with each of the Authorisation Principles in turn by first summarising the principle as contained in the SAM DD29 Document and then providing our view as to how it ought to be applied in the South African context:

12.1. <u>Authorisation Principle: Risk-based approach</u>

12.1.1. SAM DD29 Document: This principle allows the regulator to assess whether the insurer applying for the licence has the necessary expertise and resources to manage the risks it is taking on as part of its insurance business.

12.1.2. On page 23 of the SAM DD29 Document, it is stated that "*non-life insurers will no longer be able to issue policies relating to life, disability or death events. Only life insurers will be authorised to underwrite these events <u>because of the skills and expertise required to underwrite these types of risks</u>*" (own emphasis).

12.1.3. It is unfortunate that credit life insurance is called credit life insurance since it is not life insurance at all. The risk event being insured under credit life insurance is the *contractual obligation (the debt) not being settled, as contemplated in the contract as a risk,* and not the life event itself. The National Credit Act allows a credit provider to require a consumer to maintain credit life insurance during the life of the credit agreement (importantly, <u>not</u> the life of the policyholder). These types of credit life insurance policies are thus of a short-term nature and generally do not exceed 3 to 5 years (other than mortgages).

12.1.4. Three classes of non-life insurance that bear comparison insofar as they specifically describe events of a non-life nature are: Guarantee policy, Liability policy and Miscellaneous policy. Each of these classes described risks relating to **an event contemplated in the specific contract** as <u>a risk relating to incurring a liability</u>, <u>to discharge an obligation</u> or <u>a risk event due to any other contractual matter</u>. This highlights the importance and the fact that the contractual risk event (e.g. the failure to pay a liability) weighs more than what caused or brought about the contractual risk event (e.g. death, disability or loss of employment).

12.1.5. For credit life policies, the term/period is limited (3 to 5 years) and the liability is known (the outstanding balance under the credit agreement), and thus limited underwriting and much less actuarial work is required. The expertise and resources required are significantly less onerous than those required in the long-term insurance industry.

12.1.6. Short duration credit life policies covering the insured on the happening of defined events (ordinarily including health events, disability events, loss of employment and death) are not life policies. They fundamentally differ from life products, which are long-term in nature and so require long-term reserving, even where they cover the same or similar events. Life companies will have different underwriting expertise from that required to write these short-term products, whereas non-life insurers have the experience, skills and expertise to underwrite these types of risks and have been doing so for decades.

12.1.7. It therefore makes sense that credit life insurance continues to be regulated within the non-life insurance industry. Aside from the fact that credit life insurance is simply *not* life insurance, there is insufficient reason or benefit to be gained from depriving non-life insurers of the right to insure credit risks and depriving consumers of the right to receive this type of insurance from a non-life insurer. Credit life insurance fits well with other types of non-life insurance (e.g. product insurance and consumer credit insurance).

12.2. <u>Authorisation Principle: Relevance</u>

12.2.1. SAM DD29 Document: The relevance of specific classes in the SA market needs to be considered.

12.2.2. Many jurisdictions have authorisation classes that are tailored to their particular environments. In South Africa, the retail credit industry plays an essential role in enabling consumers in the low to middle-income brackets (LSM 3 – 7) to afford basic necessities like fridges and stoves. Short term credit life insurance is essential to the sustainability of the credit industry in that it:

- enables credit provision by mitigating the risk attached to it (an integral element of the credit industry);
- enables access to credit for lower income groups that might have otherwise been excluded on the basis of their risk; and
- gives peace of mind to the consumer in that their debt will be paid up if they die, become disabled, or lose their employment through no fault of their own.

12.2.3. The critical role of credit life insurance in promoting the development of credit and insurance markets that are accessible to all South Africans, cannot be denied.

12.2.4. If non-life insurers within the retail industry are effectively prevented from offering credit life insurance (because of the significant costs and difficulties of setting up a separate vehicle to operate under a life insurance licence and compete with mainstream life insurance players), consumers will have no choice but to take credit life insurance from mainstream life insurers, with the result that:

12.2.4.1. credit provider debtor books will be placed under significant risk as it will be difficult/impossible for credit providers to monitor whether the consumers pay their insurance premiums and thus maintain insurance cover;

12.2.4.2. mainstream insurers will no longer have any competition from credit providers who provide insurance;

12.2.4.3. consumers, and in particular low income earning consumers, will in all likelihood not be able obtain specific cover from mainstream insurers for a fridge or television set only, for example, thus low income earners may accordingly be denied access to short-term insurance;

12.2.4.4. without credit life insurance, consumers may be denied access to credit altogether. Without access to credit, consumers may not be able to afford to purchase basic items for living such as a stove or fridge, and as a result, may be forced to approach unregulated "loan providers" to obtain loans that will enable them to purchase these essential items.

12.2.5. Accordingly, credit life insurance is highly relevant to the South African market and should continue being included as a class of non-life insurance.

12.3. Authorisation Principle: Third country equivalence

12.3.1. SAM DD29 Document: CEIOPS CP 78 does not prescribe the authorisation classes but emphasises the authorisation process.

12.3.2. In other words, South Africa does not stand to be excluded from third party equivalence on the basis that its insurance classes and sub-classes may differ slightly from those in the EU.

12.4. Authorisation Principle: Practical considerations

12.5. SAM DD29 Document: When assessing international practice, it is important to consider local relevance and the transition costs and risks.

12.6. We have not had sight of any **economic impact assessment report** performed in respect of the transition costs and risks of the proposal to reclassify/remove Credit life insurance as a class of non-life short-term insurance. This may be an omission and if so, ought to be remedied before bringing the Bill into force in its current form.

12.7. We understand that one of the reasons for the proposed change to the credit life insurance regime is to bring it in line with international best practice. Having read the SAM DD29 Document, the proposed change in respect of credit life insurance is **not** in line with international practice. In this regard:

12.7.1. the **EU** (Annex 1 of Directive 2009/138/EC) (page 4 of the SAM DD29 Document) lists "instalment credit" as a sub-class of "Credit", and "Employment risk" as a sub-class of "Miscellaneous" in the list of classes of **non-life insurance**;

12.7.2. the **Australian** Prudential Regulatory Authority (APRA) (page 10 and 38 of the SAM DD29 Document) lists "Consumer Credit (CCI)" as **non-life insurance** (which is cover to protect a consumer's ability to meet the loan repayments on personal loans and credit card finance in the event of death or loss of income due to injury, illness or unemployment); and

12.7.3. the Office of the Superintendent of Financial Institutions **Canada** (OSFI) (page 11 and 40 of the SAM DD29 Document) lists "Credit Protection" as **non-life insurance** (which is insurance under which an insurer undertakes to pay off credit balances or debts in the event of an impairment or potential impairment in the individual's income or ability to earn income).

12.8. It appears that **these countries regard credit life insurance as a short-term non-life insurance product**. In light of this, we fail to see how it can be said to be in line with international practice to move short term credit life insurance from the short-term (non-life) insurance realm into the life insurance realm.

13. In light of the above, we respectfully request that the Authorisation Principles be re-considered in the context of how to classify credit life insurance. The **risks**, the **costs** involved, local **relevance** and the **practical consequences** ought to be very carefully assessed before continuing with the proposed dramatic changes to the South African short-term credit life insurance landscape in the manner contemplated in the Bill.

14. Over and above the request to re-consider the Authorisation Principles, we also request that you take the following additional considerations into account when considering how best to

14.1. The outcome of the Bill should not be to disrupt and shut down sections of the short-term insurance industry to the advantage of the long-term insurance industry. It will be very difficult and extremely costly for short-term insurers to effectively compete with pre-existing life insurance companies.

14.2. The existing classes of short-term insurance took years of refinement after careful consideration by the Regulator, and all of these classes exist for good reason. Respectfully, one should be extremely careful before implementing material changes to these long-existing classes without assessing the ramifications of such changes.

14.3. The proposed treatment of credit life insurance represents a significant departure from current legislation, is suggestive that due consideration may not have been given to all relevant factors (including the Authorisation Principles), and will:

- deprive credit life insurance participants of their equal rights to the protection and benefit of the law;
- discriminate unfairly against the short-term credit life insurance industry;
- permit the arbitrary deprivation of property/proprietary built up over a number of years;
- disallow the provision of sound short-term insurance benefits to consumers which has been provided for many years and is in the public interest; and
- limit current rights enjoyed by the short-term credit life insurance industry to an extent that is not reasonable or justifiable.

Our proposal

15. To address these concerns, we propose that credit life insurance be included in Table 2 as a class of non-life insurance that may be offered under a non-life licence as follows:

"**CREDIT LIFE INSURANCE**:	*Lump sum payable to satisfy all or part of a financial liability to a credit provider upon the happening of a specified risk event, including in the event of a consumer's death event, health or disability event, unemployment, or other insurable risk that is likely to impair the consumer's ability to earn an income or meet the obligations under a credit agreement.*"

Alternatively consider including credit life as a component of the "Consumer Credit" class in Table 2 as follows:

"**CONSUMER CREDIT**: *Lump sum payable to satisfy all or part of a financial liability to a credit provider under a credit agreement upon the happening of a specified contingency, including:*

* *loss resulting from the possession, use, ownership or benefits of the goods or services supplied in terms of the credit agreement;*
* *insurable risks that are likely to impair the consumer's ability to earn an income or meet the obligations under the credit agreement, including the consumer's death event, health or disability event, or unemployment."*

b) Microinsurance

16. We note that microinsurers will be able to underwrite both life and non-life insurance classes under the same microinsurance licence (i.e. they may be licensed as composite insurers) but that they may only conduct microinsurance business. It follows that such licensee may then only conduct microinsurance business, and no other insurance business.
17. Given the difficulties raised above in regard to the proposed reclassification of the non-life insurance class "credit life insurance" to the life insurance category, existing short-term insurers offering credit life insurance to consumers may wish to consider registering as a microinsurer (provided of course that they meet the relevant criteria).
18. However, the current lack of information with regards to the microinsurance regime makes it impossible for stakeholders to properly assess their position and rights under the Bill. Short-term insurers may be forced to re-structure their company groups and their insurance products to comply with the Bill (either life or non-life insurance), only to have to go through the process again once the microinsurance framework is finalised. This will lead to consumer confusion, and will have enormous financial implications for such insurers.
19. We therefore propose that the draft prudential standards for microinsurance be published for public comment as a matter of urgency and in any event before the coming into force of the Bill, so that stakeholders can assess their position and rights under the Bill, and begin preparing their corporate structures and business offerings to comply with either the microinsurance regime or the life/non-life insurance options.

We trust that due regard will be had to these submissions. We will gladly make ourselves available at any time should you wish to meet or call to discuss any aspect raised in this letter.

Yours faithfully

Monarch Insurance Company Limited

Per:____________________

Mr LA Davies

Chief Executive Officer